S. HRG. 99-772

DUAL PRICING OF NATURAL RESOURCES

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 1292 and S. 1356

JUNE 26, 1986

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

62-985 O WASHINGTON : 1986

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THURSDAY, JUNE 26, 1986

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 2:07 p.m. in room SD-215, Dirksen Senate Office Building, Hon. John C. Danforth (chairman) presiding.

Present: Senators Danforth, Chafee, Heinz, Long, Moynihan, and Baucus.

[The press release announcing the hearing and a staff report on S. 1292 and section 502 of S. 1356 follows:]

SENATE FINANCE COMMITTEE SETS HEARING ON DUAL PRICING OF NATURAL RESOURCE LEGISLATION

Senator Bob Packwood (R., Ore.), Chairman of the Senate Committee on Finance, announced today that the International Trade Subcommittee will hold a hearing on S. 1292 and section 502 of S. 1356, both dealing with the dual pricing of natural resources. The hearing will take place at 2 p.m. on Thursday, June 26 in Room 215 of the Dirksen Senate Office Building.

Both S. 1292 and section 502 of S. 1356 would amend U.S. countervailing duty laws to address government practices and policies relating to the pricing of natural resources. Witnesses are asked to include in their written statement a listing of those practices and policies by country which would be addressed by this legislation, together with such historical and factual information as may be available on such practices or policies.

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510

June 25, 1986

MEMO

TO: FINANCE COMMITTEE MEMBERS

FROM: FINANCE COMMITTEE TRADE STAFF (Len Santos, 4-5472) LS

SUBJECT: JUNE 26, 1986 HEARING ON LEGISLATION DEALING WITH DUAL PRICING OF NATURAL RESOURCES

The Subcommittee on International Trade will conduct a hearing at 2:00 p.m. on June 26, 1986 on S. 1292 and on Section 502 of S. 1356. Both bills amend U.S. countervailing duty law with the purpose of addressing the dual pricing of natural resources. The hearing will be held in SD-215 of the Dirksen Senate Office Building. A witness list is attached.

I. Background

The dual pricing of natural resources refers to the practice of certain foreign governments of establishing a dual pricing system whereby the government of the exporting country establishes a selling price of a natural resource at a level lower for domestic than for foreign purchasers. U.S. producers purchasing this resource would thus pay more than producers of the dual pricing nation. This difference in the cost of the natural resource to U.S. producers is said to place them at a competitive disadvantage in relation to producers of the dual pricing nation who are in a position to sell their production at lower prices than those charged by U.S. producers.

Although a number of countries engage in the dual pricing of natural resources, the practice that has received the most attention has been the Mexican government policy with respect to development and pricing of its energy resources. It was estimated in 1983, for example, that Mexican natural gas was sold internally to various industrial users at prices as low as 44 cents per MMBtu, while foreign purchasers, including those in the United States, paid $4.94 per MMBtu. Low-priced Mexican natural gas is converted in the home market into such products as ammonia and cement, which are then exported to the United States for sale in direct competition with higher-cost ammonia and cement produced by American companies. The Mexican government does not permit American producers to purchase Mexican natural gas at the lower internal price.

Canadian policy with respect to the pricing of timber products has also been the focus of the debate over the dual pricing of natural resources. Approximately 90% of Canadian timber land is owned by provincial governments. The price of stumpage (standing timber) in Canada is therefore mostly determined by government policies. The provinces of British Columbia

(B.C.) and Quebec provide the bulk of Canadian lumber imported to the United States, and their pricing policies are indicative of how stumpage prices are determined in Canada. Stumpage prices in B.C. are set using the residual value method. The residual value method takes as its base the selling price of the end product and makes deductions for transportation and operating costs and for profit and risk to arrive at the stumpage price. The residual value method is also used in the United States to determine stumpage prices. In the United States, however, residual valuation only provides the base price used in the competitive bidding process whereby the final selling price is determined. In 1983, the different appraisal systems led to stumpage prices for fir, for example, of U.S. $10.08 dollars per thousand board feet (mbf) in the Canadian B.C. region compared to a U.S. price of $50.35 in the national forest lands in Washington and Oregon.

Various countervailing duty actions have been brought against the Mexican dual pricing scheme by United States petrochemical interests, but thus far none have been successful. Similar actions involving Canadian lumber have also not been successful although the American softwood industry filed a new countervailing duty petition on May 19, 1986 which is in progress. The inability of U.S. producers to reach these dual pricing practices under existing United States countervailing duty law is at the heart of the current debate over this practice.

II. Current Law

Existing countervailing duty law authorizes the imposition of duties on goods imported into the United States that have benefitted either from "export" or "domestic" subsidies. Export subsidies are those typically dependent upon the export performance of a particular industry, and have the specific effect of enhancing the export capabilities of that industry. Export subsidies are countervailable, with only limited exception, under both United States law and international accords.

In contrast, domestic subsidies are not tied to the export activities of the enterprize receiving the benefit; they are provided to an industry or a group of industries without regard to the eventual disposition of the merchandise produced. As such, the definition of domestic subsidies encompasses a myriad of government activities that benefit industries by directly or indirectly lowering the costs of production-activities ranging from the development of infrastructure to the establishment of an investment tax credit. Although governments often regard domestic subsidies as legitimate tools of public policy, the GATT Subsidies Code acknowledges that certain domestic subsidies may have potential harmful trade effects. Although domestic subsidies are not prohibited under the Subsidies Code, signatories to the Code are required to avoid the injurious or prejudicial effects of such domestic subsidies on the interests of another member. In the Trade Agreements Act of 1979 implementing the Subsidies Code, the United States specifically defined the forms of domestic subsidization that could be countervailed.

Under U.S. law, 19 U.S.C. Section 1677 (5)(B), in order to be countervailable, a subsidy must be one that is "provided...to a specific enterprise or industry, or group of enterprises or industries." The Commerce Department has interpreted this language to mean that the government programs which are "generally available" - for example, infrastructure development or the investment tax credit mentioned earlier - are not countervailable under current law. The law thus requires that a particular government benefit be "sector specific" in scope before a countervailing duty may be imposed.

This sector-specific approach of the statute, as interpreted by the Commerce Department, resulted in negative countervailing duty determinations on Mexican and Canadian natural resource inputs. In the Mexican ammonia investigation, the petitioners had alleged that Pemex, the government instrumentality that is the monopoly owner of Mexico's natural gas as well as its sole producer of ammonia, transferred natural gas to its ammonia-producing division at a price "far below the fair market world price," and thereby conferred a benefit on the ammonia-producing division equal to the amount by which the "world price" for gas exceeded the price "paid" by the division. The Commerce Department concluded that the transfer price paid for natural gas by Pemex was actually higher than the price of natural gas sold to other industrial users in Mexico. Accordingly, the Commerce Department concluded that Mexico had not provided a sector-specific benefit to its ammonia industry, and further that the existence of a price differential between domestic sales did not, in and of itself, give rise to a countervailable subsidy. This methodology was used by the Commerce Department to resolve similar cases involving Mexican energy policy.

Similarly, in its investigation of the Canadian softwood industry, the Commerce Department refused to countervail the foreign government's natural resource practices on the grounds that the challenged programs were not sector-specific. Although numerous Canadian practices were challenged in that petition the key practice was Canadian stumpage pricing. Commerce concluded that the challenged stumpage programs did not confer domestic subsidies because they were not sector-specific in scope; rather, the Canadian and provincial governments made the programs available to any interested user, regardless of the nature of the industry. While the number of industries using stumpage might be limited in number, the Commerce Department concluded that this factor was a reflection of the characteristics of the resource itself and of the current technology. Commerce acknowledged that nominal general availability does not defeat the sector-specific nature of a subsidy if in fact it is provided only to a specific industry or group of industries. However, the Department found that the number of industry groups in Canada - including the paper and wood products industry, the veneer, plywood and building boards industry, the paper and pulp industry, and the furniture manufacturing industry - used stumpage and thus were eligible to participate in the stumpage programs.

III. Proposed Legislation

S. 1292 and section 502 of S. 1356 expand the definition of "subsidy" in the countervailing duty laws to include any "resource input subsidy." A resource input subsidy is defined as a practice whereby a government, acting through a controlled or regulated entity, sells an input product, or sells or grants the right to remove or extract an input product, to domestic industries at a price that is below market value for such inputs or removal rights. The subsidy only exists:

-- for input products, if the controlled domestic price of the input product is not freely available to U.S. purchasers for export of the input to the U.S.

-- for both input products and removal rights, if the resource component (at fair market prices) constitutes a substantial portion of the total production costs of the downstream manufactured product.

Countervailing duties would be levied against downstream manufactured products, in an amount equivalent to the benefit from resource input subsidies and other subsidies. However, an injury test would be required in all cases in which resource input subsidies are alleged.

The measure of a "resource input subsidy" would be the difference between the domestic price of an input product or removal right and its fair market value (netting out transportation costs on both sides).

The "fair market value" would be the price that, absent government regulation, a willing buyer would pay a willing seller in an arms-length transaction. The Commerce Department's determination of "fair market value" of input product would take into account the input product's export price, its world market price, the market clearing price in market economies, and the availability of such markets.

The determination of "fair market value" of a removal right would take into account the price paid in the exporting country from comparable non-controlled removal rights, prices paid there for removal rights sold through competitive bids, and prices paid for comparable removal rights in comparable regions of other countries.

Thus, in the case of resource input subsidies, both S. 1292 and section 502 of S. 1356 would dispense with the current requirement of U.S. countervailing duty law that a benefit may be countervailable only if provided to a "specific" industry or group of industries.

(TED-0343)

Senator DANFORTH. I want to apologize in advance for what is going to be a very ragged afternoon as far as the Finance Committee is concerned. We have a contentious issue now on the floor of the Senate on the Manion nomination. There will be probably at least two more rollcall votes on that. There may be some votes on treaties. There is a conference report on the supplemental appropriations bill, which I am going to have to debate myself. So it is sort of going to be in and out as far as the Finance Committee is concerned. I want to apologize to all witnesses for that in advance.

The subject of this hearing is natural resource subsidy legislation. Natural resource subsidies are an issue about which, I think, everyone agrees that there is a problem, and there is wide diversity of opinion on what, if anything, should be done about the problem.

We have an excellent list of witnesses beginning with Congressman Gibbons, who is chairman of the Trade Subcommittee on the Ways and Means Committee. Congressman, always good to have you on this side.

STATEMENT OF HON. SAM GIBBONS, U.S. HOUSE OF REPRESENTATIVES, STATE OF FLORIDA

Mr. GIBBONS. Thank you, Senator Danforth. I want to express my appreciation for your inviting me here to testify about this subject this afternoon. I will try to be brief, because I know you have got a fine list of witnesses. Really, my message is very simple and very direct.

Subsidies are perhaps the greatest threat to free, open, and competitive trade that we have. There was no need for subsidies right after World War II when the world was prostrate, and there was a big demand out there for all kinds of goods and very little production to meet that demand.

But, as conditions have changed, as ad valorem taxes have come down, our tariffs have come down; and, as the supply of goods has vastly increased, thank goodness, countries are more and more tempted to subsidize. In the GATT and basic in the fundamental of American law from the beginning of time has been that injurious subsidies, or even before injurious subsidies, just any subsidies were a violation of our U.S. law.

The law was very clear, very plain. It said any bounty or grant given by a government to a private corporation, private business, for the production of goods was a subsidy. That definition has been eroded by judicial interpretation and administrative interpretation over the years. But, essentially, we find ourselves in a much different situation than we found ourselves when the fundamental rules of the GATT were put together.

But, even then, the signatories to the GATT declared that subsidies were something that we all wanted to avoid and were actionable if they injured us.

A few years ago, as a part of our international concessions, we gave up the injury test. But the problem of subsidies continues to grow.

Now all of us know and understand—and I don't think there is a centillion of evidence that supports an argument that you can take money out of a national treasury and use that money to subsidize a product and then export it so that it injures one of your trading partners. I don't think there is any doubt in anyone's mind that that is forbidden under GATT.

We have all agreed to get rid of those subsidy practices. I would ask you the question: What is the difference between money in the Treasury and a resource in a treasury? When you stop and analyze and think about it, there is really no difference.

Its economic impact is the same. It was with this in mind that we began developing some 4 years ago language to spell out very clearly in our laws that input subsidies from the treasury of an exporter, of an exporting nation, had the same impact as giving money out of that treasury for the same purpose.

We have developed very carefully that language, Mr. Chairman. It has been through more hearings, domestic hearings, international hearings, than any one piece of language I have seen in my career as a legislator on the matter of trade.

We have been refining the draft and refining the draft and refining the draft. Therefore, I am pleased to see that the language in S. 1292 and section 502 of S. 1356 are very similar to the language that the House has sent to you, in the trade bill that we sent to you the other day.

Some will argue that this is a violation of the General Agreement on Tariffs and Trade. I could read you, but it would be better if you read it yourself, the statement that I have here that proves to my satisfaction that that is not so. I have talked to as many people as I can find who participated in the General Agreement on Tariffs and Trade, and in the antisubsidies codes that were negotiated thereafter, and all agree that it is within the sovereign power of the United States to define what is a "subsidy," as long as we don't interrupt the general spirit of the General Agreement on Tariffs and Trade.

My statement, Mr. Chairman, is very learned and well researched by our professional staff of the House Ways and Means Committee. And it, I believe, will correspond with the positions of most of the expert witnesses that you will have here this afternoon.

This is a very controversial subject, but it is one that we must necessarily decide. I think decide in the same way that the House decided it. Because if we don't, the temptation to subsidize will wreck any international trading system that we can put together.

I go back and reiterate. I think the greatest threat to a free and open and competitive trading system between the nations is the temptation to subsidize, and that there is no difference between a subsidy-in-kind or byproduct in the treasury of a country than there is in the money of a country.

Now in order to lean over backwards in our definition of finding injury, we require that it be substantial injury. We also require that the product not be freely available for export to the United States at the same price that it is sold for in its own country.

We have put every safeguard in this that we can possibly think of, because I think, Mr. Chairman, I have always been, I will always be, and I certainly am now a person who believes in a free and open and competitive trading system. And it is in the search of protecting that trading system and strengthening that trading system that I commence this opposition to subsidies, which I deem to be the most serious problem we have.

Now, Mr. Chairman, I have come to the end of my statement. I would like to insert my written statement in the record at this point, if it is possible.

Senator DANFORTH. Without objection.

Thank you very much, Congressman. I just have one question. A lot of people think that if we were to begin countervailing against natural resource subsidies provided by other countries, they might do the same against us.

Mr. GIBBONS. Well, that would be fair. And I, frankly, think that they ought to. If we are abusing their markets by pushing our subsidized goods in there subsidized out of our Treasury, whether they be by cash or byproduct, we have all got to live by the same law. If our act is improper, we ought to clean it up.

Senator DANFORTH. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Congressman Gibbons, I think you have done a great job here as far as anyone else I am aware of in pointing out the problem of natural resource subsidies. I think you are right. It probably is one of the greatest temptations that nations have not only to enact resource subsidies but other forms of subsidies to try to get their industries an advantage over industries in other countries.

I know you have worked very hard on this. You have spent a lot of time on this. And I know that you have, in fact, bent over backward to try to find a reasonable, commonsense sort of approach to all this. I know you to be a very reasonable, thoughtful man.

I applaud you for this effort you have undertaken. You have not come up with this willy-nilly. It is not a whim. It is not something that popped into your head one night. It is something you have worked on very, very assiduously.

You have mentioned that you believe strongly that this approach is GATT legal although we have heard from some, including the administration, who argue that perhaps this approach is GATT illegal.

I wondered if you could just, again, tell us why in your mind you think that your bill, virtually the same bill here, does not violate the GATT. I think it is important that we nail that down as much as we possibly can because it will help us to know if it is not GATT illegal. Could you just in your own words tell us why you think that?

Mr. GIBBONS. Well, I think perhaps it would be best if we start on page 3 of my statement. "Some in the administration maintain that clarifying our countervailing laws to explicitly cover resource input subsidies would violate the GATT subsidies code. I strongly disagree. Article 11 of the subsidies code addresses subsidies other than export subsidies." That is, domestic subsidies. Paragraph 2 of that article contains an explicit recognition by the signatories that such domestic subsidies may cause or threaten injury to domestic injuries in other countries and urges signatories to avoid causing such effects through the use of these subsidies.

As a consequence of the code obligations, the United States is obligated to avoid domestic subsidies that may cause injury to other trading nations, and has a right, without being limited by notions of specificity, to define domestic subsidies, for the purposes of the U.S. countervailing duty law, as those foreign practices that injure domestic industries and which the granting government has an obligation under the code to avoid. The international trade effects, therefore, are the litmus of a code acceptable countervailing duty law; not the defined class of subsidy recipients.

The codes does provide examples of possible forms of domestic subsidies, such as Government financing of commercial enterprises, including grants, loans or guarantees; Government provision or Government financing provisions of utility, supplies, distribution and other operational or support services, Government financing of research and development of programs; fiscal incentives; and Government subscriptions to, or provisions of, equity capital. And the code states that these forms of subsidies are normally granted either regionally or by sector. And I emphasize "normally" granted either regionally or by sector.

But the code has no prohibition on countervailing subsidies that are not regional or sectoral, and emphasizes that the list is illustrative and nonexhaustive. No objective reading of the code can elevate these nonexhaustive illustrations of possible forms of subsidy into an obligation that limits Congress in the definition of a countervailable subsidy.

In fact, the code recognizes that the illustrative list of domestic subsidy practices should be reviewed periodically. This is entirely consistent with the authority of Congress to revise the U.S. laws to take into account the dynamics of world trade and of evolving subsidy programs in other countries.

The code's description of possible forms of domestic subsidies that were apparent in 1979 and the observation that those forms are normally granted either regionally or by sector does not set the limit on the authority of Congress to evolve concepts of countervailable subsidies. Instead, the only code-mandated limitation is that newly minted domestic subsidies can only be countervailed if they have adverse extraterritorial effects on industries in other countries.

In summary, the code does not mandate a specificity requirement. Instead, the code describes possible forms of subsidy that were generally used in 1979, but categorically states that the illustrations are nonexhaustive. And, therefore, the Congress and legislatures of other signatories have the authority—that is, not limited by any specificity benchmark—to define countervailable subsidies to take into account the domestic programs of other countries that cause extraterritorial injury.

Now that is a research of our staff who conscientiously looked at this. I have before me a summary of the testimony of Prof. Gary C. Hufbauer, who is an internationally known, recognized, scholar in the field of international law and international trade. And while I have not read the whole statement, the first statement in his summary is this:

The GATT subsidies code does not limit the authority of the U.S. Department of Commerce to determine what practices can be defined as subsidies. Congress has unfettered discretion to set this definition.

I have to go back and ask you again from a practical point of view: All of us recognize that money can't be used to subsidize. If money is being held—if something other than money is being held in the treasury of a subsidizing country and that product is used in place of money, then what is the difference? There is no difference.

Senator BAUCUS. I very much appreciate that. Essentially what you are saying is article II lists certain actions that may be countervailed against. There is also specific language in article II which says numerated forms of subsidies is meant to be illustrative but not exhaustive.

Mr. GIBBONS. That is right. And I think if the drafters of GATT had stopped there—but it is like a lot of these judges that we run into as lawyers. They sometimes get to writing and keep on writing and keep on writing and sometimes lose track of what they were thinking about. And it just perplexes lawyers in trying to read these long opinions.

You look at GATT, and you read it, it makes sense. And a subsidy is a subsidy is a subsidy. Any bounty or grant is a subsidy. We go even further. It has got to be injurious.

Senator BAUCUS. I very much agree with that. I thank you again.

Senator HEINZ. Senator Long.

Senator LONG. I thank you for what you said. I think you state the case for the House provision very well indeed. I am very happy you sent this bill over to us.

Mr. GIBBONS. Good.

Senator HEINZ. Congressman Gibbons, I am going to put an opening statement in the record. I want to apologize that I didn't hear all of your testimony, but it tracks some of the things that I have said from time to time.

Mr. GIBBONS. Yes, sir.

Senator HEINZ. I do have one question for you.

Mr. GIBBONS. Certainly.

Senator HEINZ. Some people argue that the natural resources legislation violates the GATT subsidies code because it contains no requirement that the subsidy be confined to a specific industry or group of industries as in current law. How do you respond to that argument?

Mr. GIBBONS. Well, I don't think that the GATT subsidies code really says exactly that. I read that long statement out of my own testimony here, Senator Heinz. There could be regional subsidies apparently under the GATT code, but I don't believe that the GATT code in any way should be interpreted as that question suggests.

I know that that was sort of the thrust of that Canadian lumber decision, but I have read that thing over and over again and I wish that the person that wrote that had had a broken hand so they wouldn't have written so much. Because the more you read, the more you get confused about what you are reading.

Senator HEINZ. It reminds you of the judge who has an inexperienced counsel come before him, and the counsel starts reading this interminable document, and the judge says: Counsel, I urge you to make your point and make it briefly. And counsel just keeps going right on. Finally, at the conclusion of an hour and a half, counsel concludes. And the judge says, counsel, I am just as ignorant now as I was an hour and a half ago. Counsel says, ignorant, yes, your honor, but surely better informed. [Laughter.]

Mr. GIBBONS. Yes, sir, let me say this just makes commonsense. We all know that we cannot take money out of our treasury and use it as a bounty or a grant to subsidize goods coming into a country in an injury to that country. There is no difference in practice in having a resource in your treasury and using it as if it were money.

And that is what this legislation tries to put an end to.

Senator HEINZ. Very well.

Congressman, thank you very much.

Senator LONG. I would like to ask one question. Would you tell me, Mr. Gibbons, how you look at the situation concerning Canadian timber imports into the U.S. market? I know you have heard arguments both ways, for it and against it. How does that look to you?

Mr. GIBBONS. Well, there have been allegations that the Canadians are using the timber as a subsidy to the lumber and plywood and shingle shake business in Canada. I hate to quote this because I am not sure of what I am saying here, so let us make real sure that I——

I think the International Trade Commission has just ruled today——

Senator BAUCUS. That is right.

Mr. GIBBONS [continuing]. In a unanimous decision.

Senator BAUCUS. Five to zero. That is right.

Senator LONG. What did they rule?

Senator BAUCUS. U.S. lumber is injured.

Mr. GIBBONS. So by this Canadian practice, Senator Long.

I have tried to keep this whole matter generic rather than product specific. And when you look at the detailed language that you have here in the Senate and the material we sent over from the House, you find that we do not talk about any specific product or any specific type of product, except, of course, it must be an input product, and we don't mention any country or anything like that.

I think it is an emerging problem that we are going to find it more and more used to our disadvantage unless we nip it in the bud right now, and say we are just not going to put up with people taking their natural resources, using them in their industries that subsidize costs, and then pushing them into our country and destroying our own industry.

I think this problem is not near as bad as it is going to get unless we do something about it.

Senator LONG. I agree with you. Thank you very much.

Senator HEINZ. Congressman, thank you.

Mr. GIBBONS. Thank you.

[The prepared written statement of Congressman Gibbons follows:]

STATEMENT OF CONGRESSMAN SAM M. GIBBONS BEFORE THE SENATE COMMITTEE ON FINANCE ON DUAL PRICING OF NATURAL RESOURCE LEGISLATION JUNE 26, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM PLEASED THAT THE SENATE COMMITTEE ON FINANCE IS HOLDING THIS HEARING TODAY ADDRESSING THE PROBLEM OF RESOURCE INPUT SUBSIDIES AND, AS THE SPONSOR OF LEGISLATION IN THE HOUSE WHICH IS VIRTUALLY IDENTICAL TO THE PROVISIONS OF S. 1292 AND SECTION 502 OF S. 1356, I AM GRATEFUL FOR THE OPPORTUNITY TO SHARE MY VIEWS WITH YOU ON THIS IMPORTANT SUBJECT.

AS MOST OF YOU WHO KNOW ME ARE AWARE, IN ALL OF MY MANY YEARS IN CONGRESS I HAVE BEEN AN ARDENT ADVOCATE OF FREE TRADE. I CONTINUE TO BELIEVE THAT FREE TRADE IS IN OUR ECONOMIC BEST INTERESTS. HOWEVER, IN MY VIEW, GOVERNMENT SUBSIDIES ARE PERHAPS THE BIGGEST THREAT TO OUR WORLD TRADING SYSTEM. WE AND OUR TRADING PARTNERS MUST BE PREPARED TO TAKE ALL NECESSARY STEPS TO REMOVE THE INJURIOUS EFFECTS OF SUBSIDIES FROM THE INTERNATIONAL MARKET PLACE.

IT IS FOR THIS REASON THAT I SPONSORED LEGISLATION (H.R. 2451) IN THE HOUSE OF REPRESENTATIVES TO ADDRESS THE PROBLEM OF RESOURCE INPUT SUBSIDIES. THERE IS NO QUESTION THAT AN OUT-RIGHT GRANT OF MONEY BY A GOVERNMENT TO AN INDUSTRY THAT RESULTS IN INJURY TO AN INDUSTRY IN THE IMPORTING COUNTRY IS ACTIONABLE UNDER THE GATT SUBSIDIES CODE AND UNDER U.S. COUNTERVAILING DUTY LAW. FOR RESOURCE-INTENSIVE INDUSTRIES, WHEN A GOVERNMENT PROVIDES RESOURCES TO ITS INDUSTRIES AT LESS THAN FAIR VALUE AND

AT A PRICE THAT IS NOT AVAILABLE FOR EXPORT TO U.S. COMPANIES, THIS HAS THE SAME INJURIOUS EFFECT ON U.S. INDUSTRIES AS AN OUTRIGHT GRANT OF MONEY. IT IS CLEARLY A SUBSIDY AND SHOULD BE TREATED AS SUCH WHEN IT RESULTS IN INJURY TO A U.S. INDUSTRY.

THE SUBSIDIZATION OF INPUT PRODUCTS USED IN MANUFACTURING ENERGY-INTENSIVE ARTICLES SUCH AS CEMENT, AMMONIA, CARBON BLACK, PETROCHEMICALS AND GASOLINE IS HAVING SIGNIFICANT TRADE DISTORTING EFFECTS, AS IS THE SUBSIDIZATON OF REMOVAL RIGHTS RELATING TO INPUT PRODUCTS SUCH AS TIMBER OR MINERAL ORES. SUCH SUBSIDY PRACTICES ALLOW FINISHED PRODUCTS TO BE SOLD IN THIS COUNTRY AT PRICES SUBSTANTIALLY BELOW WHAT WOULD OTHERWISE BE A FAIR PRICE ABSENT ANY GOVERNMENT REGULATION AND BELOW PRICES CHARGED TO U.S. PRODUCERS WHO DO NOT HAVE ACCESS TO SUCH SUBSIDIZED INPUTS OR REMOVAL RIGHTS.

THE LEGISLATION BEFORE THIS COMMITTEE WOULD AMEND THE DEFINITION OF SUBSIDY IN THE TARIFF ACT BY EXPLICITLY INCLUDING "RESOURCE INPUT SUBSIDIES" AMONG THE LIST OF GOVERNMENT PROGRAMS SUBJECT TO COUNTERVAILING DUTIES. THE BILL WOULD CLEARLY ESTABLISH THAT A SUBSIDY EXISTS WHEN A GOVERNMENT, ACTING THROUGH A CONTROLLED OR REGULATED ENTITY, SELLS AN INPUT PRODUCT OR SELLS OR GRANTS THE RIGHT TO REMOVE OR EXTRACT AN INPUT PRODUCT TO DOMESTIC INDUSTRIES AT A PRICE THAT IS BELOW MARKET VALUE FOR SUCH INPUT PRODUCT OR REMOVAL RIGHTS.

WE HAVE TAKEN A NUMBER OF STEPS IN THE HOUSE TO MAKE THIS BILL REASONABLE AND FAIR IN ITS APPLICATION. FOR EXAMPLE, THE SUBSIDY WOULD ONLY EXIST IF THE RESOURCE COMPONENT CONSTITUTES A SIGNIFICANT PORTION OF THE TOTAL PRODUCTION COSTS OF THE FINAL MANUFACTURED PRODUCT AND, FOR IMPORT PRODUCTS, IF THE CONTROLLED DOMESTIC PRICE OF SUCH INPUT PRODUCTS IS NOT FREELY AVAILABLE, "BY

REASON OF GOVERNMENT REGULATION OR CONTROL", TO U.S. PRODUCERS FOR EXPORT TO THE UNITED STATES. THE PROVISION WOULD AUTHORIZE A COUNTERVIALING DUTY AGAINST THE FINAL MANUFACTURED PRODUCT, BUT ONLY IF IMPORTS OF SUCH PRODUCT CAUSE OR THREATEN TO CAUSE MATERIAL INJURY TO U.S. PRODUCERS OF THE LIKE PRODUCT.

THE ADMINISTRATION MAINTAINS THAT CLARIFYING OUR COUNTERVAILING DUTY LAW TO EXPLICITLY COVER "RESOURCE INPUT SUBSIDIES" WOULD VIOLATE THE GATT SUBSIDIES CODE. I STRONGLY DISAGREE! ARTICLE 11 OF THE SUBSIDIES CODE ADDRESSES "SUBSIDIES OTHER THAN EXPORT SUBSIDIES" (I.E., DOMESTIC SUBSIDIES). PARAGRAPH 2 OF ARTICLE 11 CONTAINS AN EXPLICIT RECOGNITION BY SIGNATORIES THAT SUCH DOMESTIC SUBSIDIES MAY CAUSE OR THREATEN INJURY TO DOMESTIC INDUSTRIES IN OTHER COUNTRIES AND URGES SIGNATORIES TO AVOID CAUSING SUCH EFFECTS THROUGH THE USE OF SUBSIDIES.

AS A CONSEQUENCE OF THE CODE OBLIGATIONS, THE UNITED STATES IS OBLIGATED TO AVOID DOMESTIC SUBSIDIES THAT MAY CAUSE INJURY TO OTHER TRADING NATIONS AND HAS THE RIGHT--WITHOUT BEING LIMITED BY NOTIONS OF SPECIFICITY--TO DEFINE DOMESTIC SUBSIDIES, FOR PURPOSES OF THE U.S. COUNTERVAILING DUTY LAW, AS THOSE FOREIGN PRACTICES THAT INJURE DOMESTIC INDUSTRIES AND WHICH THE GRANTING GOVERNMENT HAS AN OBLIGATION--UNDER THE CODE--TO AVOID. INTERNATIONAL TRADE EFFECTS, THEREFORE, ARE THE LITMUS OF A CODE-ACCEPTABLE COUNTERVAILING DUTY LAW--NOT THE DEFINED CLASS OF SUBSIDY RECIPIENTS.

THE CODE DOES PROVIDE "[E]XAMPLES OF POSSIBLE FORMS" OF DOMESTIC SUBSIDIES, SUCH AS "GOVERNMENT FINANCING OF COMMERCIAL ENTERPRISES, INCLUDING GRANTS, LOANS OR GUARANTEES; GOVERNMENT PROVISION OR GOVERNMENT FINANCED PROVISION OF UTILITY, SUPPLY DISTRIBUTION AND OTHER OPERATIONAL OR SUPPORT SERVICES OR

FACILITIES; GOVERNMENT FINANCING OF RESEARCH AND DEVELOPMENT PROGRAMMES; FISCAL INCENTIVES; AND GOVERNMENT SUBSCRIPTION TO, OR PROVISION OF, EQUITY CAPITAL." (ARTICLE 11:3) AND, THE CODE STATES THAT THESE FORMS OF SUBSIDIES "ARE NORMALLY GRANTED EITHER REGIONALLY OR BY SECTOR." (EMPHASIS ADDED) BUT THE CODE HAS NO PROHIBITION ON COUNTERVAILING SUBSIDIES THAT ARE NOT REGIONAL OR SECTORAL AND EMPHASIZES THAT THE LIST IS "ILLUSTRATIVE AND NON-EXHAUSTIVE." NO OBJECTIVE READING OF THE CODE CAN ELEVATE THESE "NON-EXHAUSTIVE" ILLUSTRATIONS OF POSSIBLE "FORMS OF SUBSIDY" INTO AN OBLIGATION THAT LIMITS CONGRESS IN THE DEFINITION OF A COUNTER-VAILABLE SUBSIDY.

IN FACT, THE CODE RECOGNIZES THAT THE ILLUSTRATIVE LIST OF DOMESTIC SUBSIDY PRACTICES SHOULD BE "REVIEWED PERIODICALLY." (ARTICLE 11:3) THIS IS ENTIRELY CONSISTENT WITH THE AUTHORITY OF CONGRESS TO REVISE THE U.S. LAW TO TAKE ACCOUNT OF THE DYNAMICS OF WORLD TRADE AND EVOLVING SUBSIDY PROGRAMS IN OTHER COUNTRIES. THE CODE'S DESCRIPTION OF POSSIBLE FORMS OF DOMESTIC SUBSIDIES THAT WERE APPARENT IN 1979 AND THE OBSERVATION THAT THOSE "FORMS" ARE "NORMALLY GRANTED EITHER REGIONALLY OR BY SECTOR" DOES NOT SET LIMITS ON THE AUTHORITY OF CONGRESS TO EVOLVE CONCEPTS OF COUNTER-VAILABLE SUBSIDIES. INSTEAD, THE ONLY CODE-MANDATED LIMITATION IS THAT NEWLY MINTED DOMESTIC SUBSIDIES CAN ONLY BE COUNTERVAILED IF THEY HAVE ADVERSE EXTRATERRITORIAL EFFECTS ON INDUSTRIES IN OTHER COUNTRIES.

IN SUMMARY, THE CODE DOES NOT "MANDATE" A SPECIFICITY REQUIREMENT. INSTEAD, THE CODE DESCRIBES "POSSIBLE" FORMS OF SUBSIDY THAT WERE GENERALLY IN USE IN 1979, BUT CATEGORICALLY

STATES THAT THE ILLUSTRATIONS ARE NON-EXHAUSTIVE. THEREFORE, CONGRESS AND THE LEGISLATURES OF OTHER SIGNATORIES HAVE AUTHORITY, THAT IS NOT LIMITED BY ANY SPECIFICITY BENCHMARK, TO DEFINE COUNTERVAILABLE SUBSIDIES TO TAKE INTO ACCOUNT DOMESTIC PROGRAMS IN OTHER COUNTRIES THAT CAUSE EXTRATERRITORIAL INJURY.

THE RESOURCE INPUT SUBSIDY PROVISION WHICH I INTRODUCED HAS A GREAT DEAL OF SUPPORT IN THE HOUSE OF REPRESENTATIVES. IT RECENTLY PASSED THE HOUSE AS SECTION 135 OF H.R. 4800 AND A FLOOR AMENDMENT TO STRIKE THE PROVISION WAS DEFEATED BY A 4-TO-1 MARGIN. THIS IS A RATIONAL AND REASONABLE PROVISION WHICH IS NOT INCONSISTENT WITH THE GATT. I URGE THIS COMMITTEE TO MOVE SWIFTLY TO REPORT A TRADE BILL WHICH INCLUDES THIS PROVISION.

Senator HEINZ. Our next panel is Hon. Alan Holmer and Hon. Gil Kaplan. Will they please come forward?

Mr. Holmer, please proceed.

STATEMENT OF HON. ALAN F. HOLMER, GENERAL COUNSEL, U.S. TRADE REPRESENTATIVE, WASHINGTON, DC

Mr. HOLMER. Thank you, Mr. Chairman.

First, I want to extend by apologies on behalf of Ambassador Smith, who had hoped to be here this afternoon. He is tied up right now with negotiations with the Japanese on semiconductors, and, therefore, is unable to be here.

Mr. Chairman, the international rules and the countervailing duty law recognize that you can't countervail every conceivable Government program under the sun, and that you have to draw a line some place. The line that has developed over the years is the so-called specificity test. In order for a Government program to be considered to be countervailable as a domestic subsidy, it must be provided to a specific industry or group of industries. Programs that are generally available, like investment tax credits or capital cost recovery allowances—you may be changing those soon, but they currently exist under our tax law—or irrigation projects or cheap hydroelectric power or good transportation systems—those programs are outside the reach of the countervailing duty law, even though they may directly or indirectly make exports more competitive.

Conversely, programs that are provided to specific industries, such as cheap loans to industry X, would be countervailable. This so-called specificity test was enacted by Congress in the Trade Agreements Act of 1979, is recognized in article 11, paragraph 3 of the subsidies code, and has virtually universal international acceptance. There is no doubt in my mind that if this legislation were enacted and faithfully implemented by Mr. Kaplan, which I am sure it would be, we would be taken to the GATT and we would lose.

And I would be very happy in the question and answer session to respond in more detail as to why it is that I reach that conclusion.

Our trading partners could demand compensation in the form of reductions in U.S. tariffs that currently limit their exports to our market. And if we fail to provide satisfactory compensation, they could retaliate by raising their tariffs to shut out American exports. It is essentially a zero-sum game. We will be taking jobs from one industry in order to save jobs in another industry.

The second major problem that we have with this legislation, beyond the GATT violation, is that other countries would use mirror legislation to attack some of our strongest export industries. Now the drafters of this bill have attempted to craft a definition of resource subsidy that would provide a safe harbor for generally available programs of the U.S. Government. But since we will be violating the international rules, other countries will not feel bound by our self-serving definition.

Let me give you two examples. In 1980, the European Communities seriously considered initiating a countervailing duty case against U.S. textile exports to the EC based on the argument that our controlled natural gas prices lowered the production cost of our textile manufacturers.

We went to the EC and said you can't file this case. Controlled natural gas prices are generally available throughout the United States; it is not available to a specific industry; you can't go with that case. The EC agreed.

The second example I would like to give you is more current. Right here we have a petition filed by the Ontario Canada Corn Producers Association. It starts out by alleging that our agricultural price support program is a countervailable subsidy. It goes on to list over 70 U.S. Government programs, including the Small Business Administration loans, low income and farm labor housing, agricultural research grants, USDA commodity future market reports, PL480 food aid, rural electrification and many, many others.

At this minute, a U.S. delegation is in Canada for consultations on this subject. The U.S. argument is that the Canadians can't bring this case and attack these programs because these programs are ones that are generally available throughout the United States economy. The Canadians can't countervail them because they are not directed to a specific industry or group.

If this bill is enacted, it will blow our argument right out of the water against the Canadians. The Canadians will say, and I think rightfully so, "if you are not bound by the specificity test, then neither are we."

Thank you, Mr. Chairman.

Senator HEINZ. Thank you very much, Alan.

[The prepared written statement of Mr. Holmer follows:]

TESTIMONY OF ALAN F. HOLMER
DEPUTY UNITED STATES TRADE REPRESENTATIVE
BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE OF THE
SENATE COMMITTEE ON FINANCE
June 26, 1986

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to appear before you today to testify on S. 1292 and Section 502 of S. 1356, bills to amend the countervailing duty law to apply countervailing duties to resource input subsidies. With me today is Gilbert B. Kaplan, Deputy Assistant Secretary of Commerce for Import Administration. I intend to testify on the overall implications of these bills. Mr. Kaplan will address concerns more specifically relating to the countervailing duty law.

These bills would make dual pricing of foreign government-owned or -regulated natural resources a subsidy. Since 1983 when this idea was first proposed, it has been extensively debated. Each time the Administration has been asked for its views, it has opposed the provision. Mr. Chairman, we must continue to oppose it. Although some technical changes have been made (including provision of an injury test in all resource input subsidy cases), the sources of our fundamental concerns have not been addressed. The bill departs starkly from the law and policy--developed jointly by Congress and the Executive Branch--to separate <u>selective</u> trade-distortive governmental actions from <u>general</u> government measures. The departure from this policy risks dismantling the international consensus on countervailing measures, which has protected U.S. industries from unfairly traded imports and shielded U.S. exports from harassment abroad.

These bills violate the GATT Subsidies Code. There is a broad international consensus that the proper test of the countervailability of a domestic subsidy is whether a government is providing benefits only to a specific industry or specific group of industries. This so-called "specificity test" was enacted by Congress in the Trade Agreements Act of 1979, is recognized in Article 11:3 of the Subsidies Code, and has universal international acceptance. We should not enact legislation that would violate the GATT and would compel us to countervail practices outside the internationally accepted definition of a subsidy.

Violating the GATT exacts a high price. It gives other countries the legal right to retaliate against our exports. Our trading partners recognize our right under Article VI of the GATT to apply antidumping and countervailing duties. However, applying countervailing duties to practices outside the internationally accepted definition of a subsidy would not be regarded as a legitimate exercise of our Article VI rights. Our trading partners could demand compensation in the form of reductions in U.S. tariffs that currently limit their exports to our market, and if we failed to offer satisfactory compensation, they could retaliate by raising their tariffs to shut out American exports. If we unilaterally protect resource-dependent industries in violation of the international rules, other industries will suffer. "Saving" American jobs in one industry will cost jobs in another. We should not make our export industries pay this price.

All governments intervene in the marketplace and directly or indirectly affect the competitiveness of certain industries. All governments set broad macroeconomic policies that are designed to lay a solid foundation for economic growth. The United States, builds irrigation projects to help our farmers and hydroelectric projects to supply electricity. The U.S. Tax Code currently offers a wide variety of subsidies to our businessmen, such as investment tax credits, accelerated depreciation allowances, and interest deductions. The money we spend on defense and space research helps our aerospace and high tech industries. Accordingly, it is absolutely essential to distinguish countervailable subsidies from other government actions.

The international consensus, as reflected in the GATT and the Subsidies Code, that the specificity test marks the dividing line between countervailable and noncountervailable government subsidies, serves U.S. interests well. Unlike some other governments, we rarely channel benefits to specific industries, but instead engage in broader policies designed to foster economic growth. The specificity test therefore provides a safe harbor for many of our programs from foreign governments which might otherwise be looking to impose countervailing duties on American exports.

Our programs are not targeted at specific industries, even though, for example, government funding of schools and universities may provide disproportionate benefits to high-tech firms which need a highly educated work force.

If we follow the course of S. 1292 and Section 502 of S. 1356 and disregard the specificity standard, we will open a Pandora's box. Other countries could and would use mirror legislation to attack some of our strongest export industries. I know that the drafters of the bills have attempted to craft a definition of a "resource subsidy" that would provide a safe harbor for the natural resource practices of the United States government. But, since we would be violating the international rules, other countries would not be bound by our self-serving definitions. They would draft their own definitions to go after American industries with a competitive advantage in their markets, such as high-tech and agriculture. If we depart from the specificity principle and countervail generally available benefits, we risk an open season on any sort of government intervention, including our own. We cannot violate the international rules for one sector and expect the damage to be limited to this sector. In an open season, all American businesses could be the losers.

Even if for some reason foreign governments were to follow the general approach of the bill and limit themselves to natural resource inputs, they could attack a number of U.S government programs, including oil depletion allowances, special tax breaks for the timber industry, price controls on natural gas, Tennessee Valley electricity, and Western dams and irrigation projects. We should not enact rules for imports unless we are prepared to live by the same rules for our exports. We should not enact rules designed to serve the narrow interests of a few industries at the broader expense of all American industries.

Mr. Chairman, while we oppose these bills, we are not insensitive to the Subcommittee's concern over the broader issue of trade in natural resource-intensive products. We believe this is an issue that should be subject to multilateral negotiation, as part of the global trade talks soon to get underway. We have proposed that the issue of natural resource subsidies, including dual pricing, be on the agenda because international rules in this area do not adequately deal with this issue. Over the coming weeks as the preparatory process comes to an end, we will strive for broad international consensus to better address trade problems caused by government intervention in natural resource markets.

We share the Subcommittee's concern over the potential for long-term trade problems in such areas as lumber, gasoline, ammonia, petrochemicals and cement. Clearly, a number of these industries have suffered problems, but they are not necessarily the result of imports.

Mr. Chairman, I have tried to lay out some of the Administration's concerns over these bills. We have disagreed in the past over bills, and undoubtedly we will disagree in the future. But our differences have always been those between honest men and women who share concern for the welfare of our firms and workers and for the health of the international trading system. As specialists in trade, we at USTR and the Members of this Subcommittee have long shared a recognition that our national welfare is irrevocably bound up with the welfare of the international trading system. The Executive Branch and this Subcommittee have worked effectively together to develop solutions that meet the interest of American industries and workers and the international trading system as a whole. We understand and share your concern about the impact of imported lumber, gasoline, ammonia, petrochemicals and other resource-based products on our firms and workers. We want to work with you to address your concerns and to explore common solutions that are consistent with the GATT and long-term U.S. interests.

Thank you for opportunity to present USTR's views on S. 1292 and Section 502 of S. 1356. I would be happy to answer any questions that you might have.

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STATEMENT OF HON. GILBERT B. KAPLAN, DEPUTY ASSISTANT SECRETARY FOR IMPORT ADMINISTRATION, DEPARTMENT OF COMMERCE, WASHINGTON, DC

Senator HEINZ. Mr. Kaplan.

Mr. KAPLAN. Thank you, Mr. Chairman.

I don't want to repeat too much what Mr. Holmer said, but I think I will go over a few points from the point of view of the Department that administers the countervailing duty program. In our view and in the administration's view, this legislation is a very major change in the way that we regularly administer the law, primarily in the way that we look at specificity and also in the way that we look at preferentiality in trying to define what is or is not a subsidy.

I think it is counterproductive to try to stretch the countervailing duty laws to solve every kind of trade problem, and we have seen a pattern over the years of efforts to try to do that.

Finally, the issue of specificity and preferentiality is something we have been looking at very carefully in the Department over the last few months, and in a minute I will go into our recent decision on carbon black and also into the recent reinitiation of the lumber case and try to give you some sense of what we are doing administratively to solve some of the concerns which you are looking at here.

I think that in the countervailing duty law, as it exists now, we have had the ability to provide enormous amounts of relief to American industry without having retaliation and without having mirror legislation, without having harm to other exporting industries because we have been responsible and limited in what we try to do in the countervailing duty law.

This whole law is obviously not a one-way street. If we expand our law, other people are going to expand their laws and start slapping duties on our exports without the kind of justification we like to see. And, obviously, the corn petition against American agricultural exports is a dangerous signal and perhaps worse than that. There are about $50 million worth of exports to Canada of American corn every year, and I don't think we want to see large duties placed on those or similar kinds of exported products.

I think what we would find, if we had to apply this law and some of the principles which are intrinsic in this law, that almost every export into the United States could probably be subject to a countervailing duty case. There are so many broadscaled Government programs abroad and in the United States which provide some kind of benefit to industry one way or another that we would really not be limited at all in terms of what the countervailing duty law could apply to.

Let me say a word about our recent decision in carbon black feedstock. We came out with a preliminary decision, reversing a decision of several years ago, that found carbon black feedstock not generally available.

I think some of the thinking in this area has evolved at the Commerce Department and some of the concerns which this committee has which are embodied in this legislation can be dealt with administratively in a way that will work and in a way that is GATT consistent.

I would also cite our recent initiation of the lumber case, again, and note that there too we are rethinking some of our basic premises about what is or is not specific and generally available.

Let me say that those are both preliminary decisions. In the case of lumber, just a preliminary decision to initiate. In the case of carbon black, just a preliminary decision. And I am not prejudging the outcome of those by mentioning those here. We will have to look at those very carefully.

So, in closing, I think that we are handling some of these problems administratively. Legislative activity would not be warranted at this time. And in a commonsense view, trying to expand the scope of the countervailing duty law to cover generally available programs simply will not be an effective way to handle these legal problems.

Thank you.

Senator HEINZ. Mr. Kaplan, thank you.

[The prepared written statement of Mr. Kaplan follows:]

TESTIMONY OF GILBERT B. KAPLAN DEPUTY ASSISTANT SECRETARY FOR IMPORT ADMINISTRATION DEPARTMENT OF COMMERCE BEFORE THE SENATE FINANCE COMMITTEE SUBCOMMITTEE ON INTERNATIONAL TRADE

JUNE 26, 1986

Mr. Chairman and members of the Subcommittee, I am pleased to appear before you today to discuss the natural resources subsidy bill, S. 1292, and section 502 of S. 1356.

While the Administration recognizes that some natural resource pricing practices by foreign governments are a source of concern to many U.S. industries, it opposes the solutions outlined in this legislation. We think that this legislation represents a major departure from longstanding U.S. and international practice regarding the definition of a subsidy and would be unadministrable.

The countervailing duty law has been very effective in offsetting many unfair benefits that governments provide to certain industries. However, it is counterproductive to attempt to stretch the countervailing duty law to solve all potential trade problems. Furthermore, as a result of recent refinements in the Commerce Department's thinking on the issues of "specificity" and "preferentiality", many of the Committee's concerns about natural resources may ultimately be addressed in the context of the current law. In contrast to the proposed legislation, any refinements that may emerge as a result of the Department's rethinking will be both workable and GATT consistent.

The Commerce Department has shown that it can act quickly and effectively. The number of countervailing and antidumping petitions filed has increased from 53 in 1980, when the administration of these laws was transferred to the Commmerce Department, to 147 in fiscal year 1985. Between 1980 and the end of 1985, Commerce investigated 579 antidumping and countervailing duty cases. While 31 percent of these cases were withdrawn by petitioners, only 6 percent were terminated because of final negative determinations by Commerce. In all of these investigations, we have never missed a deadline. Commerce has administered the countervailing duty and antidumping laws quickly and effectively.

This aggressive enforcement has, however, resulted in the unfortunate belief that all international trade problems should be addressed under either the countervailing duty or antidumping laws. In those cases in which Commerce has found that no subsidies are involved. the inevitable conclusion seems to be that either Commerce was mistaken or that the countervailing duty law should be amended to cover that particular foreign trade practice.

We believe that, particularly with respect to the natural resources provisions presently before this Subcommittee, such efforts to amend the countervailing duty laws are ill-advised. These bills would require us to countervail foreign government actions which do not provide benefits to a specific industry or group of industries. In so doing, these bills would directly contradict a fundamental principle of the U.S. countervailing duty law, as well as the GATT Subsidies Code. The principle, usually known as the "specificity" or "general availability" test, states that government actions must benefit a particular sector in order to be defined as a domestic subsidy. The specificity test draws a distinction between government actions intended to improve the competitiveness of chosen industries, and actions intended to improve national social or economic conditions, such as irrigation projects and rural electrification programs.

Thus, the natural resources bill before this Subcommittee would constitute a significant departure from longstanding U.S. and international consensus regarding the definition of a domestic subsidy. Adoption of the view that generally available benefits are subsidies could result in the inclusion of such things as public highways and bridges in the category of countervailable benefits, and could result in Commerce conducting countervailing duty cases on almost every product imported into the United States. In addition, many U.S. programs would be susceptible to foreign countervailing duty actions if we were to abandon the general availability test.

Vulnerable U.S. programs might include government funding of schools and universities that provide disproportionate benefits to high tech firms which need a highly educated work force; and accelerated depreciation allowances that provide disproportionate tax benefits to our industrial sector which spends heavily on machinery and equipment.

Similarly, the removal rights provisions in this bill nullify another basic principle underlying international trade, the principle of comparative advantage. This bill provides that no foreign government can sell the right to extract a natural resource for less than what the same right would cost in some other country (specifically, the country, other than the country providing or selling the right, which has the largest number of arms-length sales of such rights). Thus, the bill effectively requires that foreign and U.S. firms face identical raw material costs. If our trading partners adopted a similar rule in their countervailing duty laws, it could impair the ability of U.S. industries to exploit our own comparative abundance of natural resources.

As previously noted, the Commerce Department is currently revisiting two countervailing duty decisions on natural resource based products--Carbon Black from Mexico and Softwood Lumber Products from Canada. Our re-examination in Carbon Black is in the context of the first annual review in that case. In Softwood Lumber Products from Canada, petitioners have asked us to re-investigate stumpage (which is the right to harvest softwood), a program we found not to be countervailable in 1983. In part, our review has been prompted by a recent decision of the U.S. Court of International Trade in *Cabot Corp. v. U.S.* While we can not prejudge the results of these re-evaluations, they may ultimately address some of the concerns that prompted the legislation that is being discussed today.

The first part of this re-evaluation is with respect to the "specificity test" outlined above. In the preliminary determination of the first annual review of the countervailing duty order on carbon black from Mexico, the Department indicated that it had previously placed "excessive emphasis" on the inherent nature of the input product (*i.e.*, that a program cannot be "specific" if the limited use results merely from the inability of other industries to exploit the resource). Instead, in the preliminary review, we focused on the actual users of the program and stated that: "there are too few users of carbon black feedstock for us to find that it is provided on a generally available basis." Thus, Commerce reversed its earlier decision and found that carbon black feedstock was not generally available. The Department did not countervail this program, however, since it preliminarily found that the good was not provided at a preferential rate based on a comparison to prices charged by the same seller for a related good.

The second part of this re-evaluation is with respect to the "preferentiality test." While the Department did not find that Carbon Black feedstock was preferentially priced, it did acknowledge that, in certain circumstances, the Department's standard preferentiality test might not apply. This standard test looks to whether the government provides a good or service to the producer(s) of a product under investigation at a price that is lower than the price the government charges to other users of that product within the same jurisdiction. However, if the number of users is limited, there will not usually be a generally available reference price charged to other users within the jurisdiction.

In such circumstances, the Department suggested a number of alternative tests to determine whether a government is providing a good or service at preferential rates. The alternatives proposed are: 1) prices charged by the same seller for a similar or related good; 2) prices charged within the jurisdiction by other sellers for an identical good or service; 3) the same seller's cost of producing the good or service: or 4) external prices.

On June 6, 1986, the Department announced that it was initiating a countervailing duty investigation of certain softwood lumber products from Canada. In so doing, we noted that the petitioner had presented new evidence and also pointed out that there has been an evolution in the Department's interpretation of the countervailing duty law, both in terms of general availability and the measure of preferentiality, such that a re-examination of the stumpage programs is warranted.

I emphasize that the Carbon Black decision is only a preliminary decision. I also emphasize that merely because the Department decided to initiate a case on Canadian lumber does not mean that the Department will make an affirmative determination that the stumpage programs or any of the other alleged programs confer a countervailable benefit. I cite these cases only as examples of how the Department may be able to address some of the concerns relating to natural resources--particularly the concerns about the difficulty involved in measuring preferentiality--within the context of the current countervailing duty law. Import Administration has been flexible, innovative and open to change in its administration of the unfair trade laws. Our approach is not a timid one, rather it is one that ensures that the unfair trade laws fulfill their purpose. Thus, the legislation proposed may not only be unwise from an international and political perspective, it may also, in some respects, be unnecessary. On the other hand, any refinements that may result from the Department's rethinking will be both workable and GATT consistent.

We must remember that the United States is not a free actor in the international trade arena. Many U.S. programs would be susceptible to foreign countervailing duty actions if we were to abandon the specificity test. This is not simply an idle threat. On May 10, 1986, the Ontario Corn Producer's Association filed a countervailing duty petition against U.S. corn. The petition lists 77 U.S. government subsidy programs which petitioners believe should be investigated. Among the programs listed are: P.L. 480 Food Aid; Federal Crop Insurance; Farm Operating and Ownership loans; Fuel Tax Credits; Grants for Agricultural Research; T.V.A. Region and Community Development; Payments to 1809 Land-Grant Colleges and Tuskegee Institute; and Technical Assistance to Farmers' Cooperatives.

While this is the first countervailing duty case against the United States, it is unlikely to be the last. This is especially true if Congress unilaterally expands the definition of subsidy as it proposes to do in the natural resources bill before it. The U.S. government provides a number of resource inputs on an arguably subsidized basis, e.g., Western irrigation water, and government electricity projects. If Congress passes the natural resources provision before it, it is highly likely that other governments could use mirror legislation to strike at U.S. resource practices.

In addition, if this natural resource bill passes, the United States would almost certainly be accused of violating its GATT obligations. Violations of the GATT can have a high price. If we violate the GATT, other countries have a legal right to retaliate against our exports. Again, this threat of retaliation is not an idle one. The Canadians have recently filed a statement against the United States in the GATT Council simply for initiating the recent countervailing duty case regarding Canadian lumber.

Finally, this bill could have significant negative effects on the U.S. economy. It could result in countervailing duties on Mexican ammonia, thus raising fertilizer prices and reducing the competitiveness of U.S. agricultural exports. Similarly, possible countervailing duties on refined petrochemical products would produce reverberations in every sector of the U.S. economy.

A number of studies have sought to calculate the effects of this legislation. While the conclusions vary, no study estimates that there will be anything other than negligible positive effects and at least one study estimates that there will be significant negative effects. In particular, a study conducted by Wharton Econometrics estimates that such legislation would result in job losses of 275,000, while job gains in the protected industries would be at most 9,000. The study also estimated that total real U.S. output would be reduced by almost $80 billion over the 1986-94 period. It should be noted that this study is based on a "best case" scenario--that is, it assumes no retaliation by foreign countries. Job losses and the reduction in GNP would be even higher if the foreign countries affected by such legislation chose to retaliate against U.S. exports.

Thus, this legislation may have a significant negative impact on U.S. international obligations and the U.S. economy as a whole.

Finally, the operative provisions of S. 1292 and Section 502 of S. 1356 are unworkable from an administrative standpoint. The requirement that Commerce consider comparable removal rights from other countries imposes an impossible burden and is unworkable. In order to establish comparability, Commerce would have to consider a large number of factors, including the accessibility of the resource, its quality, and even the day on which it was sold.

Similarly, these bills simply define fair market value for an input product (or a removal right in certain circumstances) as the price that, in the absence of government regulation or control, a willing buyer would pay a willing seller for that product (or removal right) from the exporting country in an arms-length transaction. This type of determination is inherently ambiguous and would result in arbitrary rulings, especially in vertically-integrated industries.

In conclusion, we urge this Subcommittee to reject the natural resources provisions before it. The Administration recognizes that some natural resource pricing practices by foreign governments are a source of concern to many U.S. industries, but we strongly believe that changing the countervailing duty law is the wrong remedy. Rather than placing additional restrictions on the U.S. market, other solutions should be explored, such as seeking greater access to foreign resources for U.S. firms.

Thank you for your attention. I would be pleased to answer any questions you may have.

Senator HEINZ. Let me ask both of you: The philosophy of the Reagan administration is that it is against subsidies—foreign or domestic. The Subsidies Code is consistent with the Reagan administration's philosophy. And your principal argument, as I understand it, against the natural resources input legislation or any different construction of the specificity test and general availability test is that it would cause other countries to enact or take mirror action against certain kinds of practices that involve a subsidy here.

You mentioned a number in your statement—the irrigation project, farm programs, all kinds of things that are popular with the Congress but in many cases a lot less popular with the administration.

Why wouldn't the administration want other countries to countervail against our subsidies since the administration is against most of those subsidies?

Mr. Holmer, do you want to have the honor of going first?

Mr. HOLMER. Sure. Well, the list is much longer than the few items that I or that Mr. Kaplan had an opportunity to enumerate. I don't know that there is anyone certainly in the 1985-86 time period who is proposing that we just out and out eliminate all subsidy programs such as agricultural price support programs. There were some at an earlier time that might have wanted to do that, but there are others who realized that if we were going to be able to compete internationally in a system where we have inadequate agricultural international trading rules, it was necessary to enact the 1985 farm bill.

Our principal concern is that once you get on that slippery slope and start saying that Government programs that are broadly available are ones that can be countervailed against, there is no telling where that ultimately ends up.

Senator HEINZ. The Reagan administration has thrown in the towel on subsidies. They tried to beat them. And now they can't beat them, so they are going to join them.

Mr. HOLMER. I wouldn't agree with that, Mr. Chairman. I do think—and Mr. Kaplan can speak to this currently more effectively than I can—I do think——[Laughter.]

Mr. KAPLAN. Thank you very much.

Senator HEINZ. Mr. Kaplan, my time is about to expire.

Mr. HOLMER. My basic point is that the Commerce Department is very aggressively enforcing its countervailing duty law. We have the most aggressive enforcement of the countervailing duty law of any nation in the world. And to say that we have thrown in the towel on subsidies, I think, is not an accurate characterization.

Mr. KAPLAN. Can I follow up just very briefly? The question is not whether we are for or against subsidies. I think we are clearly against subsidies, and we have been very aggressive in combating them.

The question is, What is a subsidy? Is a student loan program or a program that provides some kind of broad-scale R&D or scientific help to a large part of the economy something which we should be going against in this country and which we would want to see our trading partners go against? There are broad-scale interventions in the economy which are really not the kinds of things we would want to have our industries subject to countervailing duties for because we do them and everybody else does them. You have got to draw a line at some point, and we think this bill goes too far.

Senator HEINZ. Mr. Kaplan, thank you.

Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Kaplan, Mr. Holmer, doesn't this really come down to where you draw the line? That is what this is all about.

Mr. KAPLAN. Yes.

Senator BAUCUS. And you in your testimony, I think, used a good trial lawyer's tactic of a crate of horribles. That is, you just cite the most extreme cases. Theoretically, it may apply. The fact is that—the standards of this bill which would very much limit where this line is drawn. The fact is that this bill sets very definite standards, very definite limits, so that the line is not drawn where you imply it is drawn.

Further, Mr. Holmer, you seem to say, in fact, expressly say that this bill is GATT-illegal, whereas I am sure you know, in the GATT subsidies code, there is no language which requires the kind of specificity which you claim it requires.

I would like you to read language to me in the GATT subsidies code that requires the specificity, test that you allege it requires. Where is the language that requires it?

Mr. HOLMER. Lawyers, both American and non-American, look at that language and can, fairly say, "it is not crystal clear; you could argue that countervailing generally available benefits is permissible." And if one were to look solely at the text, although there is language that is troublesome, if you were to look solely at the text, they would be right that the language is ambiguous.

Senator BAUCUS. The subsidies code does not require it. Looking at the text in the language, there is no language there that requires specificity.

Mr. HOLMER. The language in the text, article 11, paragraph 3, does make reference to defining countervailable domestic subsidies as those "granted with the aim of giving an advantage to certain enterprises, either regionally or by sector."

And we believe——

Senator BAUCUS. Could you read out loud the second to last paragraph?

Mr. HOLMER. Pardon me?

Senator BAUCUS. Second to last paragraph, read that for us, please.

Mr. HOLMER. The second to the——

Senator BAUCUS. The words begin: 'Signatories note * * *" Read those two sentences, please.

Mr. HOLMER. [READING]:

> Signatories note that the above form of subsidies are normally granted either regionally or by sector The enumeration of forms of subsidies set out above is illustrative and non-exhaustive and reflects those currently granted by a number of signatories to this agreement.

Senator BAUCUS. That little sentence: "The enumeration of forms of subsidies set out above is illustrative and non-exhaustive * * *."

Mr. HOLMER. That is correct.

Senator BAUCUS [reading]:

And reflects these currently granted by a number of signatories to this agreement.

Mr. HOLMER. Yes.

The important point, I think, Senator Baucus, is the GATT is what the GATT contracting parties say that it is. And the subsidies code is what the subsidies code signatories say that it is.

The subsidies code is an evolving document. There is an experts group that meets periodically to clarify some of the ambiguities of the subsidies code. At the most recent meeting of the GATT subsidies code, was held in April of this year, every single one of our major trading partners supported a paper that was tabled before the subsidies code that essentially states that subsidies are those items that are provided to a specific industry or group of industries.

Now it is true that under the advice of Senator Long the administration representatives blocked this paper. But I can guarantee there was no one but the United States that opposed this paper.

So all I am saying is that if this legislation is enacted, which departs from the specificity test, we will be taken to the GATT; there will be a GATT panel formed; and presumably, if we wanted, we could do what the Europeans do on many occasions and block a negative GATT panel finding, so they would not be able to retaliate against our exports; having a number of other negative consequences that I would be happy to get into at a later time.

But that is why I reached the conclusion that if this legislation were enacted, we would be taken to the GATT, and we would lose.

Senator BAUCUS. Mr. Chairman, my time is up.

Senator LONG. Well, let me just say one thing. If you were pleading the case for us, I know we would lose it because you would want us to lose it. And may I say that such attitudes are part of our trade problem all the time. Our own negotiators have even gone over there to make deals contrary to what this country thinks the deal should be.

I have been part of the trade lawmaking process now for many years and have some idea as to what we had in mind when we passed some of these laws. And I went through the experience of having someone on that Tariff Commission participate in a deal where they were going to say,

> Well, the foreign countries didn't have to change the subsidies code; they could just construe it down at the International Trade Commission in such a fashion that it wouldn't mean what it said at all.

So I am thoroughly familiar with seeing people who are supposed to be looking after the American citizens' interest or American industries in some cases work for the other guy. I have seen that happen.

And may I say that I don't find one line here to suggest that you people are trying to look after the interest of our people. Now you have got a deficit of over $150 billion, and the Federal Reserve Bank of New York predicated that given a few years, we will be a trillion dollars in debt, paying interest of about $100 billion a year on all that; debts that need not be run up.

I have also been told that the rule of thumb is that for every billion dollars deficit you have got, you are losing 25,000 jobs. I think it is more than that. But just use that figure and perform the arithmetic—25,000 jobs times $150 billion. That is 3,750,000 jobs we are losing here in this country.

People like you tell us, oh, I'm sorry, we are wrong; the other guy is right, and nothing can be done. Now I don't see a word to support what you are arguing here. And the fact that other governments might contend the way that you would like to argue just illustrates my point of view that we would have a representative that wanted us to lose before the case was ever heard.

Mr. HOLMER. Was that a question? [Laughter.]

Senator LONG. It would be all right for you to respond to it.

Mr. HOLMER. Well, I would stack the record of this U.S. Trade Representative and his general counsel against anybody in terms of the aggressiveness with which we defend U.S. interests, both in the GATT and elsewhere.

I do think—and this goes back to the point that Senator Baucus was making—I think it makes a lot more sense—rather than enacting a statute which may be GATT illegal—to allow the Commerce Department to complete its investigations in the countervailing duty case of Canadian lumber in a GATT-legal manner and avoid the prospect that we might act under a new statute that would, I believe, be considered by the GATT to be GATT illegal. And, therefore, to rebound very negatively against U.S. exports.

The Canadians have indicated as recently as the last 10 days their very clear willingness to act to protect their interests and to retaliate against U.S. exports when they believe that we have acted inappropriately under our law.

Senator HEINZ. Mr. Holmer, let me clarify something you said, because the implications of it are certainly new to me. You said that if we pass either the House provisions or the Senate provisions that we could be held in violation of the GATT.

I thought that if we were to be at least in violation of any code we would have to injure somebody.

Mr. HOLMER. The comment that I made was that if this statute were enacted and if it were faithfully implemented by Mr. Kaplan, which I am sure it would be——

Senator HEINZ. Fine. I understand then.

Mr. HOLMER. Then there would be a case brought——

Senator HEINZ. All right. That clarifies that. I was just a little concerned about something.

Let me turn to some recent decisions of implementation and interpretation.

Mr. Kaplan, what caused the Commerce Department to change its position in the carbon black case?

Mr. KAPLAN. I think that over time we have been looking very, very carefully at general availability and what it means. And I think when I looked at it and other people looked at it as it came up again in the last few months, it did not make common sense to say that if two companies and one industry receive a benefit, that that is generally available.

We basically felt we had relied too much on something called the inherent limitation doctrine, which is that if more than one industry or one company can conceivably use the thing, even if only one company actually gets it, it is generally available. It seemed to us we had put too much emphasis on that.

Also, there was a court case which affected our thinking to some extent. [Laughter.]

Senator HEINZ. Well, irrespective, does the decision by Commerce represent significant and permanent change in the way Commerce will interpret the law in subsequent cases?

Mr. KAPLAN. Well, it was only a preliminary decision. But if we follow that same course in the final decision, I think that will indicate something quite significant, yes.

Senator HEINZ. You are not willing to say whether——

Mr. KAPLAN. If I did, then whatever I do in the final would be thrown out by the court. I can't prejudge it. We have got to look at the record and decide it on the facts and the law.

Senator HEINZ. Well, what role do you feel that general availability should play in determining whether a product has been subsidized without reference per se to carbon black?

Mr. KAPLAN. Well, I think you have a commonsense argument and an economic argument in this issue. The commonsense argument is, if everybody in the economy takes advantage of something, then it really is not a subsidy in any normal way of looking at it. If you talk about a public highway or if you talk about hospitalization or if you talk about public education, these are things that governments do, and they are not really subsidies.

Economically, if everybody in the economy gets something, then no one is getting any particular advantage over anybody else. And it is hard to say that it is a subsidy '

Senator HEINZ. Well, no one is really arguing that if something is truly generally available that that is a subsidy. No one is arguing that.

Senator Baucus said, I think with quite considerable correctness, that you have to use judgment as to what is and is not within the commonsense meaning, as opposed to some lawyer's doctrine, generally available. And the problem that I think many of us have with Commerce's interpretation of the law or lack of it is we don't understand what standard you are using.

And as of today in answer to my first question, you are not entirely sure what your standard will be in the future either. So isn't there some measure that we can use other than what we are using now, the so-called doctrine of general availability, that will be more accurate and more effective in recognizing when a product is being subsidized?

If you can't come up with something better than what we have got, Congress may have to come up with something better.

Mr. KAPLAN. Well, we have sort of used a head count over the years, frankly. If hundreds of industries and people get the benefit, that looks generally available. If two or three do, then we say it is not generally available.

But I don't think the solution that is in the current bill really gets us where we want to be either, even if there are some flaws in the way we are thinking. And we are working on that. There is an evolving process going on.

But I don't think this bill does it either. Let me ask you a question in response to your statement about things that are truly available to everybody. What if the electricity rates in a large sector of a country tend to be lower than they would be if the electricity were sold at fully commercial prices? Would you call that a subsidy?

Senator HEINZ. I think it would depend on whether there was a Government policy of subsidizing electricity nationally.

Mr. KAPLAN. Well, I think, obviously, that is one of the programs that people say in some parts of the United States are subsidies. And that really is not a Government program, but in some instances governments have built the dams, governments control the water rights and things like that which lead to the electricity. I think we would be surprised if other countries started countervailing our electricity rates.

Senator HEINZ. I am not going to get into an argument on that, but the examples that have been before the Department aren't like that.

Mr. KAPLAN. Some are and some aren't.

Senator HEINZ. Well, I am thinking of Canadian softwood. And I gather there was some kind of a decision by the ITC in that.

Mr. KAPLAN. Yes, there was.

Senator HEINZ. And, second, carbon black.

Let me yield. Senator Baucus, do you have any further questions?

Senator BAUCUS. Mr. Chairman, very briefly.

I will tell you what bothers me, frankly. I don't plan to get into an argument either. What bothers me is that it seems that the administration wants to—legislation that is GATT-illegal because it does not want to pursue natural resource subsidies. That is the impression I get.

Frankly, that disturbs me. I think it probably disturbs most Americans who have thought about this issue. That is, that it seems improper, unfair, certainly contrary to the spirit of the subsidies code for a country to not only subsidize an industry with monetary remuneration but also subsidizes an industry through the natural resource that country gives to that industry. I am thinking particularly of the Canadian subsidy of stumpage. I think that is unfair.

I frankly believe that the administration should, our trade negotiators should, protect American industry, fight for American interest. It is not up to the administration to decide whether or not it is GATT-illegal. In fact, I think we should take it to GATT and find out whether it is GATT-legal.

My personal view is that it is nowhere close to being GATT-illegal, nowhere close. I believe some of the members of the GATT may like to find an action that the U.S. Congress may pass along these lines as GATT-illegal because it is hurting them.

The facts are that on a per capita basis subsidies in most every other country greatly exceed all subsidies that this country has. I haven't seen studies that break down natural resource subsidies versus nonnatural resource subsidies. The facts are that in almost every other country—I don't know of any exception. I will say every country until somebody points out an exception. Every country has subsidies in total which greatly exceed subsidies of the

United States, both natural resource subsidies and nonnatural resource subsidies.

The fact is that measured in the United States, we have spent much less on subsidies than all the other OECD countries throughout the last few decades. In 1980—this is the last year for which we have figures available—Canada spent five and a half times as much as the United States in total subsidies. Between 1972 and 1980, Canadian subsidies increased by 282 percent by contrast to the United States subsidies which decreased by 27 percent in that same period.

Well, I can understand why other signatories in the GATT may not like what we are about to do because they subsidize their industries much more than do we. Well, I am saying let's fight for our country, let's fight for America, let's fight to put a stop to all kinds of subsidies that other countries engage in which are very detrimental to the American industries. And let's fight for our country. Then go to GATT and do our very best there to make sure that what we do is not GATT-illegal, but, in fact, GATT-legal.

I am not going to get into an argument with you. I am just telling you what my opinion is.

Mr. KAPLAN. Sure.

Senator BAUCUS. And I am hoping very much that you, frankly, leave a stronger impression that you are more concerned about American interests than you are about some law review, hypothetical, about whether it is or is not GATT-illegal. Let's stand up for America and let's worry about those other questions on down the road.

Mr. HOLMER. Senator Baucus, I want to assure you that that is our objective, certainly with respect to the Canadian lumber situation. As you know, we had talks ongoing with the Canadians. Our industry decided that they wanted to file a countervailing duty case after Mr. Kaplan came out with his latest carbon black decision. We have been pressing the Canadians to proceed on two tracks: One with respect to the comntervailing duty case, but the other with respect to the ongoing negotiations in an effort to try to resolve that issue.

We are pressing aggressively to place the overall natural resources issue on the agenda for the new round of multilateral trade negotiations. And we are hopeful that that will be successful.

So I would submit that we are attempting to do all that we can to address this problem. And I can also assure you that Mr. Kaplan and I take back new resolve from this hearing to proceed further.

Senator HEINZ. Senator Long.

Senator LONG. It just seems to me that it is not and should not be important to this country whether some foreign nation is subsidizing one producer of a commodity within their own country compared to another producer of a commodity. I can't see that that is important to us at all.

What is important is whether they are subsidizing their exports compared to our products with which they are competing here in this country. And to me it is just a little short of criminal for you people to try to find excuses not to take action when foreign governments just subsidize their exports of products made from natural gas or their exports of products made from timber when clearly it was, in my judgment, the intent of those laws to say that if those governments are subsidizing their producers to give them an unfair advantage over our producers, we would take action.

And, furthermore, I sort of find myself chuckling from within because it is so ridiculous that for all these years we have heard the administration telling us now you see, all roads lead to the budget; all this is because fiscally we have an unbalanced budget, and therefore nothing can be done. That means high interest rates. And high interest rates mean an overvalued dollar. So you have got to sit there and take all this and nothing can be done about what is one of the largest single causes of all our economic problems. And then the Secretary of Treasury decides he will do something about the problem and proceeds to do it, after we have heard all that propaganda about how all roads lead to the budget: "Nothing can be done", and then you see the yen down to about 150 after you have heard all that conversation down through the years.

So I must say that I fought to give that job of USTR cabinet status. The administration didn't want it at the time, and I fought hard to do it, hoping we were going to get somebody in there who would have the stature to fight for American industry when it seeks to compete with foreign industry and to do for our people what other nations do for theirs.

And I am really sorely disappointed. That makes me think I should have left the USTR sitting below the salt so he wouldn't have this recognition that he gets otherwise because I can't see we are getting much results out of it or much benefit from trying to upgrade the position.

You can comment on that, if you want to. Do you want to comment on that, Mr. Holmer? [Laughter.]

Mr. HOLMER. Yes.

Senator LONG. Go ahead. That is all right.

Mr. HOLMER. Well, I have only been at USTR since Ambassador Yeutter arrived at USTR. And I can't speak for what the record was prior to that time. I can remember sitting through the hearing that Ambassador Yeutter had here when he was confirmed, and I look back on what it is that Ambassador Yeutter was told by the Finance Committee, what you expected him to do. And I see a very, very large portion of what he was expected to do having been achieved—in terms of self-initiated section 301 cases, in terms of making sure that section 201 is enforced and relief is provided under section 201, and ensuring that unfair trade laws continue to be aggressively enforced.

I am happy to stack up the record of this administration in terms of enforcement of those laws against that of any other administration.

Senator LONG. Well, I am not sure if you are bragging on any of you. As a matter of fact, hope springs eternal. Based on some of the things Mr. Yeutter said to me about natural resource subsidy, it sounded to me as though he wants to try to help us. Now it may be he is not saying the same thing to Canadians and others, but—and I won't be inclined to quote him without his consent—but things he said to me, suggested he thinks we are right about it, although I must admit what you say would not sound like that. Maybe you two ought to get together. [Laughter.]

Senator HEINZ. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

I would just like to sound a dissenting note here, if I might. If I understood what the Senator from Montana said, and I may have misunderstood him, when he said he wants you to plunge on and fight for America and don't be held back by law review type things like—did you say the GATT? [Laughter.]

But somehow I got the feeling like don't let these—and I may be unfair in what I understood—but sort of plunge on, don't be bogged down by these treaties we are into, all out for America.

Well, there are lots of sides to this as to what is best for America. And what is best for America in my judgment is to have an agreement such as GATT to have it obeyed, obeyed by us and obeyed by others. And we just can't cavalierly go ahead and do things that are contrary to that agreement. Now maybe we want to junk the whole agreement, but that hasn't come before this Committee yet as a proposal.

So I would just like to sound a cautionary note, if I might, that we are restricted by an agreement that we should do everything we can to make the other countries observe. But if they don't observe it, I don't think it is quite—there are ways of handling that other than us just cashiering the whole thing.

And we are going to have evidence come in here that these lumber imports—the next panel, I suspect, will indicate that the lumber imports aren't un-American. That as a matter of fact, they are quite helpful to America in many, many ways. So don't go out of here with the feeling of rip that GATT thing up and junk it and get that American flag out and wave it.

Now you have gotten clear directions. [Laughter.]

Senator BAUCUS. Will the Senator yield?

Senator CHAFEE. Yes.

Senator BAUCUS. I would agree with the Senator if it was clear that this legislation was GATT-illegal. In fact, I think that most scholors, most lawyers, who look at this, tell us that this legislation is not GATT-illegal.

I agree with the Senator that if this were GATT-illegal then I would say we have to live by our international obligations. But this is not that case. This is nowhere close to being that case.

My point is that when at best the question of GATT-legality is ambiguous, the U.S. Trade Representative should fight for America's case; let GATT determine whether or not the action taken by this country or any other country is or is not GATT-legal.

This is a clear case, in my judgment, where legislation is GATT-legal. Even if it is ambiguous, I see that our USTR is a USTR. He is not a world TR. He is a USTR. And as a USTR, he should fight for American industry.

Senator HEINZ. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I don't have any very special knowledge of this subject. Senator Danforth and I have assembled a collection of trade polls which we hope we are going to be dealing with here.

But I would like to say that beyond the test of what is GATT-illegal and what is not, it is a question of whether which measures we are talking about include economic sense. This is going to be very painful for individual firms and inspectors and regions to hear, but on the surface of the matter, if other countries want to sell you things which are in need or they want to sell them to you much cheaper than they actually are—some of them below market prices—some cases can be made that it is to our advantage to buy them.

I had some involvement in the Kennedy and Johnson years a little bit later on the question of whether or not we should build a supersonic transport. Everybody got very mad at the President's Advisory Committee when it said don't; don't do this; it is not going to make any economic sense; it is going to cost you a lot of money.

In the end it was abolished. But they gave what turned out to be very good advice. You can read in the Wall Street Journal what a nice thing it is to fly to Paris in 3 hours and let the French pay for it.

The principle must be contended that one of the problems we have in our Government right now is finding from the executive branch some reliable assessment of the cost and benefit studies that are made in these areas. Senator Long has talked about giving the trade representative cabinet status. Others have talked about creating a Department of Trade to include agriculture, and that is where the subject ends.

But the Wharton Econometric Group has made an estimate, a study, of this general proposal. They have taken—they have made their model of the U.S. economy from 1986 to 1994 with the changes that would result with the passage of natural resource subsidy legislation. They estimate that the—not necessarily right, but it is projected—that we might gain 9,000 jobs in the industries directly affected and would lose 275,000 in those indirectly affected. In the event of retaliation, which we have learned from Canada it is very swift and diverse and unexpected, they estimate a job loss of 385,000.

It is one thing to say, well, it is all right to lose your job. It is not an easy judgment to make, but certainly the down side has to be attended. I hope we might get from USTR within the resources you have available to you some judgment of how good the Wharton study is because there are some that seem to have another view. But anything that projects the loss of 300,000 to 400,000 jobs sets a real impact on any model.

Could I ask either of the gentlemen how they feel about the Wharton study?

Mr. HOLMER. Mr. Moynihan, I have not had a chance to review the Wharton study carefully. I would certainly be happy, though, for USTR to do the kind of analysis that you have requested and to provide it to you for the record.

Senator MOYNIHAN. I wish you would, sir. Obviously, there are some rebuttals. You can only give your assessment.

Mr. HOLMER. Yes, sir.

Senator MOYNIHAN. It is not just a matter of opinion. It is a matter that gets——

Mr. HOLMER. We will do that, Senator.

Senator MOYNIHAN. I thank you.

Senator HEINZ. I just have one question, and I guess it is for Mr. Kaplan, to clarify what seems to me has been a lot of sparring, at times even shadowboxing. It is this: Let me give you a very precise question. There are a number of conditional factors in the question which I hope I make clear.

If a material resource is produced and subsidized, and the clear effect is to predominantly benefit one or a few industries of foreign countries and the intent is to clearly do that and the effect is injurious to the benefits that the United States had expected to realize under the GATT agreement, is that something, Mr. Kaplan, that the Commerce Department should take action against?

Mr. KAPLAN. Yes.

Senator HEINZ. If the intent can't be proved in that list of conditions, is that something the Commerce Department should take action against?

Mr. KAPLAN. I don't think intent makes too much difference. It is almost impossible to determine intent in a lot of these cases.

Senator HEINZ. Thank you very much.

Senator Baucus.

Senator BAUCUS. Mr. Chairman, very briefly. I think the point raised on the Wharton study is important. I hope the USTR and Commerce look at the Wharton study. I am sure that both of you gentlemen know that CBO also analyzed the Wharton study. The CBO analysis—let me just read one sentence quoting the CBO on the Wharton study: "The Wharton analysis appears to overstate the market price effects of the bill," and it concludes, "The bill would not have a substantial aggregate economic effect."

So I hope that when you look at the Wharton study you also look at the CBO analysis.

Mr. HOLMER. We will.

Senator BAUCUS. Thank you.

Senator HEINZ. Gentlemen, thank you very much. We appreciate your being here.

Our next panel consists of Mr. David Stahl, Mr. Charles Coe, Mr. David Smith, Mr. Ron Piercy.

Gentlemen, please come foward. Mr. Stahl, you appear first on our witness list, and would you please proceed?

STATEMENT OF DAVID E. STAHL, SECRETARY, COALITION FOR FAIR LUMBER IMPORTS, WASHINGTON, DC

Mr. STAHL. Thank you, Mr. Chairman. Good afternoon. My name is Dave Stahl. I am secretary of the U.S. Coalition for Fair Lumber Imports and a former executive vice president of the National Association of Homebuilders.

The Coalition for Fair Lumber Imports represents the full breadth of the softwood lumber industry and its members account for over 70 percent of U.S. softwood lumber production. I appreciate the opportunity to testify today in support of the proposed legislation dealing with natural resource subsidies, S. 1292.

The last 3 years should have been the biggest boom years in the history of the U.S. softwood lumber industry. Our industry is a cyclical industry, following the peaks and troughs of the housing market and U.S. lumber consumption. In past peak years, lumber manufacturers made good profits. This allowed for a reasonable return on investment over a business cycle which invariably included several lean years. Yet, during the past 3 years when housing starts have been at high levels, and lumber consumption has been moving to record levels, this industry has been struggling badly to earn any profits.

The cause of poor economic conditions for the U.S. softwood lumber industry is Canadian softwood lumber imports. We are pleased to say this was preliminarily confirmed by the International Trade Commission this morning by a unanimous vote of 5 to 0.

Heavily subsidized Canadian imports have steadily increased in good times and in bad. Softwood lumber prices, which are usually quite sensitive to demand, rise and fall with consumption. However, large subsidies for Canadian provincial governments have allowed Canadian lumber imports to be impervious to demand and price fluctuations. Instead of demand for lumber setting the price of timber for any given level of supply, the Canadian system establishes a timber price that independently affects the supply of lumber.

The result is increased supply of subsidized Canadian lumber caused by provincial government intervention rather than by market forces. The impact on the U.S. lumber industry has been price suppression and sales lost to price undercutting by the Canadians. At this time, I would like to submit for the record statements made by Mr. John Faraci of the International Paper Co. and by Dr. William Noellert, an economist with the law firm Dewey Ballantine which outlines the disastrous economic impact of Canadian timber subsidies.

Senator HEINZ. Without objection, so ordered.

Mr. STAHL. Thank you, Mr. Chairman.

[The prepared statements of Mr. Faraci and Dr. Noellert follow:]

Testimony of John Faraci, Manager of Wood Products Operations at International Paper Co., before the International Trade Commission
June 10, 1986

I am John Faraci, Manager of Wood Products Operations at International Paper Company. I have worked in the forest products industry for 12 years. International Paper manufactures and sells softwood lumber at eleven mills in the United States. These mills are located in the northeast, south and Pacific northwest.

Subsidized softwood lumber imports from Canada are materially and seriously injuring IP everywhere that it operates.

It is my understanding that the International Trade Commission considers a number of factors in determining if a U.S. industry is injured by imports. From a business perspective, the bottom-line is that an operation must be profitable over time. Profitability, in turn, is directly related to prices and sales volume. When increasing levels of subsidized imports cause an industry injury by depressing prices and taking sales, the domestic industry will naturally lose employment and mills and the ability to adequately raise capital. That is exactly what subsidized Canadian softwood lumber products are doing to the U.S. softwood lumber industry.

At International Paper, our softwood lumber operations have not been profitable since lumber demand dropped in 1979 and 1980 despite record levels of demand in 1984 and 1985. We have proactively responded to a tough business environment with aggressive marketing, lower opeating cost and a massive capital investment program. Despite our losses since 1979, we have invested over $100 million in new technology and capital equipment to increase our efficiency and productivity and to improve our competitive cost position. Even with these actions, we have not been able to offset the impact of lower prices caused by subsidized Canadian imports. The result has been continuing losses in our softwood lumber business.

We are not profitable because Canadian lumber is crossing the border at prices which result in sales revenues at our mills which are below costs. Producers in the United States find it very difficult to match the Canadian price because the Canadian industry enjoys huge subsidies. U.S. lumbermen are squeezed between lost sales and falling prices both caused by increased Canadian lumber imports.

To illustrate the extreme disadvantage our U.S. operations face, one of our mills in Louisiana recently purchased a substantial quantity of bug-damaged timber which sells at a discount. We purchased that timber, delivered, at $81.00 per hundred cubic feet, 75% of our normal price. This mill had been modernized in 1981 at a cost of over $10 million. Nonetheless, the mill that cut that timber continued to lose money because lumber prices are so low. Significantly, that mill was still paying 8 times what a British Columbian Interior mill must pay for stumpage. With lumber prices depressed and Canadian firms paying so little for stumpage, we cannot compete.

Lumber prices usually quickly follow lumber demand, either up or down. In the last several years, however, despite increasing demand, lumber prices have remained low and, in fact, have dropped. The reason for these depressed prices is that Canadian lumber is flooding across our border. Between 1983 and 1985 imports of Canadian lumber increased from 11.9 BBF to a record 14.5 BBF. Further, in the first quarter of 1986, imports of Canadian softwood lumber were running 7.3% above the pace of the first quarter of 1985. Those Canadian lumber imports have been at prices which are below U.S. prices. Indeed, Canadian lumber, particularly B.C. Spruce-Pine-Fir, is a price leader. In fact, the Wall Street Journal publishes only Canadian SPF prices for spot lumber prices. As our economist has demonstrated, the flood of subsidized Canadian imports has kept prices well below where they would be if the market were allowed to operate.

International Paper Company and the U.S. softwood lumber industry cannot be profitable with depressed prices and increasing imports. The conditions which I am describing exist during a time when softwood lumber consumption is at an all-time high. Historically, such levels of consumption have meant prices and profits that were adequate to enable the industry to compete for capital and keep our facilities modern and our cost structure competitive. Such profits were necessary to carry the industry through its periodic recessions. The fact that today, despite peak demand, U.S. lumber firms are losing money or are operating on a margin indicates that this industry is suffering material, and likely irreparable, injury.

The disastrous effects of imports of subsidized Canadian lumber can be seen most dramatically and accurately by comparing the performance of U.S. softwood lumber manufacturers in the last full year--1985--to their performance in 1978, the last period of peak demand. In 1978, with U.S. ~~consumption of 42.6 BBF U.S. softwood lumber manufacturers~~ produced 31.9 BBF. In 1985, while U.S. consumption had risen to 43.7 BBF, U.S. production had fallen to 30.6 BBF. During the same time period Canadian softwood lumber imports increased by 23%. More importantly, between 1978 and 1985, despite increased consumption, the nominal price of softwood framing lumber fell by 16.4%. The real price of softwood lumber, expressed in constant 1967 dollars, fell by 43.3%. The obvious declines between these two periods best show the losses we suffer because of Canadian lumber.

Depressed prices and high levels of imports caused by Canadian subsidies have resulted in a downturn in a number of other industry indicators. U.S. softwood lumber production actually fell in 1985, despite an increase in consumption. Mills are being forced to close. Employment is down. U.S. softwood lumber mills are finding it difficult to raise the capital necessary for investment in new machinery which will improve mill productivity. Capacity utilization is far below where it should be given the level of U.S. consumption, and the U.S. industry's share of our own market has been steadily falling . . . As an example of the industry's condition, International Paper's softwood lumber capacity utilization in 1985 was only about 70% despite record setting U.S. consumption. (By comparison, capacity utilization at International Paper in 1978 was well over 90%.) We are losing, and losing big.

From the perspective of a person in the industry trying to compete, it is obvious that the playing field is not level. Our employees, suppliers and many communities are being injured by growing levels of Canadian lumber imports. Despite our best efforts to improve our competitive position, our industry is being injured and, in fact, devastated by increasing amounts of subsidized Canadian softwood lumber imports.

Testimony of Dr. William A. Noellert, PhD.,
Economist at Dewey, Ballantine, Bushby, Palmer & Wood,
Before the International Trade Commission

The U.S. softwood lumber industry has been materially injured over the last three years by sharply increasing subsidized imports from Canada that have severely depressed prices. What is particularly significant about this injury is that U.S. softwood lumber producers should be making record profits now because U.S. consumption of softwood lumber has never been higher.

[Chart 1]

This chart shows, based on ITC questionnaire data, that the current profit performance of the industry is way out of line with the current level of consumption. This is a cyclical industry. Softwood lumber is a homogenous product. The U.S. industry traditionally makes small profits or loses money during periods of low consumption. When consumption and lumber prices increase, producers must make sufficient profits to keep them in business over the next cyclical downturn. The cyclical nature of this industry is a function of the demand for lumber. Lumber demand is cyclical because the largest percentage of softwood lumber consumption is accounted for by the housing and construction industries. This derived demand results in a demand function that is price inelastic.

Historically real softwood lumber prices have had a strong positive correlation with consumption of softwood lumber, rising more than demand in peak consumption years and falling more than demand in slack years. However, the historical correlation between prices and consumption broke down in 1983.

[Chart 2]

This chart shows quarterly movements in the real price of lumber and U.S. consumption for the past 15 years. Until 1983, the movement in consumption and prices was highly correlated. In mid-1983 consumption continued on an upward trend but prices moved down. While consumption increased to record levels, prices moved back down to recessionary levels. This unprecedented price movement can be seen more clearly if we examine real softwood lumber price movements in the last three economic expansions.

[Chart 3]

This chart tracks real softwood lumber price movements, by quarter, over the past three economic expansions. The chart clearly shows the anomalous behavior of prices in the current recovery. Indeed, the price index in the 4th quarter of 1985 was at the same level it was at in the 4th quarter of 1982, when the economic expansion began.

The U.S. softwood lumber industry has lost money over this period because prices, instead of rising with the increase in consumption, have fallen since the middle of 1983.

The inability of U.S. producers to earn profits over this period because of depressed prices is especially significant because softwood lumber consumption in the United States has never been higher.

[Chart 4]

Consumption hit a record annual rate in 1985 of 43.8 BBF. The three year cumulative consumption level from 1983-1985 also established a record, surpassing the previously record levels reached in 1977-1979, the last time this industry was profitable.

Despite this period of record demand, and despite industry performance in past years of peak consumption, U.S. producers have lost money on their softwood lumber operations. Our survey of the industry shows that U.S. producers had a net loss (operating income) in 1984 and 1985 while earning a small profit in 1983. Profit is a function of prices and sales volume, both of which have been depressed by imports. The fact that this industry has not earned profits during this period of peak consumption means that the industry is unlikely to earn a profit for years to come unless the volume of subsidized imports is reduced.

U.S. production of softwood lumber increased only marginally, from 29.7 BBF in 1983 to 30.7 BBF in 1985, an increase of 3.4%. Production was up 5% in 1984, but declined almost 2% in 1985 because of increasing imports. The volume increase from 1983 to 1985 was 1 BBF. Even the currently suppressed output levels can not be maintained unless prices, and therefore profits, recover.

Despite historically unprecedented demand, employment, like production, has remained flat during this period. Softwood lumber mill employment was 85,609 in 1983 and 86,486 in 1985, an increase of 1%.

U.S. producers' share of the market has dropped 5% during the period, from 70.2% in 1983 to 66.8% in 1985.

Despite adverse economic conditions caused by imports of Canadian softwood lumber, U.S. producers have maintained and are increasing their production efficiency. The softwood lumber industry in the United States is a well managed industry. The ITC's own analysis of this issue has shown that the U.S. and Canadian mills producing similar products have "near equal" productivity and that productivity in the United States is rising faster than in Canada, but this won't continue at current price and profit levels.

The reason for the disastrous economic performance of the U.S. softwood lumber industry during this time of record consumption has been the large increase in the volume of subsidized Canadian imports. The volume of subsidized Canadian imports has risen sharply over the period, increasing from 11.9 BBF in 1983 to 14.5 BBF in 1985, an increase of 22%. Import penetration went up by 11%, from 29.8% to 33.2% of the U.S. market.

[Chart 5]

As the chart shows, this increase in Canadian imports of 22% is disproportionate to U.S. consumption, which grew by 9.5%, U.S. production, which increased by only 3.4%, and U.S. employment, which had a marginal 1% increase. The import volume increase was almost three times the increase in the volume of production (2.6 BBF vs. 1 BBF).

[Chart 2]

Given the commodity nature of softwood lumber, Canadian imports are highly substitutable for U.S. production. Thus, the large growth in the volume of subsidized imports has depressed U.S. softwood lumber prices. Despite record demand, softwood lumber prices have fallen over the period. The nominal price index has fallen 6.6% and the real price index of softwood lumber has fallen 8.4%. For the first time softwood lumber prices have fallen at a time of peak consumption. In 1983 the historical strong positive correlation between softwood lumber consumption and real softwood lumber prices broke down. Real softwood lumber prices in 1984 and 1985 were at levels normally associated with periods of economic recession and low consumption. The sharply increasing supply of subsidized imports has depressed domestic prices and profits and reduced U.S. producers' output.

* * *

Because the Commission will be analyzing information on the first quarter of 1986 from the questionnaire responses, I would like to briefly draw attention to some seasonal fluctuations in the quarterly data for this industry.

The quarterly data on U.S. production show the same pattern and trend as the annual data. In addition, the quarterly data indicate that over the past three years, U.S.

output has always peaked in the second quarter of the year and output has always fallen sharply in the fourth quarter of the year. The peak of production in the second quarter of the year corresponds with the seasonal nature of the housing industry. The sharp decline in the fourth quarter relates to the seasonal decline in consumption in that quarter.

The quarterly data on imports and market share support the trends revealed by annual data -- sharply rising imports and Canadian market share over the period. The quarterly data indicate that Canadian imports are always lowest in the first quarter of the year. This occurs because of poor weather conditions for harvesting timber toward the end of the year in Canada. Import penetration is also lowest in the first quarter because along with the relatively lower import volume, U.S. consumption generally begins to recover as the spring construction activity takes off.

Finally, the quarterly data on prices show the same trend as the annual data -- sharply declining prices over the 1983 to 1985 period. While the price trend has been declining, the quarterly swings in that trend are revealing. In 1984 and 1985 prices reached their highest level in the first quarter of the year. This was also the quarter when import volume was lowest in both years. Unless this trend changes, prices in the first quarter of 1986 will probably be the highest level that will be attained this year. I would also note that the most recent price information available indicates that prices are on a trend down throughout April and May.

[Charts 6 and 7]

Similarly, imports and import penetration are likely to be at their lowest level for the year in the first quarter.

These quarterly fluctuations will be important to keep in mind as the Commission decides how to evaluate data on the first quarter of 1986.

The data conclusively reveal that this industry has suffered material injury. The only economic indicators that are positive are consumption driven. There is no question that the adverse economic condition of the U.S. softwood lumber industry, at a time of record demand, is due to the growth in the volume of subsidized imports of Canadian softwood lumber.

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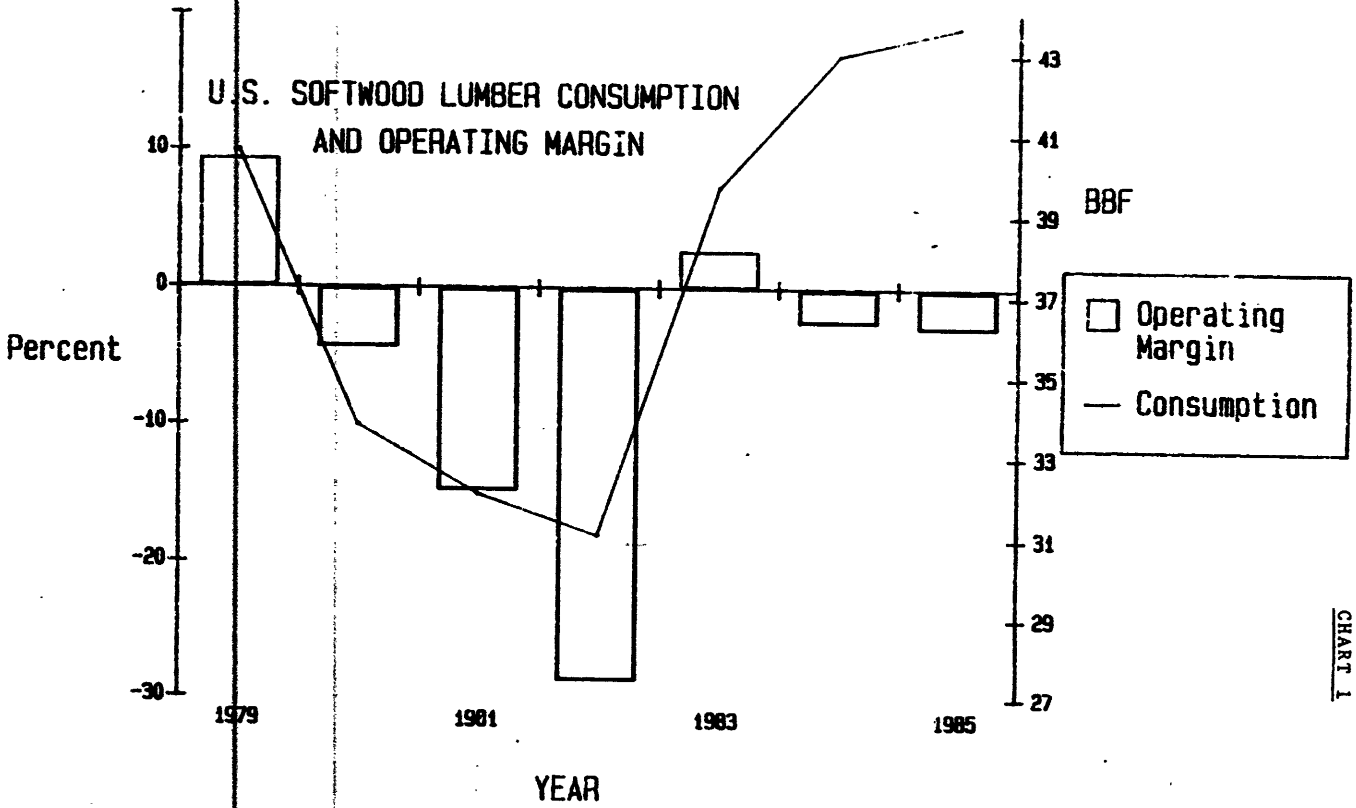


CHART 1

U.S. CONSUMPTION OF SOFTWOOD LUMBER
AND REAL SOFTWOOD LUMBER PRICES
BY QUARTER

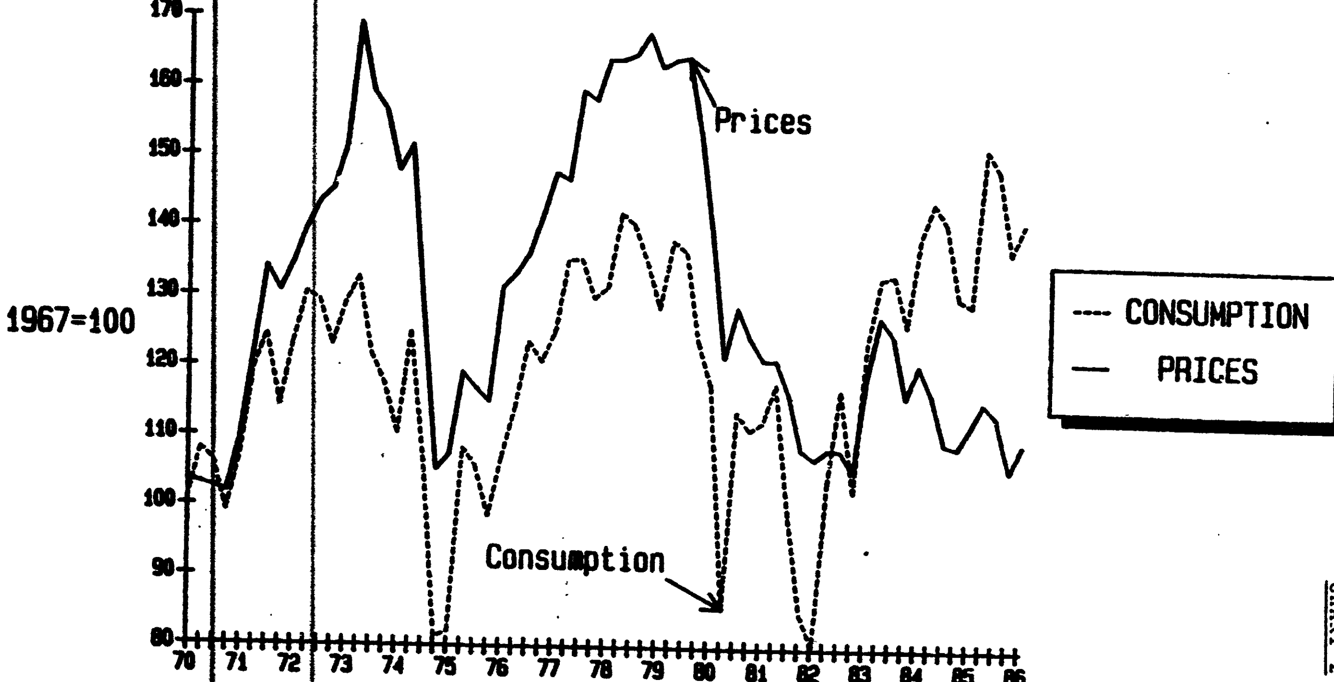
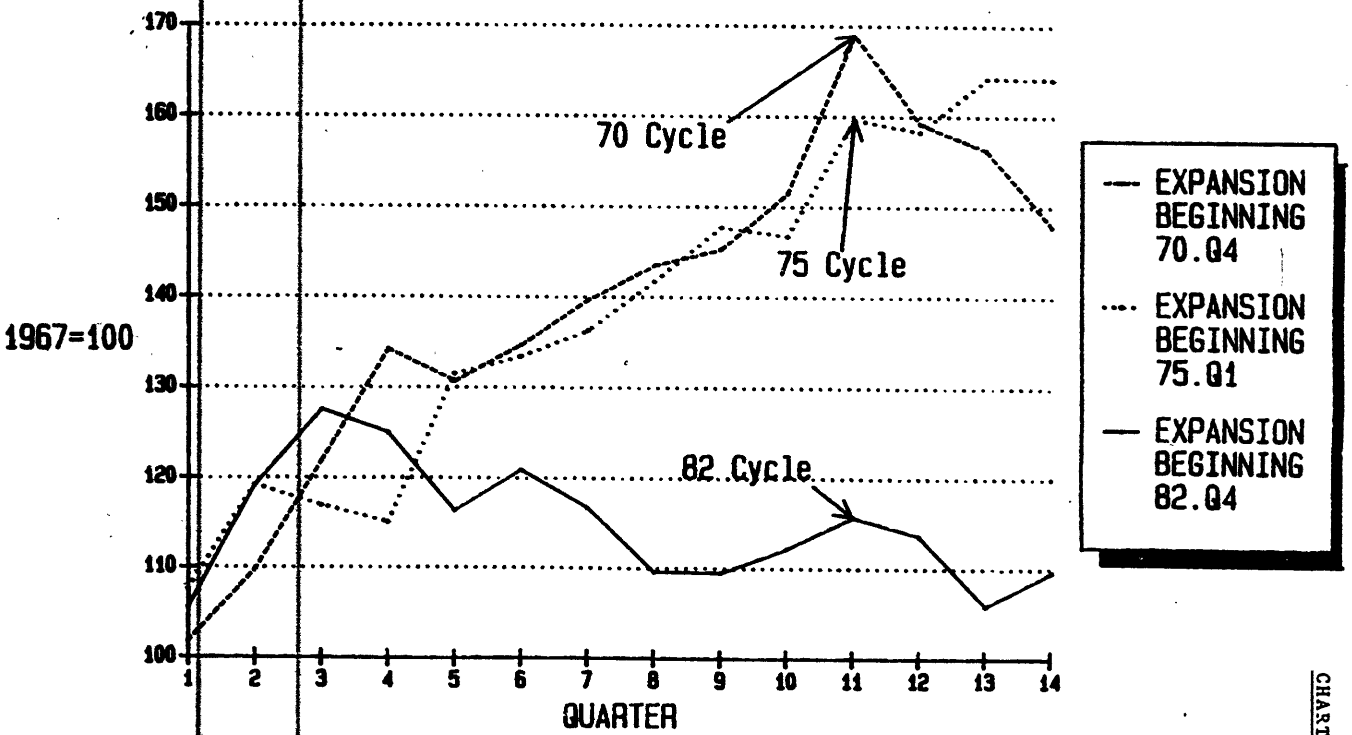


CHART 2

CHART 3

REAL SOFTWOOD LUMBER PRICE MOVEMENTS IN THE PAST THREE ECONOMIC EXPANSIONS



U.S CONSUMPTION OF SOFTWOOD LUMBER 1970-1985

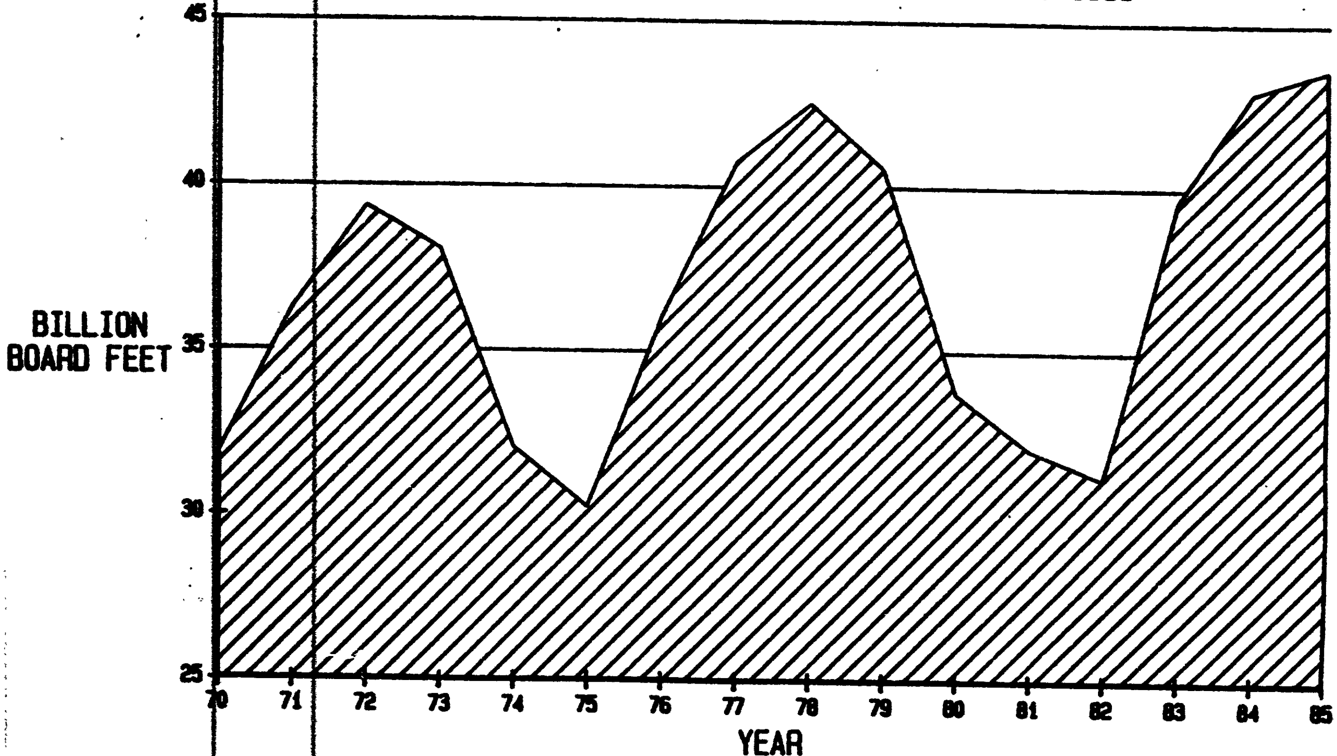


CHART 4

CHANGES IN U.S PRODUCTION, CONSUMPTION, EMPLOYMENT AND CANADIAN IMPORTS OF SOFTWOOD LUMBER, 1983-1985

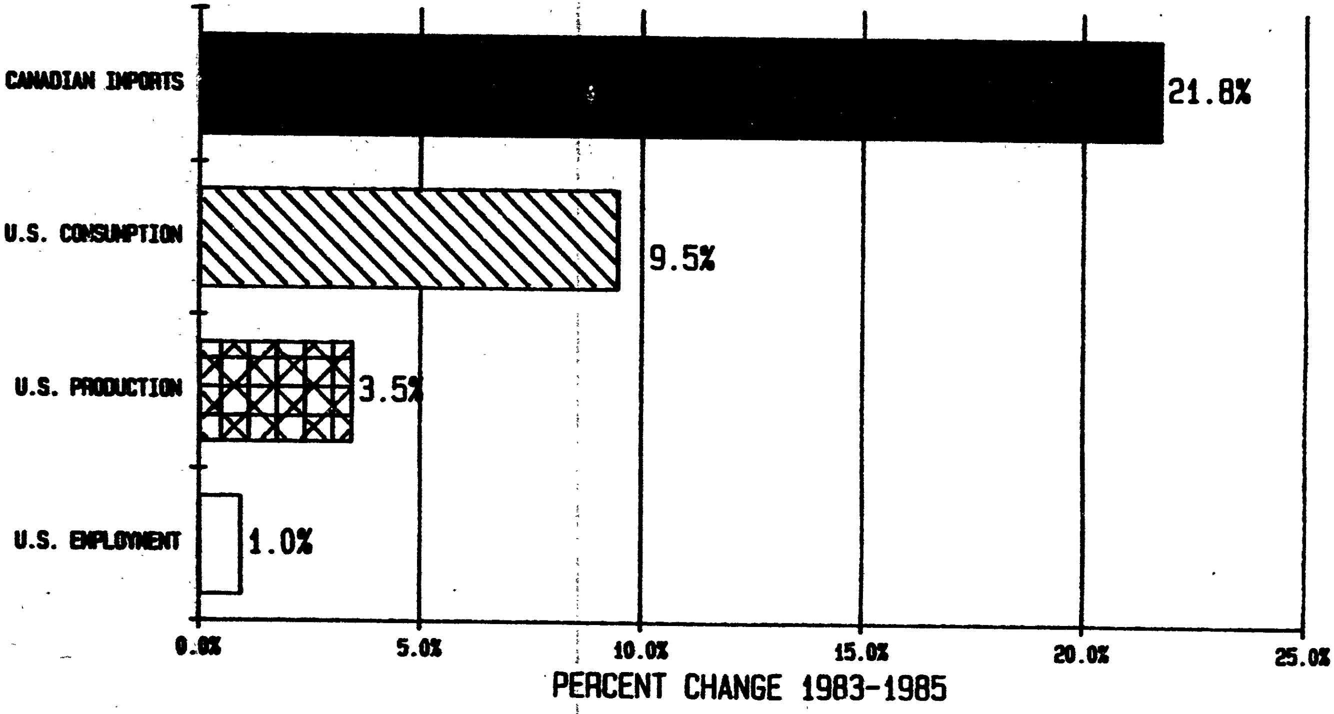


CHART 5

Composite Framing Lumber Prices
January 1986 to May 1986 by Week

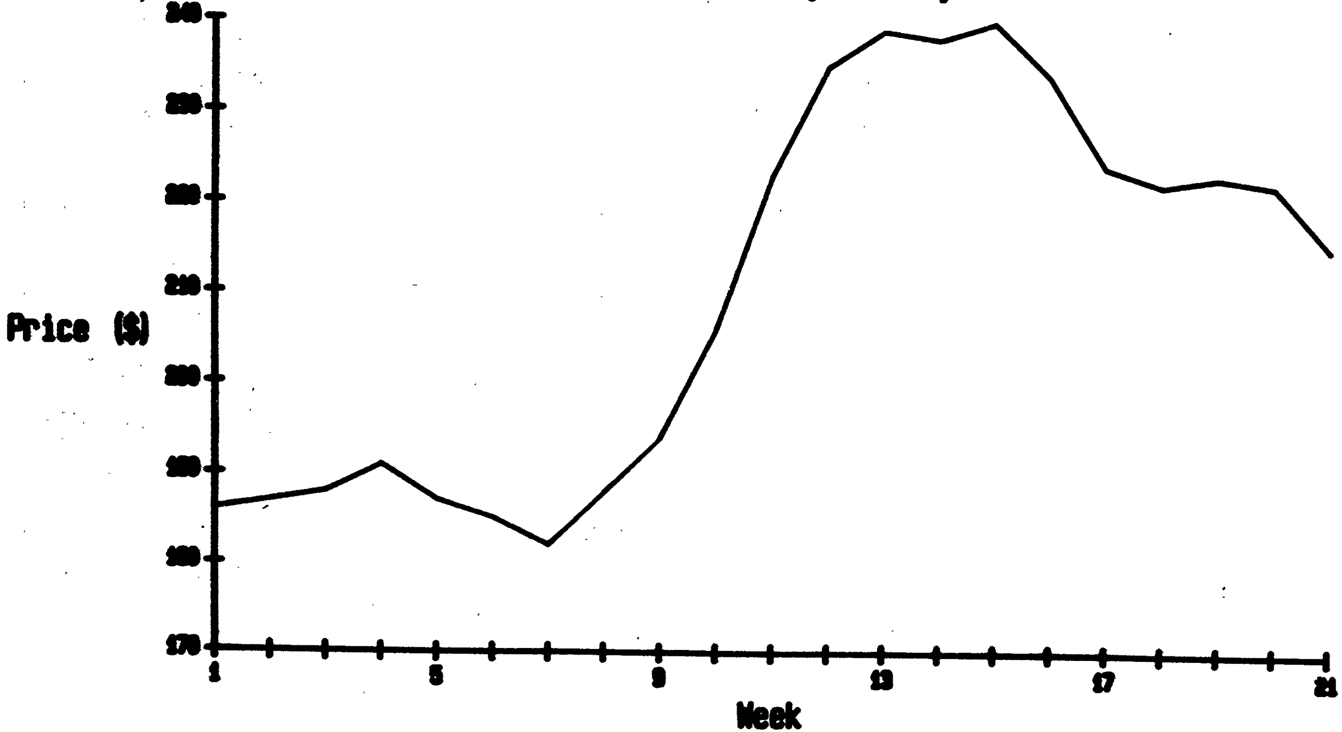


CHART 6

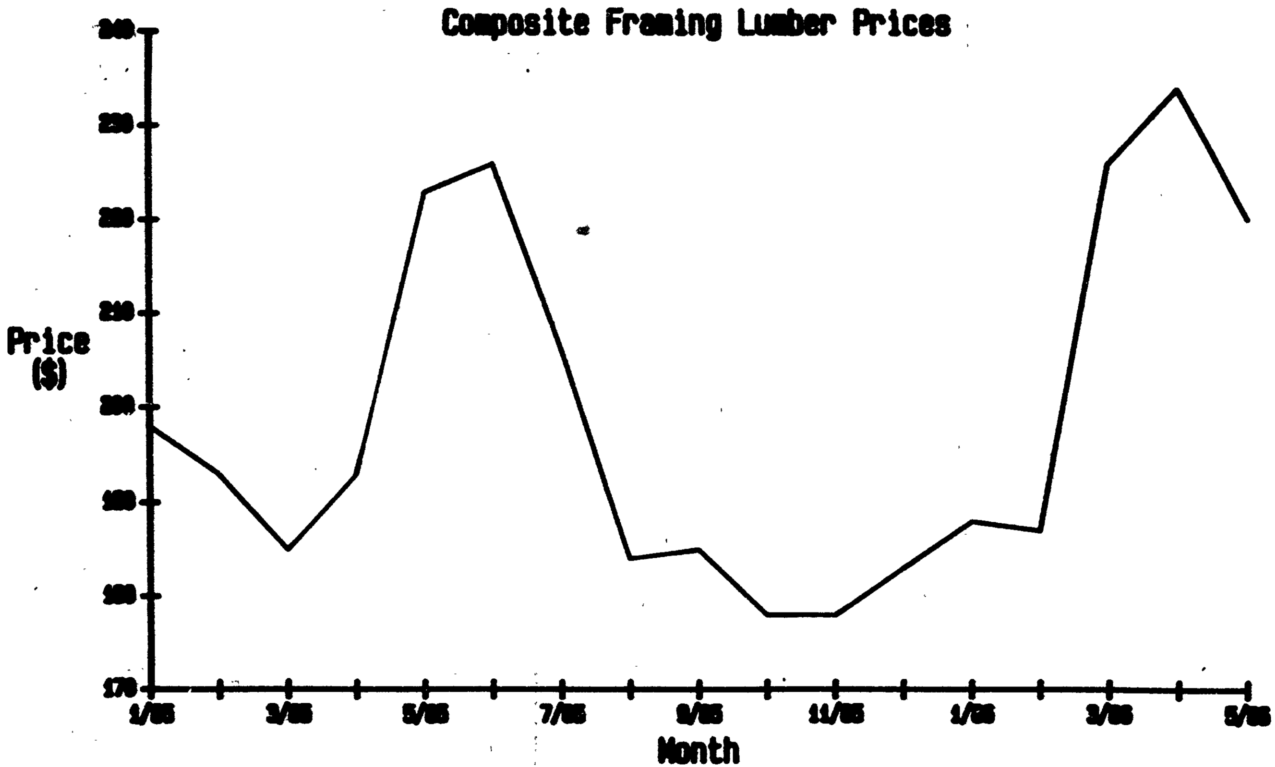


CHART 7

Mr. STAHL. The natural resource subsidy bill under consideration by this committee addresses these problems. S. 1292 would relieve trade distorting effects resulting from the Government provision of removal rights at less than fair market value by clearly stating that such subsidies are subject to countervailing duties. It would address subsidy practices which allow imported finished products to be sold in this country at prices substantially below what would otherwise be a fair price, absent any Government intervention, and below prices charged to U.S. producers who do not have access to such subsidized inputs or removal rights.

This legislation provides a definitional standard on what constitutes a natural resource subsidy. It is reasonable to define Government-owned resources sold at below market prices as a subsidy, The provision of a resource component or the right to remove such a resource component, at a below market price has the same effect—the same subsidizing effect—as an outright grant of money, which clearly is countervailable under our U.S. trade laws.

The market value of a natural resource in foreign countries can be fairly measured by representative competitive sales of the natural resource, even if these sales occur in another country. S. 1292, by adding natural resources to the list of countervailable subsidies in current law, would provide an effective means of dealing with these subsidies with certainty, predictability, and in compliance with our international obligations. I have with me today Alan Wolff, the Coalition's chief counsel, and Professor Gary Hufbauer. In Mr. Wolff's written statement, he explains how this legislation would be applied. He states that the fair market value standard upon which S. 1292 is based is sound in principle and not excessively difficult to administer. Mr. Wolff also explains that it is necessary to amend the countervailing duty law. He notes that this problem cannot be resolved as an unfair trade practice under section 301 of the Trade Act. He goes on to say that Congress should not fail to act because of preliminary administrative decisions.

In his statement, Professor Hufbauer, one of the U.S. negotiators of the GATT subsidies code, explains that the legislation would not violate GATT. Chairman Gibbons referred to some of Professor Hufbauer's testimony earlier. Both are willing to answer your questions.

In summary, there is one single dominant cause of the economic problems faced by the U.S. softwood lumber industry. This problem is Canadian timber subsidies. No local U.S. market has been distant enough from the Canadian border to be spared from the effects of these subsidized imports from Canada. We believe that S. 1292 currently under consideration is necessary to address the cause of the problems currently facing the U.S. lumber industry. Thank you, Mr. Chairman.

Senator HEINZ. Mr. Stahl, thank you very much. Mr. Coe?

[The prepared written statements of Mr. Stahl, Mr. Wolff, and Professor Hufbauer follow:]

Testimony of

David E. Stahl, Secretary

U.S. Coalition for Fair Lumber Imports,

before the

Trade Subcommittee

of the

Senate Finance Committee,

June 26, 1986

Good morning. My name is Dave Stahl. I am the Secretary of the U.S. Coalition for Fair Lumber Imports, and a former President of the National Association of Homebuilders. The Coalition for Fair Lumber Imports represents the full breadth of the softwood lumber industry. It includes a number of the largest U.S. lumber producers as well as all of the major lumber associations from across the United States. These include the National Forest Products Association, Southern Forest Products Association, Western Forest Industries Association, and the Southeastern Lumber Manufacturers Association. Those associations account for over 70 percent of the U.S softwood lumber production, and their members are distributed throughout all the lumber producing regions of this country.

I appreciate the opportunity to testify in support of the proposed legislation dealing with natural resource subsidies, S. 1292. Specifically, I will comment on the problems faced by the U.S lumber industry and why the proposed legislation addresses these problems.

The last three years should have been the biggest boom years in the history of the U.S. softwood lumber industry. Our industry is a cyclical industry, following the peaks and troughs of the housing market and U.S. lumber consumption. In past peak years, the industry was strongly profitable. This allowed for a reasonable return on investment over a business cycle which invariably included several lean years. Yet, during the past three years, when housing starts and lumber consumption have been moving to record levels, this industry has been struggling badly.

During the economic recovery period between 1983 and 1985, U.S. consumption of softwood lumber has risen to record levels. During that period, however, U.S. production and employment have remained relatively stagnant. By contrast, sixty-five percent of the increase in consumption over the last three years has been supplied by Canadian imports.

The U.S. softwood lumber industry has lost money during this period because prices, instead of rising naturally with the increase in consumption, have fallen since the middle of 1983. When the most important economic indicators -- prices and profits -- are at such low levels, firms cannot justify remaining in business, nor can timber growers reinvest in trees. When it is remembered that this is the peak of the building boom, these facts are nothing short of disastrous.

The cause of the poor economic conditions of the U.S. softwood lumber industry is apparent. Heavily subsidized Canadian imports have steadily increased, in good times and in bad. Softwood lumber prices are usually quite sensitive to demand and rise and fall with consumption. However, large subsidies from the Canadian provincial governments have allowed Canadian lumber imports to be impervious to demand and price fluctuations. Instead of demand for lumber setting the price of timber for any given level of supply, the Canadian system establishes a timber price that independently affects the supply of lumber. The result is increased supply of subsidized Canadian lumber caused by provincial intervention to maintain employment, rather than by market forces. The result for the U.S. industry of this increased supply of Canadian lumber has been price suppression and lost sales. In fact, Canadian imports are two and three-quarters billion board feet, or 23%, above the level in 1978, the last year of comparable U.S. demand, and now represent a third of U.S. consumption. As a result, real prices for lumber are only 60% of the price level in 1978.

The natural resource subsidy bill under consideration by this Committee addresses these problems. S. 1292 would relieve trade distorting effects resulting from the government provision of removal rights at less than fair value by clearly stating that such subsidies are subject to countervailing duties. That bill would address subsidy practices which allow imported finished products to be sold in this country at prices substantially below what would otherwise be a fair price absent any government regulation, and below prices charged to U.S. producers who do not have access to such subsidized inputs or removal rights. Similar legislation, introduced by Chairman Gibbons, was recently approved by the U.S. House of Representatives as part of H.R. 4800, the omnibus trade legislation. A proposed amendment to that bill to address natural resource subsidies as unfair trade practices, for which any remedy is discretionary with the President, was overwhelmingly defeated by a bipartisan majority during the floor debate.

This legislation is necessary to provide a definitional standard on what constitutes a resource subsidy. It is reasonable to define below market government resources as a subsidy. Providing a resource component or the right to remove such a resource component at a below market price has the same subsidizing effect is an outright grant of money, which clearly is actionable under our countervailing duty statute and the General Agreement on Tariffs and Trade. Further, the market value of the resource in the foreign country is fairly measured by representative competitive sales of the resource, even if those sales occur in another country. For example, timber in Maine is virtually identical, in species, quality and location, to timber in Quebec. The same is true of timber in Idaho and the British Columbian Interior. The forests are the same and the border is merely an imaginary line. To the extent that the timber on the north of the border is sold for less than virtually identical timber in the same region south of the border, it is being sold for less than fair market value and is, therefore, a subsidy.

By providing this definitional standard, this legislation would provide an avenue for redress from foreign natural resource subsidies. While the President currently has authority to act against unfair trade practices, including unfair natural resource pricing, under Section 301 of the Trade Act, the plethora of outstanding trade disputes demonstrates the inability of such discretionary remedies to deal adequately with our current $150 billion trade deficit. Countervailing duty decisions are made in public, quasi-judicial proceedings which allow both sides to effectively present their case. If a foreign program is a subsidy and injures a U.S. industry, a duty should be placed upon goods benefiting from that subsidy. H.R. 4800 and the Senate bill, by adding natural resources to the list of countervailable subsidies in current law, would provide an effective means of dealing with these subsidies with certainty, predictability, and in compliance with our international obligations.

In summary, there is one single dominant cause of the economic problems faced by the U.S. softwood lumber industry, and that is Canadian subsidies. Only through the disposal of timber at a fraction of its market value has Canada managed -- with a less efficient forest sector, with less beneficial weather, with poorer roads and worse logging conditions, with higher wages, with less intensive silviculture, and with less productive and less commercially useful forests -- to continue to undercut domestic prices and steadily increase share in the United States softwood lumber market. No local U.S. market has been distant enough from the Canadian border to be spared from the effects of these subsidized imports from Canada. We believe that S. 1292 currently under consideration is necessary to address the cause of the problems currently facing the U.S. lumber industry.

With me today are Alan Wolff and Professor Gary Hufbauer. Mr Wolff is counsel to the Coalition and is prepared to address how this suggested provision fits within the scope of existing statutory and case law. Professor Hufbauer, one of the principal U.S. negotiators of the GATT Subsidies Code, is prepared to answer any questions on how the proposed legislations relates to our GATT obligations. Both Mr. Wolff and Professor Hufbauer have submitted written testimony.

Thank you for this opportunity to testify. I would be happy to answer any questions.

Testimony of Alan Wm. Wolff
for the Coalition for Fair Lumber Imports,
before the
Trade Subcommittee
of the
Senate Finance Committee,
June 26, 1986

Good afternoon. I am Alan Wolff, appearing here today as counsel for the Coalition for Fair Lumber Imports. I am here to testify as to the proposed natural resource subsidy legislation and its potential effects on the U.S. lumber industry.

Dave Stahl, Secretary of the Coalition, has testified that the U.S. lumber industry is in dire economic straits: mill closures have plagued the industry; companies are losing money; lumber prices are depressed and falling . . . . The situation is made all the more critical because, with lumber consumption at an all time high, the U.S. softwood lumber industry should be in the midst of a boom. Without adequate profits in this time of record consumption, the industry will be decimated when consumption turns down, as it inevitably will.

While the U.S. industry is suffering injury, however, the Canadian lumber industry is producing record volumes of softwood lumber and taking an ever-growing share of the U.S. market, over 33% in 1985. Canadian production is up well over 100% since 1975, and since 1978, the last year of comparable U.S. consumption, Canadian production has increased over 20% while U.S. softwood lumber production has actually fallen. In 1985, Canada shipped almost $3 billion of subsidized lumber into the United States.

This pattern of growing Canadian market share is, from a market perspective, startling. U.S. softwood forests are more bountiful than Canadian forests; U.S. mills are closer to the market; U.S. wage rates are lower, and U.S. mills and mill workers are as productive as Canadian mills and workers. Yet Canada now controls one-third of the U.S. lumber market, up from about one-fifth from 1970-1975. There is one critical difference between the two lumber industries that explains this: U.S. mills must purchase timber competitively on the market. Canadian timber (approximately 95% of which is owned by the Canadian provinces) is given to Canadian mills at far less than a fair value to encourage Canadian development and the resulting jobs. The system is no different than if the provinces charged a fair value for their timber and gave the mills a $65 grant for every thousand board feet harvested. Where Canadian jobs are artificially created by below-market stumpage, however, U.S. jobs are unjustly lost. The U.S. softwood lumber industry needs relief from the Canadian timber subsidy.

Natural resource subsidy legislation, as adopted by the House and proposed by Senator Baucus (and co-sponsored by Senators Long and Symms of the Finance Committee), would redress the subsidies which are injuring the U.S. lumber industry. This proposed legislation is simple in concept and effect. The legislation would make clear that the government provision of a resource input product or a resource removal right at less than fair market value -- what a willing buyer will pay a willing seller in an arms-length transaction -- is a countervailable subsidy. The legislation also provides illustrative lists of factors to be considered in determining a resource's fair market value. For a resource removal right, the Department of Commerce would be directed to consider the price of private sales of the resource to purchasers in the country in question, the price of competitively-sold government resources, and the price of comparable removal rights from comparable regions of other countries sold competitively.

Significantly, the legislation is not limited by a requirement that the resource be given to only a specific industry or group of industries. As Senator Heinz observed in February, a U.S. lumber manufacturer is injured by Canadian timber pricing subsidies regardless of whether the Canadian paper industry also has access to below-market timber. Products, which in significant part are made from undervalued government natural resources, which injure U.S. industries should be subject to duties.

The natural resource subsidy legislation would not represent a major change in the statute. The legislation would specify for the Department of Commerce how the artificial competitive advantage conferred by government pricing of an input product, i.e. the subsidy, is to be measured. The legislation would also clarify that such pricing of natural resources is the type of competitive advantage which is to be subject to offsetting duties, if injury is caused by the resulting trade distortion. Significantly, current caselaw is beginning to take this position. In Cabot Corp. v. the United States, 620 F. Supp. 722 (1985), the Court of International Trade indicated that natural resource pricing subsidies clearly can be subject to countervailing duties based on the facts involved in a particular case, and in an annual review of duties on the same product that was at issue in Cabot, the Department of Commerce enunciated a methodology that could allow some natural resource subsidies to be countervailed in the same manner as that set forth in this bill. That statement, the Preferentiality Appendix, indicated that in various situations it is appropriate to measure a subsidy by the difference in the government price and the private price of the resource or the price of a comparable resource in another country. Such analysis is consistent with the approach in this proposed legislation, and in fact, the Coalition has filed a case relying in part on that Appendix. It is entirely appropriate that the Congress adopt this natural resource subsidy legislation in order to assure effective application of the countervailing duty law.

Even though the Department of Commerce is moving toward a recognition that below market pricing of natural resources is countervailable, this legislation is necessary. First, while the Department of Commerce's Preferentiality Appendix will yield an appropriate result in many cases, it is lacking an explicit acknowledgment that the calculation of a subsidy on government-provided goods should be based upon a determination of what is the fair market value of those goods. That is, the subsidy calculation should be based on the extent to which a foreign government is distorting the market by selling products at less than the price that would exist absent government interference. Further, the Preferentiality Appendix is only preliminary, and is subject to administrative change. Congress should act to make it clear that a countervailing duty is to be imposed.

Let me briefly address some of the arguments which have been raised in opposition to the natural resource subsidy legislation.

First, it has been said that a fair market standard is not administrable. The administration of the law, however, always places some burden on the administrator, but the fair value standard, with a list of factors which can indicate fair value, is not unduly difficult to administer. Indeed, in administering the trade laws the Department often has to develop a constructed value of a product or go to individual plants in other countries to determine cost of production of a product. For other subsidies, such as loans or equity purchases, the Department currently seeks to determine the fair market value of a government-provided benefit, and for both German coal and Brazilian iron ore subsidies, the Department has consulted world market values. Certainly all of these values are far more difficult to determine than fair market value as indicated by the price of a product in various markets.

The Congress could develop more arbitrary standards, such as the average price of the resource in the United States, but such a standard might not be an adequate or appropriate measure of the distorting effects of the subsidy. The proposed test is a very reasonable one and is based upon the principle of offsetting the government-produced distortion. Finally, any difficulty in administering a fair market value standard is insignificant compared to the injury suffered by U.S. firms because of foreign natural resource subsidies.

It has been argued that natural resource subsidy legislation would be violative of the GATT. As Professor Hufbauer sets forth more fully in his testimony, this is not the case. The GATT and the GATT Subsidies Code simply do not address the issue of natural resource subsidies, and they leave the signatories free to offset these injurious distortions of the marketplace.

In the House, an amendment to the natural resource provision was proposed and soundly defeated by a bi-partisan majority, which would have termed below market natural resource pricing an unfair trade practice actionable under § 301 of the Trade Act rather than a countervailable subsidy. An amendment to § 301, however, would not provide a clear solution. The President currently has the ability to act against unfair natural resource pricing but has not done so. U.S. industries suffering from such foreign subsidies should not be left with a remedy that is totally discretionary with the President -- a remedy that politicizes the issue rather than resolving it with full review in a quasi-judicial proceeding. Further, a countervailing duty proceeding is fully consistent with U.S. international obligations, and, unlike a § 301 case, does not invite foreign retaliation. Moreover, there is no reason to distinguish natural resource subsidies from other subsidies which are subject to duties -- countervailing duties are the most appropriate response.

Finally, some have argued that if a foreign government gives U.S. companies access to resource removal rights, no subsidy exists. While the natural resource legislation does apply a nondiscrimination clause to input products, such a requirement should not be applied to removal rights. A removal right, by definition, must be exercised in the country granting that right. Even if the right is freely available to U.S. companies which move to the foreign country to exploit the right, the United States, at the very least, will lose large segments of its resource industries to other governments' subsidies without an explicit remedy in U.S. law.

Natural resource subsidy legislation is an appropriate, fair response to foreign subsidies which are injuring U.S. industries. By clearly defining as a subsidy government distortion of resource pricing, this legislation would allow any nation to capture the full benefits of its natural advantages, which will be reflected in a resource's fair value, but if the foreign government chooses to subsidize its industries, distorts trade, and injures U.S. industries, offsetting duties will be required. Congress should make a clear, direct statement that these subsidies are violative of the U.S. countervailing duty law, and, if continued, will be subject to countervailing duties.

Statement of

Gary C. Hufbauer
Wallenberg Professor of International Finance
Georgetown University

Before the
Trade Subcommittee
of the
Committee on Finance
United States Senate

June 26, 1986

I submit this statement as an expert witness retained by the Coalition for Fair Lumber Imports. During the Tokyo Round of Multilateral Trade Negotiations, in my capacity as Deputy Assistant Secretary of the Treasury for International Trade and Investment Policy, I was actively engaged in the negotiation of the Subsidy Code negotiations. Later, with Joanna Shelton Erb, I published a book titled Subsidies in International Trade.[1] This statement is based on my experience in those negotiations and my subsequent research.

The question I wish to address is this: To what extent, if at all, does the GATT Subsidies Code limit the U.S. Congress, or the U.S. Department of Commerce, in defining natural resource subsidies for purposes of the U.S. countervailing law?

A preliminary point must be noted. The U.S. Congress, in the Trade Agreements Act of 1979, §§ 3(a) and 771(5), made it plain that nothing in the Subsidies Code would constrain the U.S. Commerce Department in determining what practices might be defined as subsidies. The relevant language may be quoted (emphasis added):

> (5) SUBSIDY. - The term "subsidy" has the same meaning as the term "bounty or grant" as that term is used in Section 303 of this Act, and includes, but is not limited to, the following:...

In other words, the 96th Congress retained unfettered administrative discretion (and, a fortiori, congressional discretion) to define what practices are and are not subsidies. Bearing this key fact in mind, what restraints might the Subsidies Code place on the United States in defining natural resource subsidies, assuming that the retained discretion were exercised in conformity with the Code?

The Subsidies Code negotiation involved a number of actors and a great many subjects. The evolution of the relevant part of the negotiations may be summarized as follows. In 1977 and 1978, the United States sought to reach agreement on a general definition of export subsidies. Sample language advanced by the U.S. negotiators appears in Exhibit A (see the first bracketed paragraph). The attempt to reach a general definition was rebuffed by the European Community and the Canadians and abandoned in December 1978. Instead, a list of specific illustrative practices was negotiated. This list appears as an Annex to the Subsidies Code, titled "Illustrative List of Export Subsidies."

~~In 1978,~~ the United States also sought to gain international acceptance of a parallel, and similarly detailed, illustrative list of domestic subsidies. This episode is described in an article by Richard Rivers and John Greenwald

(See Exhibit B for the relevant text). Again this effort was rejected by the European Community and the Canadians, and it was abandoned in late 1978 by the United States. Instead, the Canadian draft of November 1978 (reproduced as Exhibit C) became the basis of Article 11 of the Subsidies Code.

One may speculate on the direction subsequent events might have taken if U.S. initiatives had been accepted. If the United States had obtained agreement on general definitions of export subsidies and domestic subsidies and if the definitions were illuminated by detailed illustrative lists, then perhaps, in turn, the U.S. negotiators would have accepted a hypothetical demand from the Europeans or the Canadians that the Code definitions of subsidies should be used as the benchmark for national countervailing duty proceedings. But negotiations did not travel along that path. No general definitions were reached in the Code; the illustrative lists are neither detailed nor exhaustive, and, to my knowledge, our negotiating partners never suggested that the Code should provide a benchmark definition of what practices would and would not constitute a subsidy. In fact, the United States and Europe could never agree whether off-budget subsidies (for example, the assignment of valuable mineral rights free of charge) can be a subsidy. Instead, the Code left an enormous amount of grey area where subsidies would necessarily be defined on a case-by-case basis in subsequent national and international proceedings.

If so much latitude was left to national determination, what purpose was served by the illustrative lists? The purpose of the illustrative lists was to provide a clear basis for one signatory to complain, in the GATT, about any of the listed practices perpetrated by another signatory, when the requisite trade impact standards are also met. For example, if a signatory granted one of the export subsidies listed in the Annex to the Code, then *ipso facto* that signatory was in derogation of the GATT Code. (*See* Code Article 8:4, note 26, and Article 9.) In other words, the illustrative lists serve to simplify the legal burden faced by the petitioner in GATT proceedings: there can be no disagreement that the listed practices are, in fact, subsidies.

But the lists were illustrative, not exhaustive, a point explicitly stated in Article 9:2 and Article 11:3. Even a practice not listed can still be the subject of a GATT proceeding, if it causes *serious prejudice* to the economic interests of another signatory. *Any* subsidy that causes economic *injury* to another signatory's industry can properly be the *object* of national countervailing duty proceedings, whether or not the subsidy appears on the illustrative list.

To be sure, a few long-established practices were explicitly agreed not to be subsidies at all -- namely duty drawback provisions and border tax adjustments for indirect taxes (including value added taxes). These practices are protected by items (g) and (i) in the Code Annex. Otherwise, the negotiating history is silent. No inference can be drawn that other practices -- for example, the bargain sale of stumpage rights or mineral extraction rights -- were agreed not to be subsidies. I recall no discussion as to the proper dividing line between "generally available" and "sector specific" subsidies; and I recall no agreement that "generally available" subsidies should be exempt from the imposition of countervailing duties. I do recall raising the question with my European and Canadian colleagues whether certain export incentive practices should be defined not to be subsidies. The consensus held that we could not reach agreement on a "negative list" of subsidies; moreover, it was believed that the injury test in domestic countervailing duty proceedings would eliminate nuisance suits. (For more on this point, see Subsidies in International Trade, pp. 48-50.)

To summarize:

1. The Subsidies Code does provide a non-exhaustive illustrative lists of subsidies. These lists are intended to allow a country adversely affected by the enumerated subsidies to make the government practice in question the subject of GATT proceedings without a preliminary skirmish as to whether or not the practice is a subsidy. Further, no Code signatory may object if these same subsidies are offset by countervailing duties under national proceedings.

2. With very few exceptions, the Subsidies Code does not limit which incentive practices may be defined as subsidies and, therefore, countervailed when the resulting trade injures another signatory.

If the Subsidies Code does not limit the definition of subsidies subject to national countervailing duties, what prevents a Code signatory from imposing countervailing duties against injurious trade that benefits from subsidized roads or schools?

The answer to this question are "common sense," "self-interest," and the injury test required by the GATT and the proposed legislation. A recognized function of government is to provide a range of basic services to the entire population which could not be reasonably provided by the private sector. Nearly every government provides a similar range of freely available, extremely broad-based services. If one country countervailed against these basic services, other countries would justifiably adopt mirror legislation. No good purpose would be served by an escalation of punitive duties designed to offset such basic government services. In this case, however, government distortion of natural resource pricing of a particular product sector exists, and mirror legislation is not at issue. Were the United States to employ such natural resource pricing subsidies in an injurious and distorting manner, offsetting duties would be justified.

Self-interest and common sense have so far kept governments from imposing countervailing duties willy-nilly, and no such action is necessary, nor likely, under the proposed natural resource subsidy legislation. Nevertheless, international limits on the definition of actionable subsidies should be the subject of international agreements. That was the goal of some U.S. negotiators in the Tokyo Round, and that was the recommendation of Subsidies in International Trade (especially Chapter 6). But those negotiations are some distance off. In the meantime, the United States must be guided by its own enlightened self-interest -- not by the Subsidies Code -- in defining actionable subsidies.

Exhibit A

Text of Illustrative List of Export Subsidies,
agreed ad referendum by G.C. Hufbauer, F.P. Klein,
December 13, 1978.

December 13, 1978

ANNEX A

Illustrative List of Export Subsidies

[An export subsidy is any charge on the public account [or other benefit] provided or mandated by governmental action except as may be otherwise provided in Article XVI of the General Agreement or its notes and supplementary provisions or in other international arrangements and protocols not inconsistent with the GATT, which are conveyed directly or indirectly upon an exported product and which results in differential treatment [including price or earnings differences] covering products sold for export over like or directly competitive products sold domestically.]*

Following is an illustrative list of export subsidies:

a) Currency retention schemes or any similar practices which involve a bonus on exports or re-exports.

b) Internal transport and freight charges on export shipments on terms more favorable than for domestic shipments.

c) In respect of deliveries by governments or governmental agencies of raw materials for export business on different terms than for domestic business, the charging of prices below world prices.

Version 1

[d) The full or partial exemption, remission or deferral, specifically calculated in relation to exports, of direct taxes[1/] or social welfare charges paid or payable by industrial or commercial enterprises[2/].]

[*The text of an EC reservation in favor of Ireland remains to be drafted.]

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Version 2

[In lieu of paragraph (d) and its footnotes, the following paragraph would be added at the beginning or the end of the text:

The relationship of direct tax practices to export trade and pricing, and to Article XVI of the General Agreement, has been a subject of concern to many signatories to this Arrangement. It is agreed that the Committee of Signatories should examine practices and GATT findings in this area with a view to supplementing this list and formulating comprehensive recommendations for adoption and implementation by signatories.]

e) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

f) The exemption or remission, in respect of exported goods, of indirect taxes[1/] in excess of those actually levied on the same goods if sold for internal consumption.

[g) The remission of prior stage indirect taxes on goods or services used in the production of exported goods in excess of the remission of like prior stage indirect taxes on goods or services used in the

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production of the same goods if sold for internal consumption; provided, however, that prior stage indirect taxes may be remitted on exported goods even when not remitted, on the same goods sold for internal consumption, if the prior stage indirect taxes are levied on components that are physically incorporated (making normal allowance for waste) in the exported product or its packing.]

h) The remission or draw-back of import charges[1] in excess of those actually levied on imported goods that are physically incorporated (making normal allowance for waste) in the exported product with packing; provided, however, that in particular cases a firm may use a quantity of home market goods equal to, and having the same quality and characteristics as, the imported goods as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed one year.

i) The provision by governments (or special institutions controlled by governments) of insurance or guarantees against increases in the costs of exported products at premium rates which are manifestly inadequate to cover [over a long-term period consistent with commercial principles the] [the long term] operating costs and losses of the insurance or guarantee programs.[3]

4--

j) The provision by governments (or special institutions controlled by governments) of export credit [or exchange risk] guarantee or insurance programs at premium rates which are manifestly inadequate to cover [over a long-term period consistent with commercial principles the] [the long-term] operating costs and losses of the programs.

[k) The grant by governments (or special institutions controlled by [and/or acting under the authority of] governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed, or the payment by them, of all or part of the costs incurred by exporters or financial institutions in obtaining credit, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least [twelve] original signatories[4/] to this Arrangement are parties as of January 1, 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rate provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Arrangement.]

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Notes

1/ For the purpose of this Arrangement, the term "direct taxes" shall mean taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property. [The term "import charges" shall mean tariffs, duties, border tax adjustments in lieu of indirect taxes, and other fiscal charges levied on imports.] The term "indirect taxes" shall mean sales, excise, value added, franchise, stamp, transfer and personal property taxes, and all taxes other than direct taxes and import charges.

[2/ (i) The signatories reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any signatory may draw the attention of another signatory to administrative or other practices which may contravene this principle and which result in a significant saving of direct taxes in export transactions. In such circumstances the signatories shall [normally] [where appropriate] attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without

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prejudice to the rights and obligations of signatories under the General Agreement on Tariffs and Trade, including the right of consultation created in the preceding sentence.

(ii) The signatories recognize that major conceptual and practical difficulties stand in the way of full implementation of paragraph (d). Accordingly, the Committee of Signatories, recognizing the principles noted in subparagraph (i), agree to convene a special session, as soon as practicable after this Arrangement enters into force, to study different direct tax systems and the scope for harmonizing their impact on trade flows.

(iii) The signatories agree that the panel findings referenced in GATT documents L/4422, L/4423, L/4424, and L/4425 shall be reexamined in light of paragraph (d) and this note during the deliberations of the special session of the Committee of Signatories.

(iv) Pending the deliberations of that session, the signatories agree not to introduce measures in contravention of the principles of paragraph (d), and to examine methods of bringing their existing measures into compliance with paragraph (d) within a reasonable period of time, bearing in mind the need to make correlative adjustments elsewhere in their tax systems in order to accommodate firms which have come to rely on existing measures.]

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3/ The signatories agree that nothing in this paragraph shall prejudge or influence the deliberations of the panel established by GATT decision ____.

4/ An original signatory to this Arrangement shall mean any signatory which adheres ad referendum to the Arrangement on or before March 31, 1979.

Agreed ad referendum

G. C. Hufbauer
F. P. Klein

Exhibit B

Richard R. Rivers and John D. Greenwald, "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences," Law and Policy in International Business, vol. 11, no. 4, 1979.

Domestic Subsidies

In political terms, U.S. insistence on developing agreed-upon rules governing the use of domestic or internal subsidies was perhaps the most sensitive issue raised in the MTN. Domestic subsidy programs are often at the heart of government social/economic planning. When the Italian, Canadian or Israeli government decides to encourage business to locate in a depressed region,[107] the effects of such regional development programs on international trade are not likely to dictate government policy. Similarly, aid by the British to a nationalized steel or automobile company[108] is not influenced by trade considerations. Nevertheless, such programs can have as serious an impact on trade and production in other countries as any direct export subsidy. In the U.S. business community, the trend toward greater government involvement in, and aid to, foreign industry has been a major concern.[109] This was particularly so for the capital intensive industries such as steel, chemicals, computers and aircraft.[110] In the U.S. view, unless the MTN could provide some reasonable basis for coping with the trade problems likely to arise in the coming years from such government involvement, there would be no basis for a subsidies/countervailing measures Agreement.

As mentioned before, existing GATT rules on domestic subsidies fell far short of providing a useful framework for resolving such problems. Europeans and, for that matter just about everybody else involved in the negotiations, were of course quite happy with the status quo. Any attempt at stringent international regulation of domestic subsidies would, the United States was told, amount to intolerable interference in internal policy matters.[111]

[107] For a discussion of regional development plans in Europe and the United States, see R. BALDWIN, *supra* note 13, at 120–21.

[108] *See* note 3 *supra*.

[109] *See, e.g.*, Industry Sector Advisory Committee on Aerospace Equipment for Multilateral Trade Negotiations (ISAC #24), Report on Multilateral Trade Negotiations (May 7, 1979), in ISAC REPORTS, *supra* note 36, at 493, 497; Automotive Equipment Industry Sector Advisory Committee, Advisory Opinion Regarding Whether Agreements Resulting from the Multilateral Trade Negotiations Provide for Equity and Reciprocity Within the Automotive Equipment Sector (ISAC #25) (undated), in *id.* at 513, 517–18.

[110] *See, e.g.*, Industry Sector Advisory Committee, Ferrous Products, Steel Sector Report on Multilateral Trade Negotiations (ISAC #11) (June 28, 1979), in *id.* at 205, 208; Industry Sector Advisory Committee on Electrical Machinery, Power Boilers, Nuclear Reactors, and Engines and Turbines for Multilateral Trade Negotiations (ISAC #18), Report on Multilateral Trade Negotiations Issues (May 9, 1979), in *id.* at 335, 336.

[111] In the course of the negotiations, this theme was expounded often and at great length

Rhetoric aside, there were obvious limitations on the extent to which rules on domestic subsidies could be agreed to. The notion that the British government would get out of the steel business or that the Italian government would abandon, or accept fixed limits on, its programs to develop the economically-depressed MezzoGiorno was fantasy. Even the United States could not go beyond a certain point. For example, it would have been impossible for the United States to agree to a hard cap on research and development aids to industry.[112]

The United States did believe however that there was scope to identify the types of subsidies that were most likely to have an adverse effect on the trade interests of other countries and to provide for a procedure under which any country adversely affected could first consult to see whether the problem could be worked out, and, failing resolution, be authorized to remedy the situation through the imposition of countermeasures. While the United States was not after a hard obligation limiting a country's right to use domestic subsidies, it did seek a remedy, even absent a corresponding obligation. To this end, the United States proposed a Supplementary Understanding[113] to the subsidies/countervailing measures Code on domestic subsidies. It provided as follows:

> 1. Internal subsidies have a proper role in promoting important objectives of national policy. They are used by governments to, *inter alia,* aid economic development, facilitate structural adjustment of the economy, and avoid unemployment. Yet, in certain circumstances, such subsidy practices can have a significant impact on the economic interests of other countries.
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> 2. Signatories agree that they will seek to avoid the use of subsidy practices in a manner which causes serious prejudice to the interests of other signatories. To the extent that a particular practice causes or is likely to cause such serious prejudice, signatories reaffirm their

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not only by the EC negotiators (particularly Alistair Sutton) but also by representatives of many developing countries.

[112] As of 1970, for instance, 64 percent of all research funds in the United States came from the government. R. BALDWIN, *supra* note 13, at 123.

[113] Supplementary Understanding on Internal Subsidies (unpublished document on file at the offices of *Law & Policy in International Business*).

commitment to consult with the signatory or signatories affected with a view towards developing a mutually satisfactory solution to the problem under which the adverse effects of the particular practice would be substantially reduced or eliminated.

3. Below is a list of specific internal subsidy practices to which the foregoing applies. The list is illustrative, not exhaustive. Further it is not intended to create any presumption—either by inclusion or by omission—that a particular practice either causes or does not cause or threaten or does not threaten serious prejudice.

(a) Government financing of commercial enterprises on terms significantly more favorable than the terms of available non-government financing. Such government financing can conclude [*sic*]:

(i) the subscription or provision of equity capital on terms significantly more favorable to the recipient than those at which private investors would invest;

(ii) the subscription to, or provision of, equity capital to cover significant operating losses sustained over a period of at least two successive years and in the absence of reasonable grounds to believe that such losses will cease within a reasonable period;

(iii) the loan of funds on terms significantly more favorable to the recipient than those at which the recipient could then borrow comparable amounts from private sources, such terms to include the rate of interest due, the period of repayment, and the security provided to the lender;

(iv) The guarantee of indebtedness incurred on terms that would, in the absence of such guarantee, be more favorable to the recipient than those at which the recipient could borrow comparable amounts, if such guarantee is provided without appropriate cost or without the existence of an actuarially-based fund from which such guarantee could be paid; and

(v) the grant of funds without concurrent creation of a debt obligation or dilution of equity interests;

(b) Government regional development programs that provide financial assistance to enterprises locating in such regions on terms significantly more favorable than necessary to overcome the financial disadvantage of locating in such regions as compared to other geographic regions of the same country;

(c) Government financed provision of utility, supply distribution and other operational services on terms significantly more favorable than those offered to privately owned enterprises in the same country;

(d) Government benefits in such forms as reductions in or exemptions from taxation or other obligations that are available solely to specified enterprises and not generally available in that country or region of that country.

The proposal ultimately proved too ambitious for other delegations. Even though there was an express disavowal of any intention to create a presumption that the practices listed would cause serious prejudice to the trade or production interests of others, there was general concern that so detailed a listing of domestic subsidies would inevitably become the standard for acceptable or unacceptable behavior. And, in truth, the creation of such a standard was one of the U.S. objectives in fashioning the proposed Supplementary Understanding.

The U.S. proposal, however, did generate serious discussion, and out of that discussion came agreement on a number of points. First, there was recognition that widely used forms of domestic subsidies should be identified. The purpose would be to limit the scope of debate over whether a practice is a subsidy within the meaning of the Code. Second, there was general acceptance that where a domestic subsidy caused or threatened serious prejudice to the trade or production interests of another Code signatory, there should be consultations with a view to modifying the practice so as to cure the adverse effects and, should such consultations fail, a procedure under which countermeasures by the adversely affected country could be authorized.[114] Agreement on this point would create, for the first time under GATT, an express right to take action against problems caused by domestic subsidies.[115] Third, there was agreement that the concept of serious prejudice should be clarified. Delegations accepted the premise that serious prejudice could arise through adverse effects caused by competition in one's home market, by import substitution (*i.e.*, reduction of imports into the subsidizing country's market) or through competition in third markets.

These points were all included in the final Agreement and constitute the heart of the new rules on domestic subsidies.[116] They have been packaged in a manner designed to minimize the potential problems for other countries; there is recognition for example that domestic subsidies are "widely used as important instruments for the promotion of social and economic policy objectives," and a number of such objectives are listed.[117] But when one unwraps the package, it should be clear that, while hard international rules on domestic subsidies are still some way off, we have for the first time a set of rules and procedures that offers some hope for resolving trade problems that domestic subsidies may cause.

In this, perhaps more than in any other area of the subsidies/countervailing measures Code, the success of the rules will depend on the willingness of the U.S. government and the private sector to

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[114] The threat of such countermeasures was, of course, meant to provide a strong incentive to ensure that consultations to resolve a particular problem would not fail.

[115] The effect of this provision was to provide a remedy without a corresponding obligation not to cause serious prejudice. In oral comments that the authors have heard on the Code, this is perhaps the point most frequently missed. Instead, there seems to be an unwarranted focus on the obligation of article 11, paragraph 2 of the Code to "seek to avoid" causing serious prejudice. Subsidies and Countervailing Measures Agreement, *supra* note 2, pt. II, art. 11, para. 2, *reprinted in* MTA at 280. This "seek to avoid" commitment is a relatively minor aspect of the new domestic subsidy rules.

[116] The basic section on domestic subsidies is article 11 of the subsidies/countervailing measures Code. Subsidies and Countervailing Measures Agreement, *supra* note 2, pt. II, art. 11, *reprinted in* MTA at 279–81. Possible forms of such subsidies are listed in paragraph 3 of article 11. *Id.* para. 3, *reprinted in* MTA at 281. The circumstances under which serious prejudice may arise are set out in article 8, paragraph 4. *Id.* art. 8, para. 4, *reprinted in* MTA at 277–78. Article 13, paragraph 4 deals with the ability of an adversely affected signatory to take countermeasures against domestic subsidies that cause serious prejudice. *Id.* art. 13, para. 4, *reprinted in* MTA at 283.

[117] *Id.*, art. 11, para. 1, *reprinted in* MTA at 279–80.

understand sensitivities abroad when seeking to resolve particular problems. The Code rules will *not* get the British government out of the steel business but they *can* encourage policies designed to lessen the degree of subsidization and moderate its impact on trade. These sorts of problems must be approached on the basis of what is do-able—not on what, in an ideal world, should be done.

Export Subsidies on Nonprimary Products

As previously noted,[118] GATT article XVI, paragraph 4 prohibits contracting parties from subsidizing nonprimary products for export if the resulting price of such exports is below home market price. Practice has proven that this provision has a number of serious shortcomings.[119] In the face of these shortcomings, there was a consensus among developed countries that something ought to be done to improve the obligation not to use export subsidies on nonprimary products.

What was done was to draw upon the 1960 GATT Working Party Paper, which had enumerated export subsidies.[120] Agreement was reached that export subsidies on nonprimary products should be flatly prohibited,[121] and while no comprehensive definition of export subsidies was provided, there was agreement that those practices set out in a renegotiated and expanded illustrative list[122] would be declared export subsidies subject to this prohibition.[123]

The revised illustrative list is extensive and, while a number of the listed subsidies are narrowly drawn, others have a very broad sweep.[124] The effect of the new rules is to eliminate, at least in part, the dual pricing requirement of GATT article XVI, paragraph 4. A proposal by the United States to do away with dual pricing expressly was rejected.[125] However, by agreeing to a flat commitment no to use "export subsidies" and by defining practices on the illustra-

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[118] *See* note 71 *supra* and accompanying text.

[119] See notes 78–81 *supra* and accompanying text.

[120] *See* note 74 *supra* and accompanying text.

[121] Subsidies and Countervailing Measures Agreement, *supra* note 2, pt. II, art. 9, para. 1, *reprinted in* MTA at 278.

[122] *Id.* annex (Illustrative List of Export Subsidies), *reprinted in* MTA at 295–97.

[123] *Id.* pt. II, art. 9, para. 2, *reprinted in* MTA at 278.

[124] The first subsidy listed is "[t]he provision by governments of direct subsidies to a firm or an industry contingent upon export performance." *Id.* annex, para. (a), *reprinted in* MTA at 295.

[125] *See* notes 78–81 *supra* and accompanying text.

Exhibit C

Canadian draft text for Article 11
of the Subsidies Code.

Canadian Draft

Revised Draft of E, F (1) and (2)   November 21, 1978

E. Signatories recognize that subsidies are used by governments to promote important objectives of national policy; more particularly, internal subsidies (that is, subsidies other than export subsidies) are important instruments used by governments to advance major social and economic objectives of national policy. Signatories note that among such objectives are the creation of employment opportunities in regions where unemployment is higher than in other regions in the customs territory, the development of industry in such regions so as to raise levels of income; the promotion of research and development programmes by private enterprises rather than by governments; the provision of infrastructure necessary to promote economic development in areas and at locations where normal infrastructure is lacking, the development of labour skills and the necessary retraining of manpower required by technological changes and policy developments, and the adjustment and reorganization of enterprises, including their management structures and their production facilities, to changes in trade and economic policies, including international agreements which result in lower barriers to trade.

Signatories note that it is not their purpose nor is it the intent of this Arrangement to restrict the rights of governments to use internal subsidies for such purposes.

F. (1) Signatories recognize that internal subsidies may in certain circumstances cause serious prejudices, in the sense of Article XVI as defined by this Arrangement. Signatories agree that they should, in framing their internal subsidy policies and practices, take into account the interests of other signatories in the trade and production of the products concerned, and that they should seek to avoid serious prejudice being caused by such policies and practices. Signatories note that serious prejudice may be caused by such subsidy practices as participation by a government in an enterprise to the

...2

extent that imports or exports of the product in question are not governed by the normal commercial considerations, including price; government participation in an enterprise to the extent such participation covers operating losses for a sustained period of time; regional development programmes to the extent such programmes provide financial assistance to enterprises beyond that necessary to compensate for the disadvantage of locating in a particular region as compared with other regions in the same customs territory; unreasonably large grants toward the capital cost of an undertaking; an unreasonably large government loan (or guarantee) to an undertaking if such a loan (or guarantee) is at an effective interest rate significantly below the rate charged by commercial banks for similar loans;

(2) Signatories note that this Arrangement provides a framework of agreed measures and remedies under specified international and domestic procedures to prevent or limit injury being caused or threatened by imports benefiting from subsidies or serious prejudice being caused by subsidization. The provisions of this Article, while being intended to provide agreed guidance to signatories in the application of their subsidy policies and practices, do not limit the application of these other relevant provisions of this Arrangement.

STATEMENT OF CHARLES COE, PUBLIC AFFAIRS OFFICER, ENGINEERED MATERIALS SECTOR, ALLIED SIGNAL, INC., MORRISTOWN, NJ

Mr. COE. Thank you. My name is Charles Coe, and I am the public affairs director for the engineered materials sector of Allied Signal, Inc. My company has two major problems relative to today's discussions. The first deals with Canadian subsidization of feedstocks for polyethylene. Allied is a major producer of high-density polyethylene which, as you know, is used to manufacture a wide range of plastic products. Canadian polyethylene competes directly with many of our products.

If current duties were to be eliminated between the United States and Canada, the impact on our business would be severe, especially if the Canadians continue to subsidize feedstocks. It is interesting to note that some Canadian facilities are dedicated to selling their entire production to markets outside of Canada. It is also interesting to note that Canada continues to expand their ethylene and polyethylene facilities, even while overcapacity already exists in world markets through similar expansions in Saudi Arabia, Indonesia, and Mexico.

Our second problem is conceptually related to dual pricing. We ask your indulgence in addressing this example of a Canadian governmental policy that directly affects trade and natural resources. I think it also illustrates discriminatory access to raw materials. We refer to the Canadian policy requiring all uranium mined in Canada to be converted into uranium hexafluoride, or UF6, in Canada prior to export. UF6 is an essential step in the nuclear fuel cycle, coming after mining and milling and before enrichment and fuel fabrication. Allied operates a uranium conversion plant in Metropolis, IL. By this unfair trade policy, all United States and foreign converters are prevented from competing for UF6 business using Canadian-source uranium.

I would like to take this time to quote from a letter of June 26, 1984, exactly 2 years ago, to Canada's Prime Minister signed by the chairman of this subcommittee and others on the subcommittee, illustrating just how singular Canada's policy really is. And I quote:

> The fact that no other country in the world has such a bar to free competition makes Canada's position not only unique but highly visible as well.

Continued enforcement of this policy by Canada could not only cripple the United States conversion industry, which is strategically important, it could also kill it. If this happens, the domestic utility industry, which signs long-term contracts for uranium and for conversion services, will be at the mercy at whatever price the Canadians choose to set.

Furthermore, Canadian policy is inconsistent with their past positions; favoring free access to United States markets for the sale of Canadian uranium. In particular, I remind you of Canada's vigorous lobbying efforts against Senator Domenici's bill in 1982, which would have reduced imports of foreign uranium. Canada has free access to United States markets, but in fact denies us the same freedom.

It seems to me that, at a time when the United States is running a trade deficit in excess of $20 billion with Canada, that it is only appropriate for Canada to remove this unilateral barrier to free and fair trade and to put all energy resources, including UF6, on a free market basis. This would be consistent with their position as stated in the Trade Declaration of March 1985. It could only serve to encourage and strengthen overall trade between our two countries. Thank you.

Senator HEINZ. Mr. Coe, thank you very much. Mr. Smith?

[The prepared written statement of Mr. Coe follows:]

Testimony of Charles Coe

Public Affairs Director of the Engineered Materials Sector

Allied-Signal Inc.

Before the Subcommittee on International Trade

of the Senate Finance Committee

June 26, 1986

Thank you, Mr. Chairman. My name is Charles Coe and I am the Public Affairs Director for the Engineered Materials Sector of Allied-Signal Inc., headquartered in Morris Township, New Jersey.

We appreciate this opportunity to make a brief statement on our Company's difficulties in trade with Canada in natural resources.

Natural resources are critical to any developed economy. Trade in natural resources between the U.S. and Canada is large and complex - now about $20 billion per year. Allowing market conditions to determine prices is the logical vehicle for ensuring that trade remains mutually beneficial between the U.S. and Canada. Canada, however, has created some unique methods of benefiting their natural resource industries to the detriment of ours. I have two examples - the first directly concerns dual pricing.

Allied is a major producer of high density polyethylene, which is used in the manufacture of plastic bottles and bags. If duties were to be eliminated between the U.S. and Canada, the result would heavily impact our business, particularly if the Canadians continue to subsidize natural gas, the raw material for polyethylene. The Canadians continue to expand ethylene and polyethylene facilities --- even while the world market has overcapacity due to expansion in Saudi Arabia, Indonesia and Mexico.

Our second concern is conceptually related, not necessarily a dual pricing problem *per se*, but clearly linked. We ask your indulgence in addressing this second example of Canadian governmental policy that directly affects trade in natural resources and which illustrates discriminatory access to raw materials. We refer to the Canadian policy requiring that all uranium mined in Canada be converted to uranium hexafluoride (UF_6) in Canada prior to export.

Allied Signal operates one of only two uranium hexafluroide, conversion facilities in the U.S. UF_6 is an essential step in the nuclear fuel cycle --- coming after mining and milling and before enrichment.

Our principle customer is the utility industry worldwide and we have always been able to compete against other conversion operations, most of which are state owned, on a free-market basis until about late 1982.

At that time, Canada began rigidly to enforce a dormant policy requiring that all uranium mined in Canada be upgraded to UF_6 in Canada at Eldorado Nuclear, Ltd., a subsidized Crown corporation. This restrictive policy effectively precludes non-Canadians from competing for conversion of Canadian uranium. Since an increasing percentage of the world's uranium comes from Canada, this policy threatens to cripple our strategically important domestic conversion industry.

In addition to being restrictive, this policy runs counter to Canada's expressed desire in the Trade Declaration of March, 1985 to leave trade in energy to free-market conditions. I would like to remind you of the bill introduced in the Senate in 1982 which would have limited the amount of foreign uranium used in U.S. nuclear reactors. Canada opposed that bill vigorously on the basis of free trade, and it was defeated.

As a brand new facility, and a government-subsidized one at that, Canada's Eldorado should be able to compete on a free-market basis for its own conversion business. However, by requiring that conversion be tied to the sale of uranium, Canada seems to be rewriting the rules it has in the past espoused calling for free and fair trade in uranium. Canada has open access to our markets - we should have the same access for conversion of Canadian uranium.

Allied-Signal has made repeated efforts over the past three years to persuade the Canadians to withdraw their policy. Many of your colleagues are well aware of our continuing problems with the Canadians on both of the issues I have described. We have had the bi-partisan support of members in both Houses for our attempts to have Canada modify or withdraw what is obviously unfair trade policy.

We have also had direct meetings with representatives of the Canadian government. The U.S. State Department has raised the issue several times in bilateral meetings, as has the United States Trade Representative's Office. UF_6 has been on the agenda during bilateral meetings and during meetings of the International Energy Agency. A final solution has yet to be achieved - and a decision is now stalled again for other trade-related reasons.

At a time when the U.S. is running a trade deficit with Canada in excess of $20 billion, it would seem appropriate for Canada to remove this unilateral barrier to free and fair trade and to put <u>all</u> energy resources, including UF_6, on a free-market basis.

Thank you for your interest and attention.

STATEMENT OF DAVID SMITH, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, WASHINGTON, DC

Mr. SMITH. Thank you, Mr. Chairman, members of the committee. My name is David Smith, and I am president of the National Association of Home Builders and a builder from McDowell, Va. I am happy to be here today to present testimony on behalf of the National Association of Home Builders on natural resource subsidies.

NAHB opposes the removal rights provision which would ensure subsidies are found on Canadian softwood stumpage. It is a very important issue. It is not only important to the trade relations between the United States and Canada, but is important to the housing industry and to the housing consumers of America. The housing industry is the largest consumer of lumber and lumber products in the world. The construction industry uses 80 percent of all lumber in any given year.

In housing, over the past 3 years, we have used over 83 billion board feet in housing construction. Over the past several years, one-third of the lumber has been imported from Canada. We would strongly urge this committee not to incorporate language in trade legislation that would lead to the imposition of a duty on lumber from Canada. The imposition of a duty would, one, lead to retaliatory responses from Canada; two, raise the cost of home construction; three, lead to the substitution of other materials.

Mr. Chairman, to support these conclusions, we need only to look at the reaction following the tariff imposed on Canadian cedar shingles and shakes. That decision invited and received an immediate retaliatory response from the Canadians. Canada imposed tariffs on the U.S. goods which they imported. Also, effective on June 6, within days of the announcement of the imposed tariffs on shingles and shakes, the NAHB received calls from home-builder members complaining about the price increases on shingles and shakes sold domestically. One builder in California reported the increase to be $1,000 per house. Another builder, who normally used the cedar shakes, since June 6 has decided to switch to tile roofs, because of the increased cost.

If duties are imposed on all softwood lumber from Canada, the reaction to the June 6 action will pale by comparison. I realize that the Commerce Department decides whether or not a subsidy exists in a countervailing duty case; but Congress has taken an active role in these decisions by deciding to legislatively change the ground rules which determine a subsidy.

The removal rights provisions apply only to stumpage prices, which would virtually guarantee that a subsidy is found on Canadian softwood. Those who say that Canadian stumpage is subsidized should do so cautiously and realize that the U.S. also assists its timber industry through other incentives. The ITC review of the respective timber industries which was released in October 1985, states, and I quote:

> Generally, the realized U.S. tax rate for forestry is lower than the Canadian tax rate. Overall, U.S. firms benefit from the ability to claim stumpage revenues as capital gains, but Canadian firms benefit from a significantly faster depreciation schedule on plants and equipment.

We also have a great concern over the impact on the housing consumer. The NAHB Economics Department has estimated that a 15-percent increase in the cost of lumber will average over $1,000 per home on the average-priced home. That is not to mention what it will cost over the life of the mortgage, which might be another $5,000. The NAHB estimates that for every $1,000 increase in the price of the average home more than 300,000 families would be placed out of the market. As homebuyers demand decreases, fewer homes are built and less lumber is used. The industry begins laying off workers.

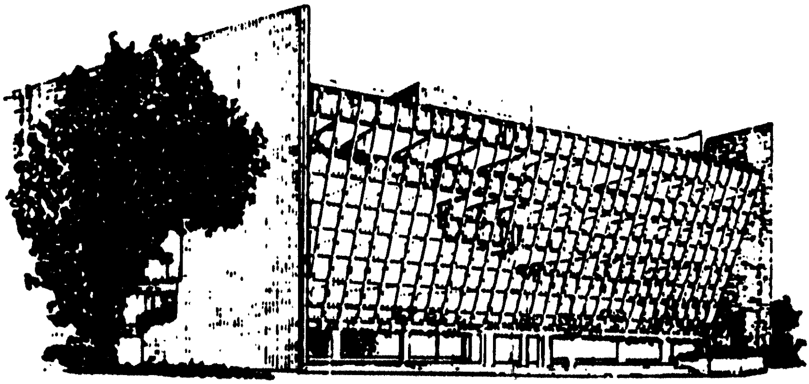
And as an addendum to my statement, I have included the list of materials which go into a 1,700-square-foot house. You can see from this list that lumber is not an insignificant cost in building. If wood flooring is included, the cost of lumber used in a home increases to over 13 percent of the total price. I thank you for the opportunity to be here with you today.

Senator HEINZ. Thank you very much, Mr. Smith. Mr. Piercy?

[The prepared written statement of Mr. Smith follows:]

Statement of the NATIONAL ASSOCIATION OF HOME BUILDERS before the

Committee:	Senate Finance Committee
Subject:	Natural Resource Subsidies
Witness:	David C. Smith
Date:	June 26, 1986
Place:	219 Dirksen Senate Office Building



National Housing Center
15th and M Streets, N.W.
Washington, D.C. 20005
(202) 822-0470

My name is David Smith and I am President of the National Association of Home Builders and a builder from McDowell, Virginia. I am happy to be here today and present testimony on behalf of the National Association of Home Builders (NAHB), a trade association representing over 142,000 members, on the subject of natural resources. NAHB opposes the "removal rights" provision which would ensure subsidies are found on Canadian softwood stumpage.

As home builders, we are by no means experts on all of the complex issues of international trade. However, we have an interest in long-term economic growth and world-wide U.S. competitiveness. Retaining and increasing American jobs and maintaining competitive costs for the long-term is something which will benefit not only home builders, but consumers and the domestic economy as well. And it is within this larger picture that we view the mounting trade deficit and the proposals to restrict Canadian softwood imports.

Recent trade debate seems to have focused on those countries which impose barriers to "free trade". This is not the case with Canada. The United States and Canada have traditionally had a special relationship, and they are each other's best customers in international trade. In 1984, the total trade between Canada and the United States amounted to over $120 billion in U.S. dollars. In fact, the Canada-U.S. relationship is the largest exchange between any two nations in the world. The United States does more trade with Canada than it does with Japan; more with Ontario than with the European Community; more with British Columbia than with China. American investment in Canada represents some 80% of all foreign capital in Canada, and 25% of all U.S. investment abroad. Conversely, Canada is the fourth largest foreign investor in the U.S..

Our economies grow together. Canada is the fastest growing foreign market for the United States. The trade of New York State with Canada in 1984 was over $15 billion, a figure larger than all U.S. trade with France. The question we pose is relatively simple-- Do we want to encourage growth in this arena, or do we want to protect ourselves from bilateral growth?

The U.S. imports $350 billion worth of goods a year; Canada's share of U.S. imports is only 20 percent. While each country could indeed go elsewhere with their exports-- and perhaps the opportunity for growth could well be greater in other directions -- NAHB believes that our trade with Canada should be encouraged and even further developed.

In 8 of the last 11 years, the U.S. has enjoyed a trade <u>surplus</u> with our trading partner to the north. But we are concerned that recent legislation to restrict Canadian timber threatens this historical relationship. If protective legislation is passed, we fear the result eventually would be to undermine both the U.S. exports to Canada and the U.S. economy in future internationally competitive situations.

On June 6, a 35% tariff was imposed on Canadian cedar shingles and shakes. The decision rendered under Section 201 of the Trade Act of 1974, invited and received an immediate retaliatory response from the Canadians. Also effective June 6, Canada imposed tariffs on U.S. goods which they import from the U.S. - computer chips, Christmas trees and books among other items. NAHB's economics department estimates the average cost increase on an average 1700 square foot home to be $800 on a nationwide basis. Within days of the announcement to impose tariffs on shingles and shakes, NAHB began receiving calls from builder members complaining about the price increase on shingles and shakes sold domestically. In California, for example, one builder reported a $1,000 increase in the cost per house resulting from this tariff.

Another builder we spoke with has ordered his material's dealer to switch from cedar shake roofs to Spanish tile roofs because of the increased cost. New England builders are expressing concern about increased costs, as well as a fear of further retaliatory action from north of the border. New England, New York and Western states are highly dependent on Canada for hydroelectric power.

The point we hope to make clear is that decisions such as the one placing tariffs on imported red wood cedar products often go beyond the intended effect of assisting a U.S. industry. They provoke second-third-and forth-tier results which are perhaps unintended by the initial decision. We would hope free trade could be encouraged. We further hope - and even believe - that U.S. industries could be competitive worldwide. That sometimes means looking carefully and analytically at the structure of the U.S. industry, and altering the manner in which we do business in order to promote long-term economic health rather than providing short-term band-aid surgery on any given sector.

I would like to add at this point that Congress will soon vote on 1987 funding levels for Forest Service programs. We hope Congress will maintain the 1986 funding level for the sales program and the road program so that adequate lumber will be available from domestic sources.

Canadian Softwood

NAHB strongly supports free trade for Canadian timber products. Some contend that the differences between U.S. and Canadian prices for timber are the result of subsidization. However, the allegation of subsidy was exhaustively debated and dealt with by the International Trade Commission (ITC) in 1982. In 1983, the Department of Commerce concluded that no significant subsidy existed.

The speculation about a subsidy came about for several reasons. Some American lumber spokesmen have claimed that the rise in Canadian lumber imports has been spectacular and have cited the fact that the Canadian share of the U.S. market increased from 19 to 32 percent between 1975 and 1984. In looking at overall American exports and imports, sharply varying conclusions can result, depending on the base year chosen and other input variables. The Canadian share of U.S. timber consumption in 1975 was uniquely low because the industry was hit by labor strikes pushing production far below normal. The Canadian industry's production and its share in the U.S. market returned to historical norms in 1976 and 1977. The ITC report used Canadian production in more normal years to measure change, and their findings concluded that the Canadian share has shown only a modest increase. According to the ITC report, the Canadian share increased from 28 percent in 1982 to 29 percent in 1984, a gain of one half a percentage point a year. In addition, the growth closely paralleled the increasing strength of the U.S. dollar, which currently gives Canadian lumber at least a 35% advantage over the U.S. dollar.

Many differences between the two countries create a difference in stumpage prices. Moreover, direct comparisons between prices paid for stumpage in the two countries and the delivered cost are very difficult to make. For instance, Canada has an abundance of forest resources while the U.S. has little surplus. Perhaps surprisingly, many Canadian mills are more advanced technologically than their U.S. counterparts.

Species mix and species preference between the U.S. and Canada are difficult comparisons to make. The largest and most productive forests in both countries are found in the far west.

In 1984, 44% of the trees harvested in Washington and Oregon were Douglas fir, a relatively valuable species. In British Columbia, which is Canada's largest timber producing region, Douglas firs accounted for only 9%.

The different characteristics of different species and the difference in the quality of millwork of the same species in different localities make comparisons of general prices difficult at best and often impossible.

The initial costs in the lumber industry are defined as the cost of the trees and the costs of cutting and delivering them to the mill. For example, a large tree on a parcel of land adjacent to a sawmill is worth considerably more than a second, identical tree on a parcel 1,000 miles from the nearest sawmill. In the case of the first tree, the mill owner must simply cut the tree and haul it next door to be manufactured into lumber. In the case of the second tree, the mill owner must cut the tree, and then pay to transport it 1,000 miles before it can be utilized. The cost of transporting the log from the second tree directly reduces the value of the tree and, accordingly, leads to a perfectly justifiable difference in the price of the first tree and the price of the second tree.

Transportation costs are only one of several factors that affect the value of standing timber. Forest industry economists explain that the value of timber is nothing more than the value of the end products (lumber and wood chips), less the costs of logging the timber; transporting the logs to mill; manufacturing the end products; and transporting the end products to market. Factors which affect these costs include the species and size of the timber, the topography and climate of the area in which the timber is located, the proximity of that area to a sawmill,and the proximity of the mill to end-product markets. Thus, the value of timber includes more than the price of the standing tree. In fact, U.S. Forest Service information shows the variation in stumpage prices within the United States to be just as great as the variation between the U.S. and Canada. While it is true that the stumpage prices in Canada are lower than in the U.S., the existence of such price differences does not necessarily constitute a subsidy.

Almost all of Canada's productive forests are publicly owned. The governments lease their land on long-term contacts. In return, the leaseholder assumes many of the costs of road building, reforestation, and forest management. Overall, Canada has a relatively large supply of timber available to a relatively small market. There are 544 million acres of productive Canadian forest, some 61 million acres more than the United States, even though Canada has only one-tenth of our population.

In the U.S., public lands constitute only about a third of the forest, yet they contain 63% of the softwood timber. U.S. public lands are considered to be the least productive because timber cutting on them is held to about 10 billion board feet a year as a matter of public policy.

Timber from U.S. government land is first appraised and then open to competitive bids. The auction bids are often higher than the appraised value because the timber will be cut later and the buyers are anticipating future rather than present markets. With the available supply of timber eligible for logging remaining relatively stable each year based on public policy, the price will rise as the market demand rises. For example, in 1979 when the construction industry was in a boom, the price of saw timber was $173 per 1000 board feet. By 1982 -- when the construction industry slumped -- the price had fallen to $61.

The claim that Canadian stumpage is subsidized should be stated cautiously because the Canadians can produce a like response regarding U.S. timber. In October 1985, the ITC reviewed the respective industries under section 332 of the Tariff Act of 1930. I would like to quote from that report.

- For Government-controlled lands in the United States, management functions are retained by the Government, and volumes of timber are put up for auction on a sale-by-sale basis; purchasers compete for each sale. In Canada, cutting rights are leased or licensed under a variety of arrangements to private companies that hold these rights over extended periods.

- Both countries assist their respective industries in order to improve economic conditions in certain regional locations, and to improve employment opportunities, and promote industrial expansion.

- Generally, the realized U.S. tax rate for forestry (logging and saw milling) is lower than the Canadian tax rate. Overall, U.S. firms benefit from the ability to claim stumpage revenues as capital gains, but Canadian firms benefit from a significantly faster depreciation schedule on plant and equipment.

- Although a ban on U.S. log exports could affect the price and supply of stumpage, and to some degree the price of lumber, changes in the U.S. economy and the levels in housing construction would have a greater effect on prices and supplies.

Impact of Duties on Housing Consumers

The removal right provision of proposed legislation could substantially increase the price of timber if subsidy is redefined as proposed in H.R. 4800, the Omnibus Trade Legislation and S. 1292, the Natural Resource Subsidies Bill.

Lumber is the main building material used in home construction and housing construction currently accounts for over 60% of the softwood lumber consumed in the United States. The Census Bureau estimates that the average annual value of new residential construction from 1964 - 1984 (in constant 1977 dollars) was $67.68 billion. According to the Bureau of Labor Statistics, single-family construction worth $1 billion creates 22,000 jobs. Of those, 9,500 are in the construction and land development industries and 12,500 are in manufacturing, mining, transportation, wholesale trade, services and other industries.

Lumber is a key part of home construction. In 1984, lumber was 22% of total hard construction costs. From the average priced house in 1985 of $100,700, lumber cost $8,545 - roughly 9% of the final price to the consumer. If the domestic price of lumber had increased during that period by 30%, the average priced home would have been $2,555 higher. If the duty were more modest, it could raise housing costs by as much as 15% or $1,000 per home. The domestic timber interests have asked for a countervailing duty of 27% on Canadian timber imports which NAHB's economics department estimates will raise the cost of lumber by 15% in our current economic environment. If economic conditions change in the U.S., the percentage of price change could vary as well. The dominant factor which could influence a greater price increase is a supply shortage, either immediately or in future years. In this regard, we hope the committee will carefully analyze the U.S. situation before proceeding with legislation which will alter the definition of subsidy on Canadian stumpage. NAHB estimates that for every $1,000 increase in the price of an average home, more than 300,000 families are priced out of the housing market. As home buyer demand decreases, fewer houses are built, and the industry begins laying off workers. As housing starts decline, the price of lumber decreases which harms the timber industry. This is a cycle with which we are all too familiar.

As an addendum to my statement, I have listed the materials which go into a 1700 square foot house. You can see from this list that lumber is not an insignificant cost of building. If wood flooring is included, the percentage of lumber used in a home increases to over 13%. I want to emphasize that NAHB's estimates in increased cost to the consumer are based on approximately 9% of the total cost. In this regard, a comparison can be drawn between any consideration to put countervailing duties on Canadian softwood and the recent decision on cedar shingles and shakes. In some circumstances, substitute products can - and will - be used if the price of the preferred product increases too much.

Conclusion

In conclusion, NAHB would like to thank the Committee for the opportunity to present our views on natural resource subsidies. We strongly oppose the "removal rights" provision which is contained in the House passed Omnibus Trade Bill, H.R. 4800, and S. 1292, the Natural Resource Subsidies Bill. The adoption of this provision will virtually insure that a subsidy is found on Canadian stumpage.

NAHB feels there are more productive ways in which the domestic timber industry could receive assistance - and it could be done without damaging U.S. - Canadian relations. For starters, Congress could insure that the Forest Service Timber Sales program and the Road program are funded at 1986 levels. Discussions between Members of the House have included reductions in the Forest Service Road Program. Without roads to go into the forests and cut the trees, they will be virtually inaccessible and therefore unavailable for commercial purposes. It should be remembered, that the Forest Service Timber Program generates direct revenues to the U.S. Treasury which contribute toward reducing the federal deficit. Moreover, a portion of these revenues are realized immediately for the right to cut trees at a future date.

Thank you for the opportunity to present NAHB's views on natural resources. I will be happy to answer questions at this time.

Materials Used in Constructing 1,700 Square Foot, Single Family House

- 9,726 board feet of lumber
- 3,016 square feet of sheathing, including roof, wall and floor sheathing
- 243 square feet of plywood for sheathing
- 55 cubic yards of concrete — 3/4 of which is poured concrete and remainder concrete block
- 3,016 square feet of exterior finish — either aluminum siding, brick or wood
- 1,992 square feet of asphalt shingles for roofing
- 2,500 square feet of insulation
- 6,484 square feet of gypsum wall board
- 90 linear feet of ducting
- 55 gallons of paint
- 302 pounds of nails
- 750 feet of copper wiring
- 280 linear feet of copper piping (water supply pipe)
- 100 plumbing fittings for this pipe
- 170 feet of plastic pipe for drain, waste and vent piping...plus 70 fittings
- 12 windows
- 10 interior doors
- 4 exterior doors
- 1 sliding glass door
- 2 tubs or 1 tub and a shower stall
- 2 toilets
- 3 sinks
- 15 kitchen cabinets
- 1 range, 1 range hood, 1 refrigerator, 1 dishwasher, 1 disposal, smoke detectors.

Lumber Used in a New Home

<u>Single Family -- 1,700 square foot home</u>

Lumber:	9,726 board feet
Lumber and millwork as a percent of sales price:	13.3 percent

<u>Multifamily Unit -- 1,058 square feet</u>

Lumber:	5,693 board feet
Lumber and millwork as a percent of sales price:	10.0 percent

Source: compiled by Economics Division, National Association of Home Builders

STATEMENT OF RON PIERCY, PRESIDENT, ADE LUMBER & SUPPLY, KANSAS CITY, MO; ON BEHALF OF THE NATIONAL LUMBER AND BUILDING MATERIAL DEALERS AND THE STOP UNFAIR WOOD TARIFFS COALITION

Mr. PIERCY. Thank you. Senators, I bring you greetings from Kansas City, the home of the world champion Royals. We are here to talk about wood and what goes into new homes, not wood of a baseball bat.

Senator HEINZ. We will convey that to Senator Danforth and everybody in St. Louis.

Mr. PIERCY. Well, Senator Danforth is a Royal fan, too. [Laughter.]

I brought along my colleague, Harry Horrocks, director of government affairs for the National Lumber and Building Material Dealers Association, and he can answer any hard questions. I will take the easy ones.

What brings me here is that I sell lumber, both Canadian and American. So, I am going to make some people mad, on one hand, and others probably glad. I want to state right here that I have got many, many more good friends in the American lumber industry than I have Canadians, simply because there are a lot more of them that I do business with, and also because 80 percent of the products that I sell out of our wholesale company are American wood-produced products, and about 20 percent of them Canadian. So, I wanted you to understand that up front.

The reason that I sell Canadian lumber is simple: It fits some of the needs of my customers and they demand it. Despite what you may have heard, all lumber is not the same and not totally interchangeable. Canadian SPF or spruce-pine-fir the majority of wood we are talking about which comes out of Canada, is better for certain uses like framing a house. Southern pine CCA treated lumber is superior for other purposes like ground contact uses, decks, etc. Douglas fir lumber and hemlock lumber produced on the west coast is superior for floor joist material, rafters, and a number of other uses there also.

What you might ask: What does this have to do with U.S. trade law? In my view, plenty. The so-called "removal rights provisions" of these bills would have the effect of raising Canadian lumber prices significantly; and my customers, who need Canadian lumber, are going to have to pay more for it; so will the purchasers of U.S. lumber if the lumber market continues to function like it always has.

I really think that the Canadians are doing us a favor, to go back to what Senator Moynihan said, for a long time by furnishing us their quantities of wood. It is my understanding that in the U.S. South, there are studies that show that we don't have that much raw material product. In the U.S. West, we have known for a long time that we don't have sufficient material raw product. That is why the timber is left the way that it is in the West and sold the way that it is.

So, if we are talking about reducing a significant portion of lumber supply by raising the price of Canadian lumber—and this gentleman says 30 percent of the lumber supply—I want to know where is the product going to come from?

The way that the national forests timber is sold, in the Western part of the United States is on a bid basis. That is really what got the western lumber industry in the problems that have really devastated them over the past 3 or 4 years. That, and the fact that, as many others—not only lumber people but steel people and other manufacturers—have not recognized is that we are in a world trade scenario. And if you haven't prepared for that world trade, then you are going get caught in it.

That is what has happened to a lot of the lumber industry. The Canadians are more productive. They have high-speed operations, and they have access to bigger and better logs in order to make the lumber.

So, I feel as if the Canadians have been doing us a favor. When a lumber dealer calls me and wants to purchase a truckload of 2 by 10 fir for floor joists, I don't ever remember that lumber dealer saying to me: "Well, I can buy Canadian SPF 2 by 10 lumber for $25 a thousand less than what your fir is; won't you meet that price?" Fir is used for one purpose and SPF for another. We are not talking about the same specie.

The 2 by 10 SPF lumber from Canada won't do the same job. It is like using a piece of reinforcing rod that would be three-eighths of an inch thick. It will do a certain job. A piece of reinforcing rod that is one-half inch thick will do a different job. You can't do the same job with the piece of three-eighths. It might not stand up.

So, in the case of the 2 by 10, if the lumber dealer did buy that SPF, he would have to use 50 percent more SPF lumber in order to get the same job accomplished with the fir. The point is that each one of these species have a place in the marketplace, and the marketplace needs them all.

Higher Canadian lumber prices resulting from a duty will drive up the price of all lumber-intensive products and activities, like homes, ladders, and remodeling. Consumers will cut back their purchases of their products. Fewer homes will be built. Less lumber will be sold. Trucks, railroads, and ships will move less lumber. With a reduced volume of business in all these industries, many jobs will drop along the way.

Now, I would be lying if I told you I know the exact effect of the complicated marketplace response to a ratcheting up of lumber prices due to a duty. I want to interject here that the estimate that has been bantered here of a 15-percent price increase is far too conservative. If we are talking about a countervailing duty of 30 percent on 30 percent of the material that is being used in light framing construction in this country, then we are not talking about a 15-percent increase in the overall costs of lumber. If we are talking about a 30-percent increase in the costs of the SPF lumber, then we are probably talking about a comparable increase in the American product. That is the idea behind this duty effort, to raise the prices so the American lumber producers can make more money.

I have firsthand experience with the Canadian red cedar shingles and shakes duty since we are Kansas City's largest wholesale distributor of wood shingle and shake products. That tariff came on June 6, and we were prepared for it as much as possible. We boosted our inventories to twice the levels that we normally have, and bought as much as we thought we were capable of buying so that we could moderate our prices. As the impact of the duty drove prices up, we tried to preserve the 300 customers that regularly buy these shakes and shingles. I think it is very clear at this point what has happened—higher prices, diminished demand and absolutely no change in the percentage of Canadian shakes and shingles sold.

Last Monday, there was a project in KC that was budgeted for 1,200 squares of half-inch shakes that changed to an alternative product. The reason it changed to an alternative product was because the project was budgeted at about $55 a square, 10 feet by 10 feet roof section and these shakes are currently selling in the neighborhood of $70 a square and that does not reflect my ordinary markup. This is average-priced shake that I an selling, the price could have been much higher.

Senator HEINZ. Mr. Piercy, your time has expired.

Mr. PIERCY. OK. Anyway, I urge you to utilize the U.S. trade law that is in place now and let it handle the Canadian lumber problem.

[The prepared written statement of Mr. Piercy follows:]

Statement of

RONALD PIERCY

President
A-D-E Lumber and Supply Company
Kansas City, Missouri

On Behalf of the

National Lumber and Building Material
Dealers Association

and the

Coalition to Stop Unfair Wood Tariffs

Good Morning. My name is Ron Piercy and I am President of A-D-E Lumber and Supply Company of Kansas City, Missouri. Accompanying me today is Mr. Harry Horrocks, Director of Government Affairs for the National Lumber and Building Material Dealers Association (NLBMDA).

I am here to represent the views of both NLBMDA and a larger group, the Coalition to Stop Unfair Wood Tariffs (SUWT). SUWT is an ad hoc coalition of 15 major U.S. trade associations and approximately 500 U.S. companies. Its membership includes lumber dealers, homebuilders, newspaper publishers, longshoremen, railroads, truckers, manufactured housing companies, stevedoring companies, frame builders, ladder manufacturers, and port authorities. What brings these diverse groups together is their opposition to pending legislation and administrative actions that seek to restrict imports of softwood lumber and other wood products from Canada.

NLBMDA and the other Coalition members strongly oppose both S. 1292 and Section 502 of S. 1356. If either is included in omnibus legislation reported out by the Finance Committee, we will be forced to oppose the entire package.

Our specific objection to S. 1292 and Section 502 of S. 1356 concerns "removal right" provisions. These provisions, while stated in generic terms, clearly target wood products from Canada; no other industry has ever been mentioned by either proponents or opponents of the removal right provision. It is simply known as "the Canadian lumber" provision.

What it __is not__ is a dual pricing provision; there is no dual pricing of Canadian wood products. U.S. firms can and do obtain access to cut Canadian timber on the exact same terms as their Canadian counterparts. In a recent year, U.S. companies cut one quarter of the timber produced in British Columbia, Canada's main timber province. Those companies paid the same stumpage fees and bore the same responsibilities imposed by the B.C. government as Canadian loggers. The story is the same in the other Canadian provinces.

If the removal right provision is not directed at Canada's denial of equal access to U.S. producers, what is its purpose? Its proponents claim it is necessary to redress unfairly low stumpage fees -- the fees which are paid to Canadian provincial governments for the right to cut government-owned timber. But that issue has already been fully investigated by the United States -- it was the centerpiece of a massive countervailing duty case filed by a group of U.S. lumber producers in 1982. The 1983 decision by the Department of Commerce in that case could not have been more emphatic:

> "We believe that a comparison of Canadian stumpage prices with U.S. prices would be arbitrary and capricious in view of: (1) the wide differences between species composition, size, quality, and density of timber, terrain, and accessibility of the standing timber throughout the United States and Canada; (2) the additional payments which are required in many provinces in Canada but not generally in the United States; (3) the fact that in recent years, prices in national forests in the United States have been bid anywhere between two to five years in advance of cut, without taking into account the fluctuations in demand for lumber; and (4) the fact that in recent years the U.S. Forest Service has restricted the supply of timber in certain national forests due to budgetary and environmental constraints.
>
> "Alternatively, even if one believes that there is a rational basis for comparing U.S. and Canadian stumpage prices, the record of these investigations includes studies showing that once appropriate adjustments are made to take into account the differences in quality, accessibility, as well as additional payments for in-kind services, Canadian prices for standing timber do not vary significantly from U.S. prices . . . indeed, in some cases the Canadian price may be higher."

Despite the clarity of Commerce's finding that stumpage price comparisons -- which would be mandated by S. 1292 and S. 1356 -- are meaningless and cannot be used to support the allegation of subsidy, U.S. lumber producers have been campaigning ever since for a change in U.S. countervailing duty law. The removal right provision is the goal of that campaign. And for good reason. Lumber producers' own representatives have concluded that the provision virtually guarantees that a subsidy will be found. For instance, in a speech before the Department of Agriculture last December, a high-ranking official of the National Forest Products Association (NFPA) -- the lead trade association supporting removal right legislation -- stated:

> "The natural resource subsidy bill would redefine the nature of a subsidy in countervailing duty law so that Commerce would have no alternative but to find with petitioners" (emphasis added).

We believe that it is totally inappropriate for Congress to write such a single-industry guarantee into U.S. trade law.

Our opposition to removal right legislation is not based simply on this policy ground, however. Instead, our fundamental problem with the provision is that it would unfairly harm thousands of U.S. companies, threaten the jobs of even more U.S. workers, and raise the prices of products -- such as new homes -- that are heavily dependent on lumber and other wood products from Canada.

U.S. lumber producers are not coy about their goal in seeking this legislation -- as the New York Times reported recently, "they want a $50 to $70 rise in the price of 1,000 board feet of Canadian lumber". That is as much as a 33% price increase.

Such an increase in the price of Canadian lumber -- and the expected ratcheting up of the price of U.S. lumber -- will cascade through the U.S. industries that consume, market and transport wood products.

Lumber dealers like me would be the first to feel the blow. There are almost 25,000 lumber yards in this country. Lumber is by far our largest selling item, accounting for nearly 27% of total revenues. By comparison, the next largest item -- hardware tools and plumbing and electrical supplies -- accounts for only 12.5% of our receipts. Lumber cost increases of 30% or more would force us to raise our prices, and would likely reduce our sales and cause us to lay off employees. Even more distressing, price increases in this range would price certain kinds of lumber right out of the market. Is this what Congress intends?

Price increases on our lumber stock would also cause economic harm to our customers, many of whom are small businesses operating on an already thin profit margin. Thus, the impact of the removal right provision would extend beyond the lumber industry to the related industries in which lumber is an important input.

Homebuilders would obviously bear a heavy burden. Lumber is the single most important material in homebuilding. According to the National Association of Home Builders' testimony before this Committee in April, lumber constitutes 22% of total hard construction costs. For the average-priced house in 1985 of $100,700, lumber cost $8,545 -- roughly 9% of the final price to the consumer. If the domestic price of lumber had increased during that period by 30% -- the approximate price increase sought by U.S. producers -- NAHB estimates that the price of the average home would have risen by $2,555. Even if the price increase were more modest, it could still raise housing costs by as much as $1,000. NAHB estimates that for every $1,000 increase in the price of an average home, more than 300,000 families are priced out of the housing market. And as home buyer demand decreases, fewer houses are built, and the industry begins laying off workers.

Other, more specialized lumber users could face even worse prospects. Some builders -- manufactured housing companies, frame builders, and timber column builders -- are heavily dependent on certain species of Canadian lumber. If the price of Canadian lumber rises too sharply, their products will become too expensive for their market and their customers will shift to products that use cheaper building materials. Thus, entire businesses would be put at risk by passage of the removal right provision.

The transportation sector would also be hit. Several of our coalition's railroads -- the Soo Line, Grand Trunk, and Missouri-Kansas-Texas -- move large quantities of Canadian wood products. The Soo Line, for example, derives $100 million in annual revenues from transporting such products. If higher prices cause a reduction in that traffic, the lost revenue would have to be absorbed system-wide, reducing the railroad's ability to continue the marginally profitable rail service it currently provides. The damage would also extend to the network of water transportation industries that carry Canadian lumber. The North Atlantic Marine Terminal Lumber Conference -- whose members reach from Massachusetts to Rhode Island, Connecticut, New York, New Jersey, Delaware and Maryland -- has stated that a large increase in Canadian lumber prices would jeopardize the jobs of vessel operators, customs brokers, truckers, steamship agencies, pilots, towboat operators, stevedores and longshoremen.

The overall impact of this legislation is difficult to quantify, but also difficult to overstate. One indication is provided by a Wharton Economics Study the Coalition released last fall. That study examined the U.S. job losses and gains attributable to a 30% increase in the price of lumber. The result? Net job losses of over 27,000 in the United States over a five-year period. Net job losses in 46 states, net gains in only four. When combined with Congressional Budget Office estimates that a removal right provision could cost up to $1 billion annually, it is possible to calculate that each U.S. lumber industry job saved by this legislation would cost $180,000 each year.

This huge amount of damage assumes that Canada would not respond to the passage of removal right legislation by imposing trade sanctions of its own against U.S. products. That is not a safe assumption. Recently, Canada served notice that it will not sit back passively in the face of what it believes are unfair trade actions by the United States. Canadian corn producers, for example, recently initiated a huge countervailing duty case against U.S. corn exporters -- the first time the United States has been the target of a countervailing duty case. The corn case, based explicitly upon U.S. trade law precedents, seeks 50% duties on U.S. corn exports and cites a list of 75 U.S. federal government subsidies, ranging from special agricultural export assistance to crop insurance, farm operating loans and farm-labor housing grants. The corn case is not an isolated example. Canada recently retaliated against the U.S. decision to impose large tariffs on Canadian red cedar shakes and shingles by raising tariffs on U.S. computers, semi-conductors and books.

From these examples, it seems certain that Canada would strike back with whatever legal firepower it could muster against a unilateral change in U.S. countervailing duty law specifically targetted at softwood lumber, a $3 billion export. One logical response would be to adopt "mirror" legislation allowing Canada to seek duties on U.S. exports that profit from below market price natural resources. Such legislation would provide Canadian companies the standing to initiate countervailing-duty cases against a variety of U.S. products: for instance, meat exports that benefit from low-cost, federal-grazing rights; Western state products that depend on low-cost federal hydropower projects; and agricultural exports utilizing low-cost irrigation programs. Thus, the direct result of passing removal right legislation could be a virtual cross-border war of trade cases, retaliation, and counter-retaliation. That is a war which no one would win, except the foreign industries that would steal U.S. and Canadian market share while the two countries fight each other.

It is also a war that recent events demonstrate is wholly unnecessary. Despite the U.S. lumber industry's rhetoric, it has shown that it believes our countervailing duty law can work -- recently, the industry filed a second petition against Canadian softwood lumber, making the same arguments that were part of the 1982-83 case. The Commerce Department has decided to initiate another full-fledged investigation; thus, once again, U.S. lumber producers will have a full and fair opportunity to prove their allegations that Canadian lumber is subsidized. The existence of an ongoing trade case is yet another reason that Congress should refrain from turning the law inside out at the behest of one industry.

All this being said, we are not unaware of the fact that certain segments of the domestic lumber industry are going through a difficult period. But the causes of the difficulty -- the high value of the dollar combined with the fact that, despite a healthy housing sector, the lumber market has not met industry expectations -- are not addressed by removal right legislation. Nor does the legislation address other domestic lumber production problem areas such as transportation, speculative timber bidding practices, and environmental restrictions. The legislation is a "solution" that has little to do with the problem. It is, moreover, a solution that would create far more problems than it would solve.

Accordingly, NLBMDA and the Coalition to Stop Unfair Wood Tariffs respectfully urge the Committee not to include a removal right provision in any trade legislation it reports to the full Senate.

APPENDIX ONE

THE NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION'S PERSPECTIVE ON THE LUMBER MARKET

The National Lumber and Building Material Dealers Association is a national association, which in turn represents 26 state and regional associations, including the Mid-America Lumbermens Association of which I am a member. The Mid-America Lumbermens Association represents the states of Missouri, Arkansas, Oklahoma, Nebraska and Kansas. Our member dealers total some 15,000 from all parts of the nation and are the principal retailers of U.S. and Canadian softwood lumber and supply materials to the homebuilding, general contracting, remodeling and building maintenance industries, and to the general public. About 65 percent of our membership's total sales are to professional builders. The remaining 35% is evenly divided between the "do-it-yourself" and remodeling markets.

The vast majority of NLBMDA's dealers run small businesses. These members tend to operate one yard, family-owned establishments usually located in a small town or community. Taken as a whole, however, we represent a large market with sales of 31.43 billion dollars and employment of 263,369 full- and part-time workers in 24,940 firms.

The lumber dealer has an excellent perspective on the U.S. market and the role of Canadian lumber in that market. Lumber is our largest selling item and, as middlemen between the manufacturer and the lumber purchaser, we see on a daily basis the marketing, wood characteristic and customer preference factors that drive the lumber market.

Canadian lumber represents a sizeable percentage of all lumber sold by lumber and building material dealers. In 1984, approximately 30 percent of our industry's total lumber sales volume consisted of Canadian lumber. We sell all types of Canadian wood species -- both Western and Eastern spruce-pine-fir, hem-fir, Western red cedar and Douglas fir -- though the percentage of specific wood species sales vary greatly from one region to another, and from one type of retailer to another.

Our dealers purchase Canadian lumber for a variety of reasons, including sizing, availability and specialized use. In many parts of the United States, the major reason that retailers buy Canadian lumber is simply that our customers -- whether contractors, remodelers or do-it-yourselfers -- prefer this lumber and therefore demand it. This customer demand for specific types of lumber is the most important characteristic of the retail lumber market.

STOP
UNFAIR
WOOD
TARIFFS

An ad hoc coalition of lumber dealers, home builders, unions, railroads, ports and others working to defeat any legislation restricting imports of Canadian wood products.

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FOR IMMEDIATE RELEASE
THURSDAY JUNE 26, 1986

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KANSAS CITY LUMBER DEALER:
LEGISLATION TO RESTRICT CANADIAN
LUMBER IMPORTS WOULD THREATEN AMERICAN JOBS

WASHINGTON -- Thousands of American workers in industries ranging from homebuilding to publishing could lose their jobs if Congress passes a law that aims at reducing imports of Canadian lumber, according to a representative of the National Lumber and Building Material Dealers Association and the Stop Unfair Wood Tariffs Coalition. In addition, housing prices would increase, countless U.S. companies would be hurt and recent Canadian-U.S. skirmishes over trade would escalate into a full-scale war if the proposed legislation becomes law, he said.

Testifying before the Senate Finance Committee Ronald Piercy, president of A-D-E Lumber and Supply Company of Kansas City, MO, said that an estimated 27,000 American jobs would be lost over a five year period if the Senate includes a provision designed to restrict Canadian lumber imports in the new trade law.

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Enactment of the provision could raise the price of an average new home by more than $2,500, Piercy said, effectively knocking hundreds of thousands of families out of the housing market, he said.

Passage of the provision could also bring on a trade war with Canada, Piercy warned. "That is a war which no one would win, except the foreign industries that would steal U.S. and Canadian market shares while the two countries fight," he said.

If passed, the provision could lead to price increases of 30 percent or more on all Canadian wood imports, Piercy said. "Such an increase in the price of Canadian lumber and the expected ratcheting up of the price of U.S. lumber will cascade through the U.S. industries that consume, market and transport wood products," Piercy said. Lumber yards, homebuilders, transportation workers and others who depend on wood and wood products wil be affected, he said.

-MORE-

Canadian retaliation against this legislation could cause widespread harm across the economy, he noted.

Already, in response to stepped-up U.S. goverment pressure on Canadian trading practices, Canadian companies are striking back -- an investigation was recently launched to determine if U.S. corn producers benefit from unfair government subsidies. The Canadian subsidy case seeks 50 percent duties on U.S. corn sold in Canada, Piercy said.

"Canada also recently retaliated against the U.S. decision to impose tariffs on Canadian red cedar shakes and shingles by raising tariffs on U.S. computers, semi-conductors and books," he added.

"It seems certain that Canada would strike back with whatever legal firepower it could muster against a law specifically targeted at softwood lumber, a $3 billion export," Piercy said. One logical response would be to adopt similar legislation, targeting U.S. exports that benefit from federal programs," he added.

-MORE-

Certain segments of the domestic lumber industry are going through a difficult period," Piercy acknowledged, noting that the proposed trade limitation is designed to aid U.S.lumber producers. However, the causes of the U.S. industry's difficulties -- the high value of the U.S. dollar, speculative bidding practices and other factors -- are not addressed by the proposed legislation, Piercy said. "The legislation is a 'solution' that had little to do with the problem. It is a solution that would create far more problems that it would solve," he said.

# # #

The Coalition to Stop Unfair Wood Tariffs is a coalition of American lumber dealers, homebuilders, unions, stevedoring companies, railroads, ports and other business people working to defeat legislation and any other action aimed at restricting imports of Canadian wood products. In all, the Coalition is made up of more than 500 individual companies and 35 associations.

Senator HEINZ. A question for Mr. Stahl and perhaps Mr. Coe. Is it true that U.S. lumber companies can take advantage of the cheaper Canadian stumpage but that U.S. petrochemical companies cannot take advantage of Mexico's cheap natural gas?

Mr. STAHL. Mr. Chairman, there are some U.S.-owned lumber companies who are operating in Canada.

Senator HEINZ. But a U.S.-lumber mill in the United States, can they purchase in Canada and bring it across the border?

Mr. STAHL. No, they cannot. There are no longer allowed exports from Canada into the United States.

Senator HEINZ. So, you can't export the logs?

Mr. STAHL. You cannot export logs from Canada to the United States. Now, when the Canadians discovered that there was a very substantial log export market in Japan and China, they quickly reduced the rigidity of their controls on those kinds of log exports from Canada and have substantially increased their log exports to Japan and China; but they have still foreclosed those logs coming out of the United States.

I guess what I am suggesting, Mr. Chairman, is that the Canadians are doing what is practical and what works.

Senator HEINZ. But an American company in Canada can buy logs if they put them through the lumber mill in Canada?

Mr. STAHL. Yes, if they have a plant in Canada.

Senator HEINZ. I would address this to Mr. Piercy and Mr. Smith: Should our countervailing duty laws take into account the fact that a country with dual pricing of its natural resource will sell to a U.S. producer at the cheaper domestic price for the production of downstream products in that country?

Mr. SMITH. I am not sure I understand the question. Would you restate that?

Senator HEINZ. Yes; if you have a situation where a U.S. producer cannot obtain the natural resource—whether it is natural gas or lumber or whatever it is—at the same price as the firm domiciled and operating in the other country, should that be considered the kind of unfair subsidy that should therefore be countervailed against? Isn't that a *prima facie* case of something funny going on? Mr. Piercy.

Mr. PIERCY. If I understand it correctly, I think in the case of Canada, we are talking about Canadian timber, would be sold on the same basis to the Americans as it would be to the Canadians. There is not a different price there.

Senator HEINZ. Mr. Stahl has just said that the Canadians will not export logs.

Mr. HORROCKS. Mr. Heinz, in answer to your question, the situation on exporting logs in Canada is the same situation that exists in United States forests. In other words, Canadian law reflects what the United States does in exporting logs from national forest lands. We don't allow a lot of exporting of logs from our public lands in the Northwest, and neither does Canada allow exporting of logs from Canada.

But to answer your question on the dual pricing, it is not a case of dual pricing with respect to lumber. In Canada, one-fourth of all the lumber manufactured in British Columbia in 1984 was manufactured by United States-based firms. So, therefore, when you are talking about dual pricing, you are really not getting the Canadian lumber issue involved in this.

Senator HEINZ. Let's, for the sake of argument, say that it isn't involved in it, but I was posing the general case. And if a United States producer in Canada or Mexico cannot buy the input that the Mexican firm can, is that a practice that we should just stand idly by and do nothing about?

Mr. PIERCY. In my view, that is not fair.

Senator HEINZ. Mr. Smith.

Mr. SMITH. There are a lot of different issues that enter into this argument, and one issue is supply. Many companies own mills in America and Canada; and you know it is nice to have that option. When the price of materials increase you cut what you have at home, and when the price decreases, you go across the line and cut in Canada. I think you have to consider supply.

We have had a lot of problems, in the Northwest, with adequate funding for the Forest Service road program. Without roads you can't cut the timber. I don't have to tell you about the wilderness area. Lack of available supply is one thing which causes the price of lumber to increase—here is a real good article right here: "Action Group Holds Old Growth Memorial Event."

Those are the types of things that are affecting our lumber supply.

Senator HEINZ. I am not arguing about the virtue of free trade. In fact, I am not even arguing with you; I am just asking a question, and I think you may have given me an answer to a different question. Let me ask you this. Do you believe that there are times when countervailing duties to combat a subsidy are justified?

Mr. SMITH. I believe we should provide the best product for the American people we can at the lowest price.

Senator HEINZ. Irrespective of whether or not there is a foreign government subsidy involved?

Mr. SMITH. That is what you all claim. That is what is being said about foreign subsidies. I am not sure that is the case myself.

Senator HEINZ. Dave, I am not talking about lumber.

Mr. SMITH. OK.

Senator HEINZ. Let's talk about steel. [Laughter.]

Mr. SMITH. If you want to talk about steel in the automobiles, I didn't see any American manufacturer chomping at the bit to get the gas mileage up to 30 miles a gallon until we got the foreign competition; and then all of a sudden they got on the ball.

Senator HEINZ. Let's talk about Brazilian steel.

Mr. SMITH. We may be going to that if lumber prices go up that much. We will have to talk about it a little bit. [Laughter.]

Senator HEINZ. Let me just ask you this, and then I will yield to Senator Baucus. I want to really get you on record as to what your position is, not that I would call your position weak. [Laughter.]

I would say it is quite forceful and strong, but I want to be clear in what it is. The Brazilians have built a steel mill inland where nobody in their right mind would ever build a steel mill. You can surmise it was built not by private industry but by politicians. And there is no way that that steel mill can ever produce steel efficiently. And the Brazilian Government has to subsidize the production of steel from that mill to sell it.

Is there something wrong with that?

Mr. SMITH. If they are subsidizing, there might be something wrong with it; but I am not sure that we have a subsidy in the Canadian lumber situation. So, if you are trying to pin me down to say——

Senator HEINZ. No, I am not. I am trying to get an answer on the steel industry. [Laughter.]

This is not a sneak, trick question from some two-timing politician. This is a one-time politician whose time is about to expire.

Mr. SMITH. I understand that. [Laughter.]

I am a one-time president of the Home Builders, too.

Mr. HORROCKS. Senator, if I could respond to your question directly? You asked about the steel mill. Well, if you are passing legislation that says that if there is a subsidy to a domestic producer of steel and you are providing a natural resource——

Senator HEINZ. Excuse me. That wasn't the reason I asked Mr. Smith the question. There is a difference here.

Mr. HORROCKS. I just wanted to point out——

Senator HEINZ. I am just trying to figure out what his view of unfair foreign trade practices is. Apparently, Dave's view is that when it comes to timber, there is no such thing as an unfair foreign trade practice.

Mr. SMITH. That is not what I said.

Senator HEINZ. Apparently—I didn't quote you.

Mr. SMITH. I could say aren't these subsidies to the U.S. timber industry? Let's talk about the timber in the ornamental tree reforestation expenses. Let's talk about the cost associated with growing trees that are deducted. The owners of timber for a right to cut timber can count their sales as capital gain. Is that a subsidy?

Senator HEINZ. Fortunately, my time has expired. [Laughter.]

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Stahl, could you explain to us what the stumpage cost differential is between Canadian stumpage and American stumpage? That is, what is the rate of lumber evolving in Canada compared with the same evolving rate of lumber sold in the United States across the board. Just give me a rough idea of the differential of the price of logs—that is, what is the amount of subsidy that Canada does provide for stumpage?

Mr. STAHL. If you are looking at the stump, the difference between comparable species, and I am talking about the same kind of trees now—we will get out of the technical jargon—can be a difference of 10 to 1. If you are talking about the delivered cost of getting that to the mill, it can be a lower number obviously because, in many instances, the Canadians must move those trees further distances.

But our view is that, overall, there is—and we have set this forth in our filing with the International Trade Commission and with the International Trade Administration—that there is a 27-percent differential that ought to be made up for by a countervailing duty.

Senator BAUCUS. Second, can you quantify for us the degree to which this differential has, in fact, adversely affected the U.S. lumber industry?

I would like to point out that the ITC has found that there is substantial injury to the U.S. industries. But could you also tell us, as a member of the forest products industry, what are the actual results of the subsidy?

Mr. STAHL. Over the years, Senator, we have participated in that decline that Senator Long referred to before, and we are one of those industries that have seen more than 3 million U.S. manufacturing jobs go overseas. The impact on the lumber-producing side of the forest products industry has been in excess of 30,000 jobs directly in the forests and in the mills. Now, in many lumber-dependent communities, that is magnified manyfold. I would submit to my good friends and former employers—the homebuilders—that they had better look damned carefully at who they are going to sell homes to, with the loss of those 3 million jobs, because many of those jobs in our society have been among the highest paying jobs in this country.

Senator BAUCUS. Mr. Smith, you have mentioned that your organization of homebuilders has all kinds of studies to show what the increased cost of lumber will do to Americans interested in buying new homes. Are you aware of the CBO study? As you know, the Congressional Budget Office is a nonpartisan organization—not Republican, not Democrat, a nonpartisan organization. I think it is widely regarded as a very objective and solid organization.

Are you aware of their study that says if this were to go into effect, the increased cost on an average home built in the United States would be $300, and if you spread that over a 30-year mortgage that is $10 a year. Are you aware of that study?

Mr. SMITH. Senator, I am glad you asked that question because I have been a builder for 26 years, and I think I know a little more about lumber costs than the CBO——[Laughter.]

Senator BAUCUS. Are you aware of the study?

Mr. SMITH. Yes; I am very much aware of it.

Senator BAUCUS. Have you read it?

Mr. SMITH. Yes; I don't agree with it.

Senator BAUCUS. Could you tell us where you disagree with it?

Mr. SMITH. Well, they assume a 14-percent duty on Canadian imports, first of all. The U.S. lumber industry recently filed a CVD petition requesting tariffs of at least 27 percent; and under this legislation, the tariffs could go much higher. Also, CBO does not attempt to estimate the number of families that will be blocked out of the housing market by the increase in housing prices.

The NAHB figures suggest that, even if CBO's conservative estimates are correct, if they aren't correct, we are talking 300,000 families to be forced out of the housing market. That is a lot of jobs, Senator.

Senator BAUCUS. Are there any other subsidies—Canada or any other country—that they impose that you might think would be unfair, or do you think all subsidies are fair?

Mr. SMITH. I don't want to respond to that at all. What I think is we have to address this issue just the way it is. Mr. Stahl talked about some jobs. I can assure you we can talk about jobs. If you look at the American economy today, who is carrying the American economy today? It is the housing industry. The oil industry is down. The gas industry is down. The farming industry is down. The automotive industry is down. Who is carrying the country today?

Senator BAUCUS. What if the Canadian Government were to provide a subsidy for Canadian citizens to go south of the border—to provide for their housing—maybe homebuilders—and the Canadian Government says all you Canadian citizens, we will send you south to the United States for 2 or 3 years. We will pay your lodging, pay for all your necessities and give you a fair salary. Would that be fair?

Mr. SMITH. It wouldn't be fair, but I would be glad for any one of you to tell me and show me where there is a subsidy. Now, I have met recently with a lot of timber people. We have also recently met with the Canadian homebuilders. We discussed this issue. I will be glad for somebody to show us if they have the information, where they can prove that there is a subsidy.

I can say to you that we have built over 6.8 million new housing units in the last 4 years. Never since I have been building, have we had that type of production. This is the first time that I think we have come out of a recession when we didn't have the price increases that we have had in previous recessions. Now, I wonder why we didn't have a great lumber price increase with 6.8 million units built in the last 4 years. I would like somebody to answer that question.

Senator BAUCUS. One more question to Mr. Hufbauer. Why shouldn't Americans just enjoy the benefits of lower priced products? After all, it is cheaper for Americans to build homes; it is cheaper lumber. Why shouldn't it be better for all countries, if the exporting countries subsidize their exports and the importing countries enjoy the benefits of the lower price? As an economist, what do you think is wrong with that argument?

Mr. HUFBAUER. Senator, that is a good question and I wrote a book on the subject. I will try to give a two-sentence answer to it. First, if we took that position, we would end up with a tremendous amount of distortion in the world economy. Some countries would choose to go heavily into semiconductors. Some would choose simply to go into lumber. Some would choose simply to go into steel. They would give just whatever resources are required to do that, and the net result would be to have industries go to countries where there wasn't any basic comparative advantage—to use the jargon of an economist—but there was a wide-open treasury.

On a worldwide basis, that is a very inefficient way to locate industry. So, that is one part of the answer.

The second part of the answer is that most people will say, hey, that is unfair. If you don't have a system of countervaling duties at the border, what you are going to get is emulating subsidization. So, the political process will, I think, not allow any major country like the United States just to sit back and enjoy it, which would be wonderful obviously. But to get into the game and thereby to answer waste with waste.

Senator BAUCUS. Essentially, what you are saying is all countries have their own subsidies, and in the long run, we are all worse off?

Mr. HUFBAUER. Absolutely.

Senator BAUCUS. Thank you.

Senator HEINZ. Senator Long.

Senator LONG. No questions, Mr. Chairman.

Senator HEINZ. Senator Chafee.

Senator CHAFEE. Mr. Chairman, there is a statement by Mr. Smith, and I would like to ask the other members of the panel about this—and this is in his summary. He says that the Canadian share of the domestic lumber market has not changed substantially since 1982. It seems to me that in your testimony, Mr. Stahl, there are quite different statistics. Which is right?

Mr. STAHL. I guess it depends on what you mean by significantly, Senator. Their share of the market has gone from the high 20's to about 33 percent since 1982. It has certainly been significant in terms of——

I think you have to compare it to the fact that we have had record levels of consumption, so their share—or their total exports to the United States have gone from about 11 billion board feet to 14 billion board feet in that period of time.

Senator CHAFEE. What do you say about that, Mr. Smith? What is significant? What do your figures show?

Mr. SMITH. I think the question should be asked to my colleague, Dave. What year did he base those figures on. I think that you will find those figures are based on 1979, which was a recessionary year, and that is not the base we should use. The figures should not reflect recessionary times, but they should reflect a normal year which would make the number higher.

Senator CHAFEE. Mr. Stahl.

Mr. STAHL. No. These are the figures from the International Trade Commission. They are not made up by the National Forest——

Senator CHAFEE. No, no. I am not saying that, but clearly if you choose a recessionary year and say they were way down at 11 and then they shot up to 14—by the way, what is that percentage of growth?

Mr. STAHL. It would be a little under 30 percent in terms of total exports.

Senator CHAFEE. Was 1979 a down year?

Mr. STAHL. No, 1979 was a year of 2 million housing starts and very active.

Senator CHAFEE. Let's get this thrashed out quickly because I am on a time limitation. Was it a big year or wasn't it, Mr. Smith?

Mr. SMITH. We started in recession. It was not a big year. No.

Senator CHAFEE. It is not when we started in. If we started in it, was the year a good year for housing? He said 2 million starts. Right or wrong?

Mr. SMITH. I can't confirm whether it was 2 million that year or not. I don't think so. It was not 2 million.

Mr. STAHL. How about 1.7 million?

Mr. SMITH. I am not sure, Dave.

Mr. STAHL. It was a hell of a housing year in any event. [Laughter.]

Mr. SMITH. 2 million is a big year.

Senator CHAFEE. Well, we round off in billions here, so—[Laughter.]

All right. Thank you very much, and thank you, Mr. Chairman.

Senator HEINZ. Very well. If there are no further questions, I want to thank all four of you for superior testimony. Thank you, Mr. Stahl, Mr. Coe, Mr. Smith, Mr. Piercy.

I would like to ask our next panel to please come forward. Mr. George Jandacek, Mr. L.L. Jaquier, Mr. Guy Erb, Mr. Joseph Blatchford, Mr. William Wurster, Mr. Bruce Lippke.

Mr. Jandacek, and I hope I am pronouncing your name correctly.

Mr. JANDACEK. Mr. Chairman, with your permission, I would like to follow Mr. Jaquier and let him open the presentation.

Senator HEINZ. Mr. Jaquier.

STATEMENT OF L.L. JAQUIER, EXECUTIVE VICE PRESIDENT, W.R. GRACE & CO., MEMPHIS, TN, ON BEHALF OF THE AD HOC COMMITTEE OF DOMESTIC NITROGEN PRODUCERS

Mr. JAQUIER. Good afternoon, Mr. Chairman. My name is L.L. Jaquier, and I am executive vice president of W.R. Grace & Co. I am speaking on behalf of the Ad Hoc Committee of Domestic Nitrogen Producers, which accounts for nearly 50 percent of domestic nitrogen production.

I represent a highly efficient and important U.S. industry, which is getting killed by unfair competition with State enterprises. State enterprises, which now control about 70 percent of world nitrogen production, unfairly disrupt competition in two ways. The nitrogen industry, like any other petrochemical industry, is capital-intensive and energy-intensive. State enterprises supply their operations with low-cost or free capital and with very low cost subsidized energy. We cannot compete against competitors who don't account for depreciation, who don't require a reasonable rate of return on invested capital, who don't pay interest, and who input energy at no cost or at a cost below fair market value.

These State enterprises, particularly in nonmarket economies, are delivering ammonia and urea into international markets at less than the cash production cost of U.S. producers. By any rational or fair accounting, these State enterprises are selling ammonia and urea below their own production costs as well. These monopolies preclude U.S. companies from exporting nitrogen fertilizers. Worse than that, they are destroying U.S. companies and our own domestic market. They are selling products at prices with which even the most efficient U.S. producer cannot compete.

The ad hoc committee has explored every possible avenue of relief provided under current law over the last 8 years. None of them will work against the practices of these State-owned enterprises. We have repeatedly testified that the unfair actions of the State enterprises would destroy the U.S. nitrogen fertilizer industry. This is happening as we speak today.

The administration has admitted that we have a trade problem. They continue to oppose this legislation but offer no alternatives. S. 1292 and S. 1356 will at least give U.S. industries a fair hearing in court to address unfair natural resource subsidies, and I urge your support. This legislation is included in the House trade bill. It was passed by a vote of 338 to 79, including a majority of 98 Republicans, this despite administration opposition.

Gentlemen, I hope I live long enough to see the administration give the same consideration to U.S. industries as it gives to our trading partners. Thank you.

Senator HEINZ. Thank you very much, Mr. Jaquier. Mr. Jandacek?

[The prepared written statement of Mr. Jaquier follows:]

STATEMENT OF L.L. JAQUIER
EXECUTIVE VICE PRESIDENT, W.R. GRACE & CO.
ON BEHALF OF
THE AD HOC COMMITTEE OF DOMESTIC NITROGEN PRODUCERS
BEFORE THE
INTERNATIONAL TRADE SUBCOMMITTEE
SENATE FINANCE COMMITTEE
U.S. SENATE

June 26, 1986

Mr. Chairman and Members of the Trade Subcommittee:

I am L.L. Jaquier, Executive Vice-president of W.R. Grace & Co. I am testifying on behalf of the Ad Hoc Committee of Domestic Nitrogen producers, a coalition of eight companies representing the majority of nitrogen fertilizer production in the United States. The Ad Hoc Committee includes the largest farmer-owned cooperative nitrogen fertilizer producers as well as other major private producers. Several member companies operate both here and in foreign nations. A list of the member companies is attached as Exhibit A.

INTRODUCTION

The natural resource subsidy problem is widespread and growing. U.S. firms and workers in the fertilizer, petrochemical, lumber, oil refining, cement, paper, steel and glass industries have been affected by it. While my testimony will focus on nitrogen fertilizer trade, many problems faced by the Ad Hoc Committee companies are generic and apply to other basic commodity fertilizer and petrochemical production -- in fact, to any energy-intensive industry.

The problem for our industry is that certain foreign government energy monopolies provide natural gas or petroleum derivatives at less than fair market value to their own industry, while denying other willing buyers the opportunity to buy their natural gas at the low domestic price. In some cases, the governments export energy to other nations at much higher market prices. This higher export price is not the result of a transportation differential added onto a wellhead price. These governments have, in essence, put two different wellhead prices on the same natural gas. Let there be no confusion: the marketplace could not perform this feat.

At the same time, these governments have constructed natural gas based industries which export gas-intensive products to other markets and undercut market-based producers. These practices combine to form blatant discrimination. Cutting through the detail, this practice looks like a subsidy and acts like a subsidy. It is no different in effect than a direct cash grant to lower production costs below the market rate for exported commodities.

It is amazing to the people in our industry that the Administration has resisted coming face to face with this problem. It is a major problem and it is <u>not</u> going to be decided by "market forces." It is anathema to free trade and the exercise of comparative advantage. If the Administration wants to redefine comparative advantage as a government function, not a market function, then we should get on with the business of nationalizing our energy resources and industries, controlling energy prices to discriminate against our competitors, targetting foreign markets and providing capital at below-market rates to build export facilities. This is the kind of competition we face.

I emphasize that noone is asking Congress to save an outmoded U.S. industry losing its struggle against superior production technologies and lower labor costs. We are asking the government to address a fundamental trade issue of discrimination based on the pricing of natural resources by governments.

I emphasize that the problem faced by U.S. producers springs from two sources: state ownership of and discriminatory control over the pricing of natural resources, and state control over the industries which use natural resources to make products which are exported to U.S. and other world markets.

The natural resource subsidy problem affects industries which use significant amounts of energy as feedstock for manufacturing products. The nitrogen fertilizer industry's basic product is ammonia, which is made by combining natural gas with air in a catalytic process. Natural gas accounts for about 70-80 percent of ammonia's cash production cost. It also affects industries such as the cement industry, which use large amounts of energy as plant fuel. In other words, it affects a huge segment of our economy.

Nitrogen fertilizers and basic petrochemicals are fungible commodities -- they are produced in similar fashion all over the world, undifferentiated in quality, and compete for markets on the basis of price. When subsidized imports enter a U.S. commodity market, the effect is to lower the market price of the commodity across the board.

In order to assess the issues and the proposed remedies, S. 1292 and Section 502 of S. 1356, it is necessary to review:

- the difference between U.S. energy policy and the energy practices of certain foreign governments;
- discrimination by government enterprises trading in competition with private firms;
- the price depression inflicted on U.S. commodity markets by subsidized imports;
- the General Agreement on Tariffs and Trade (GATT); and
- the Commerce Department's use of the "generally available" test as the exclusive criterion to determine countervailability of domestic subsidies.

POLITICS

I will begin with a few words about the politics of the natural resource legislation. We support S. 1292, introduced by Senators Baucus and Long, and co-sponsored by Senators Hollings, Symms, Cochran and Pressler. We urge that the committee include S. 1292 in its trade package. We also support Section 502 of S. 1356, introduced by Senator Heinz, and co-sponsored by Senators Dodd, Glenn, Baucus, Powell, Pressler, Riegle and Specter.

The House has already acted on natural resource subsidy legislation. The Resource Input Subsidy Act, the House companion to S. 1292, was included in final passage of the House trade bill. While H.R. 4800 contains some controversial provisions which resulted in party-line votes, the Resource Input Subsidy Act received strong bipartisan support. A move to strike the provision was defeated by a vote of 338-79. In all, 98 Republicans, a clear majority, voted to retain the provision. Notably, a natural resource subsidy provision, introduced by Rep. Henson Moore (R-LA), was included in the Republican substitute bill originally proposed in Ways and Means.

This bipartisan vote means broad support for resolving the natural resource subsidy issue. It is also due to House frustration over the Administration's refusal to take any action or to suggest any compromise to resolve the issue. In 1984, the Administration promised to work with Congress to solve what it admits to be a major trade problem. That promise was empty and the problem has gotten worse.

In the 98th Congress, the House passed similar legislation over the objections of the Administration. Administration pressure blocked consideration of the bill in the Senate, but Senator Danforth promised Senator Long that the issue would be taken up in this session. This hearing is the result of that commitment and we thank Senator Danforth for his concern. In the trade conference, the Senate conferees voted against the provision by a 4-3 party-line vote under obvious Administration pressure. It is for the lack of that one vote that we are back before you again this year.

Another political question is where the agriculture community stands on this issue. In 1984, agriculture was split. Farm cooperatives with investments in fertilizer production and oil refining were supportive of the natural resource legislation, while farm export organizations sometimes took active stands against it. These farm groups were primarily concerned about retaliation against U.S. grain sales.

This retaliation threat has been promulgated mainly by the importers of subsidized products. These importers and companies do not want to give up their subsidies in their overseas investments, and have been trying to drive a wedge between farmers and their domestic suppliers. The "Coalition to Promote America's Trade," headed by Occidental Petroleum and Cargill, sponsored a study by Wharton Econometrics which basically said that subsidized fertilizer imports are good for American farmers, and that applying countervailing duties to these imports would hurt U.S. farmers and consumers. The National Council of Farmer Cooperatives commissioned Economic Perspectives, Inc., a respected agricultural economics firm, to study the Wharton report. EPI discredited much of the report on the basis of erroneous assumptions, which the Wharton report did not spell out or reveal until pressure from the Ways and Means Trade Subcommittee Chairman finally brought them to light.

We have said this before and we will say it again. The loss of U.S. ammonia plants to these imports is not going to save U.S. farmers any money. If U.S. plants shut down, supply and demand will come back into balance and the price of nitrogen fertilizer will rise, including the price of the subsidized nitrogen imports. That's just the way the commodity market works. Without U.S. competition the subsidized imports will not have to be price undercutters.

We know, though others may forget, that our industry's viability is bound directly to the health of U.S. agriculture. In turn, U.S. agriculture has always been able to depend on the U.S. fertilizer industry. Claims that we would support legislation which would work against the U.S. farmer is ludicrous and a low blow.

This year, virtually no farm groups have opposed the legislation. A letter from farm groups to the House in opposition to provisions of the House bill did not criticize natural resources.

Given another year to look at this legislation, I think that the farm groups have become more sympathetic to the idea that U.S. producers deserve their day in court and a chance to prove that these unfair subsidies exist. The major disinformation concerning this legislation has always been that it would stop fertilizer imports. This legislation would only affect subsidized imports found to cause material injury to U.S. producers. This problem is compounded by the recent Commerce Department decision that countervailing duty laws do not apply to non-market economies (NMEs). While this decision is under appeal, it is an issue which should be addressed by the Committee in considering amendments to U.S. trade laws.

Opponents have suggested Section 301 remedies to resolve unfair government pricing and access problems regarding natural resources. Section 301 can be used to address virtually any unfair trade practice that the Administration wants to address. However, it is totally discretionary and offers no relief unless the Administration makes a commitment to do so. That commitment has not been made.

Farm groups are also more concerned than ever before about the use of export subsidies by foreign govenments. Our own government has been forced to join in the direct subsidy war, establishing a "war chest" to use against the subsidies of the European Community and other agricultural exporters. Everyone knows that this is not the long-term solution. We need legislation aimed at stopping the use and effects of subsidies.

The only rational arbiter of international trade is the marketplace, and the United States Government must, in legislation and negotiations, reinforce the market principle. Increased world trade means that we must resolve very basic differences with other nations. The failure of government to address these differences will cause trade disputes to multiply into protectionism.

When the U.S. Government takes action against unfair trade practices, any U.S. export may be affected. However, U.S. grain sales have not been singled out for serious retaliation due to any recent trade actions taken on account of other industries. Frankly, we never understood why any supposed retaliation would not more surely be directed against energy-intensive U.S. industries.

CHALLENGES TO THE INDUSTRY

The enormity of the challenge facing the U.S. petrochemical sector and its hundreds of thousands of workers may be examined by reviewing the trade picture. The U.S. petrochemical trade surplus has declined over 47 percent, from a surplus of $8.6 billion in 1980 to about $4.5 billion in 1985. Employment in the industry has fallen by since 1980.

U.S. petrochemical exports have been second only to U.S. agricultural exports in producing a positive merchandise trade balance. As in agriculture, the trade balance is shifting. Unlike agriculture, where exports are falling off rapidly, the petrochemical problem is centered in the U.S. market. While U.S. petrochemical exports declined from $11.8 billion in 1980 to about $11 billion in 1985, U.S. imports doubled, from $3.2 billion in 1980 to $6.4 billion in 1985.

This abrupt shift has three general causes: the dollar's strength, increased international competition, and unfair trade practices. This shift cannot be explained solely in terms of the dollar's strength and a loss of export markets. Imports have risen far faster than exports have declined. U.S. producers are encountering the most intense competition right here.

According to the June 16 Wall Street Journal, the dollar would have to fall another 30 percent to reduce the U.S. trade deficit to $40 billion over the next several years. We agree that a decline of this magnitude would plunge the world into recession. At any rate, do not expect to see a miraculous outburst of U.S. fertilizer or petrochemical exports and a shrinking of imports even if the dollar is allowed to continue its decline against selected currencies.

In the case of government producers using subsidized natural gas inputs, the dollar would have to fall much further before any competitive disincentive equal to their subsidy advantage would ensue. Devaluation of the dollar will not solve unfair trade problems or always work to reduce the trade deficit, unless the dollar falls against all currencies.

THE NITROGEN FERTILIZER INDUSTRY AND U.S. COMMODITY MARKETS

The current condition of the domestic nitrogen fertilizer is unstable at best. Our latest data indicates that 1.6 million tons of anhydrous ammonia production, nearly 9 percent of U.S. capacity, has been idled since last July. Production has fallen 21 percent compared to the year-earlier period, and plants are operating at less than 80 percent of capacity. The urea sector is in worse condition. Over 11 percent of U.S. urea capacity has been idled since last July, and operating rates at other plants have fallen to 70 percent. The U.S. fertilizer industry overall is experiencing significant bottom line losses and the prospects for improvement under current conditions are slim.

Profit information gathered from press reports and 10-K forms reveals that losses for 29 integrated fertilizer producers were $133.5 million in 1985, compared to a profit of $13.4 million in 1984. This year could very well be worse than 1985.

The reason for this condition is that the prices of ammonia and urea have fallen below their production costs. Since 1985, prices of urea in particular have been extremely depressed. Imports of urea from the NME nations of the Soviet Union, East Germany and Romania have surged dramatically, landing in the U.S. for the last year at prices in the $70 to $80 dollar range. We have calculated that U.S. producer's urea production costs range from about $98 to $140 per ton.

U.S. production costs are lower than in 1985, reflecting the decline in U.S. gas prices. However, this input cost decline has not improved the competitive position of U.S. producers vis-a-vis the NMEs. NME urea accounted for 50 percent of all urea imports in the first quarter of this year, compared to less than 1.9 percent in 1981. The urea price problem has extended to depress ammonia prices. Ammonia is the building block of urea production.

The U.S. nitrogen fertilizer market is a commodity market, where price competition is intense and prices are reported daily. Buyers seek the lowest price and sellers must compete with the lowest price to retain customers. This market function is well recognized in the fertilizer business. In the June 23 Green Markets, for instance, the urea report says:

> Expectations that the [urea] price will continue its downward trend were evidenced by offers of imported product for September delivery in the mid-to-high $70s/st [short ton] FOB barge. Several buyers have reported such offers, and they seem to be based on sourcing East European urea at the current prices of $62 - $70/mt [metric ton] FOB.

While U.S. producers have been forced to curtail production and shut down plants due to depressed prices in both the U.S. and world markets, the NME producers have continued to increase their share of the U.S. market.

In addition, the NMEs are further expanding their capacity to produce and export. There is already a world overcapacity problem. In urea, for instance, projected world demand for 1990 is below 1985 world capacity. However, the Soviet Union has just announced additions of over two million tons of new ammonia capacity, and industry sources estimate that some two million tons of new Soviet urea capacity will also be added by 1990.

Apparently, the prospect of continued excess capacity and low world prices does not bother the NME producers. Their response to low prices will be to make up in volume what they lack in price. This decision will continue to cause injury to U.S. producers as more product is forced onto the world market.

In a speech on February 11, 1986, Under Secretary of State Allen Wallis said that commodity markets are particularly vulnerable to damage from oversupply. A purchaser's choice of fungible products is based almost entirely on price. Demand in commodity markets is inelastic; a percentage change in the available quantity of a commodity results in a larger percentage change in its price in the opposite direction. Suppliers in such markets can obtain larger revenues on smaller supplies than they can from larger supplies, because the increase in price will more than offset the decrease in volume sold. What the Under Secretary was talking about is what I am talking about. But I would add that if some producers, by reason of government control, are basically free to disregard the realities of commodity market pricing, then private producers will be run out of the market.

Since 1980, the U.S. has lost its nitrogen self sufficiency due to recurring price depression, first in the ammonia market and now in urea as well. U.S. exports have also fallen. We are now dependent on imports added to total domestic production in order to meet U.S. nitrogen fertilizer demand.

Another U.S. fertilizer industry, the phosphate industry, is also deeply troubled. The U.S. phosphate industry is in intense competition with Morrocco and other North African producers. Ironically, these foreign industries were basically funded from scratch by low-cost loans from the U.S. Ex-Im Bank, and have now shut down a large part of the domestic industry, idling thousands of U.S. workers. Eight U.S. plants are idled and seven more are running at below-normal rates. This affects the nitrogen industry because the phosphate industry uses nitrogen to produce compound fertilizers. Total ammonium phosphate production for the July - March period equated to an operating rate of only 60.4 percent. Diammonium phosphate, which is the major nitrogen-containing U.S. fertilizer export, has seen production cut almost in half.

The fertilizer industry has also been affected by grain surpluses which have caused the Administration to mandate a new acreage reduction program for the next several years. This program will reduce fertilizer useage just as the Payment-in-Kind (PIK) farm program in 1983. Despite the drought conditions in the East, the Midwest and the West will, in all probability, again harvest huge crops. This will compound low grain prices and cause less fertilizer use. The U.S. Department of Agriculture reported in May that it is now nearly possible to meet a year's demand for wheat without planting and harvesting a wheat crop in 1986.

If nitrogen fertilizer imports do not decline in response to price and demand conditions in the U.S. market, the situation will pass from unstable to critical. History has taught us that the government-subsidized producers will not respond to price signals or the fall in demand, and will only use this opportunity to increase their U.S market share.

The bad conditions of 1985 and 1986 are not new to the domestic nitrogen fertilizer industry. Since 1978, when Mexican and Soviet ammonia began entering the U.S. marketplace in increasing quantities, periods of price depression and oversupply have weakened the domestic industry. In 1978, U.S. ammonia capacity was over 20.7 million tons. Today it has fallen to about 17.9 million tons, a decrease of over 13 percent, and may decline further in the very near future as more U.S. firms are forced to examine the feasibility of continuing to produce at a substantial loss. The capacity decline is not nearly as drastic as the ongoing decline in U.S. production. The U.S. urea industry's capacity remained basically steady from 1980 through 1985, but production declined by about 20 percent as imports from the non-market economy nations entered in record quantities. The disruption over the last fertilizer year may see the permanent closure of more large U.S. urea and ammonia plants.

THE NEED TO ADOPT THE NATURAL RESOURCE PROVISION

The U.S. nitrogen fertilizer industry is more than capable of competing with market-based competitors, and does not want to impose blanket quotas or tariffs on imports of fertilizer. Such moves would penalize fairly-traded imports as well as subsidized imports.

S. 1292 and S. 1356 do not automatically impose quotas or tariffs on any import. They do, however, give U.S. producers their day in court and the opportunity to prove the existence of unfair subsidies on a case-by-case, country-by-country basis. We feel that the remedy should be placed under U.S. countervailing duty laws because other trade remedies are ultimately discretionary with the President, and the Administration has shown no will to address this problem under its available options.

The purpose of this legislation is very clear. It intends that governments should not be allowed to provide an unfair competitive advantage to their exports by the use of discriminatory means. It functions to hold governments to the market standard which is the very basis of U.S. market economic policy. In recognizing the market imperative, the legislation upholds the principle of comparative advantage on which international trade is based. It makes the critical differentiation between trade based on a real comparative advantage and trade based on a government's discriminatory bestowal of advantage on selected producers.

The critieria are fair and very specific. An import could be countervailed only if:

1. a government entity provides a natural resource to producers,
2. at a price which is set, by government regulation, at less than the resource's fair market value; and
3. the government will not allow other willing buyers to purchase the resource at this low price; and
4. the resource constitutes a significant portion of the production cost of the product in question; and
5. the product is shown to cause injury to a U.S. industry.

Under S. 1292, fair market value is defined as the price a willing buyer would pay a willing seller in an arms'-length transaction free from government intervention. We do not know any better standard that could be applied. This is the standard that applies to us in our day-to-day dealings. Private producers find a price in the marketplace every day. If we can live with it, foreign producers trading in our market should live with it. If we can find it, and producers in other market based economies can find it, then the Commerce Department can also find it to determine the amount of countervailing duty. Otherwise the balance will remain tipped in their favor.

ISSUES

1. The "Free" Energy Marketplace and U.S. Energy Policy

The United States has succeeded in creating a "free" energy marketplace in its economy. Buyers and sellers are negotiating their natural gas contracts based on the market's pricing standards of supply and demand. Post 1978 natural gas (so-called "new" gas) is fully deregulated, and pre-1978 gas ("old" gas) has been decategorized and given a single ceiling price of $2.57 per mcf at the wellhead. Industrial users in the United States are paying prices far below that ceiling for "old" gas. Indisputably, the marketplace sets the price of U.S. natural gas.

In fact, the price of natural gas to industrial users fell below government-imposed ceilings in the early 1980s and has not been depressed artificially by the Natural Gas Policy Act (NGPA) since. This was due to market response to the move toward deregulation. The "deliverability bubble" in U.S. gas supplies currently, plus the FERC's deregulation of the old gas categories, promises U.S. consumers lower prices for gas and more plentiful supplies, by the government's estimates, well into the future.

Canada has also moved toward the free market in its oil and natural gas pricing. Canadian gas export prices are increasingly negotiated directly between buyer and seller, and are very competitive in the U.S. northern tiers. Canada has increased the volume and value of its gas exports to the United States by this decision. Canada is also removing its interprovincial gas pricing distinctions to allow its domestic buyers and sellers to determine gas prices inside Canada. Canada will further deregulate their gas pricing system in November. The Canadian and American decisions have served to establish what may be the freest market for natural gas possible in North America, and perhaps in the world.

In the late 1970s, the European Community complained that U.S. natural gas price regulations were effectively subsidizing the production of U.S. textile and petrochemical exports. During that time, U.S. gas prices were as high as the NGPA would allow, and were probably below the market price that would have existed if not for U.S. government regulation. The U.S. convinced the Europeans not to file trade cases, not by arguing that the pricing regulations were not countervailable subsidies, but that we were deregulating gas prices. In fact, we have done so.

We have learned, with 20-20 hindsight, that those regulations saved us money in the short term, only to become a burden to the economy and a bureaucratic nightmare to dismantle afterwards. During that period, the high price of oil and the drastic predictions of oil shortages sent gas prices higher. Imported gas from Canada and Mexico were priced at an oil-equivalent price of imported crude into Eastern Canada. Controls were seen as a political necessity based on the belief that U.S. natural gas supplies were rapidly disappearing. Yet, as deregulation took effect, gas supplies increased.

Whatever may be said about past regulations on gas pricing in the United States market, these facts bear repeating: the United States government never acted as an energy monopoly. The government never saw its role as the discoverer, producer, distributor, and industrial user of natural gas. The government never established public entities to operate whole industries meant to serve the domestic and international markets. We cannot even imagine such a state-controlled monopoly system here. But our industries are competing with such state-controlled monopolies with all the powers I have listed. Furthermore, the U.S. Government never adopted a policy or practice which resulted in a two-tier energy pricing system: one low price for American domestic industries, and a far higher price to non-nationals.

2. Discrimination

In contrast to the actions of the United States and Canada, many foreign governments have nationalized the ownership of oil and natural gas under state monopolies. In recent years, the monopolies have expanded to include "downstream" industries which intensively use those resources. By this expansion, governments have created monopolistic and oligopolistic enterprises which control energy resources, from their extraction to the production and marketing of energy-intensive products.

Such systems exist in the OPEC nations and Mexico. Clearly, such systems are also characteristic of the centrally-planned economies.

The nitrogen fertilizer industry was among the first U.S. industries to experience intense competition from such systems. Since the early 1970s, these systems have had an increasing impact on trade. For instance, since the early 1970s, majority ownership of world ammonia production has shifted from private hands to government hands. The same shift is evident in urea production. Today, about 70 percent of total world ammonia and urea capacity are controlled by governments.

We are not saying that government regulation of an economy's energy resources is inherently unfair or automatically disruptive of international commerce. Indisputably, governments have the right to regulate energy pricing and access in their own economies for internal developmental purposes.

However, it is not difficult to understand that such systems may create insurmountable problems for private producers operating in market-based economies. Under current law, the subsidized producers are free to pass their so-called "domestic" energy subsidies into the world marketplace and undercut market prices.

This type of discrimination has two undeniable effects. First, by setting an artificially low domestic price for energy, while denying this low price to other willing buyers, the government creates an unbeatable production cost advantage in relation to producers paying higher market based prices. Second, this discrimination is overtly protectionist. By denying other producers the low-priced energy resource, the government shields its own industry from competition.

Look at what is happening in Europe. The Soviet Union charges market-based prices for its natural gas exports to Western European nations -- apparently about $4.20 per mcf in 1985, probably less than that today due to the oil price collapse -- while domestic prices are set far below the export price. Soviet gas prices are set by central planners at different prices to different industries. I have seen estimates of internal Soviet prices ranging from $2.00 per mcf to ammonia plants to zero cost. However, two firms specializing in Eastern Block affairs report that the average official Soviet industrial price is apparently 25.88 rubles per MMbtu delivered -- which is $.40 per mcf at the Hungarian cross-exchange rate.

However, this price data conflicts with that submitted by Occidental Petroleum Corporation to the ITC investigation into government pricing of natural resources (ITC Publication 1696, May 1985). According to Occidental, the wellhead value of Soviet natural gas, based on the declared value of Soviet ammonia imported to the United States in 1984 at about $165 per ton, was about $2.70 per mcf.

If Occidental's number was anywhere near correct, then Soviet ammonia and urea have been sold since last year in the United States at absolutely monumental economic losses. Yet their imports of urea have increased dramatically. If the Eastern Bloc analysts are correct and the Hungarian cross-exchange rate provides an accurate exchange, then the Soviets are charging a discriminatory rate for their gas exports to Western Europe compared to their home market price.

The European community recently took a dramatic step by agreeing to buy Norwegian natural gas and fund an interEuropean pipeline system rather than increase their dependence on the Soviet Union for natural gas, despite a lower price offer from the Soviets.

Petroleos Mexicanos (PEMEX) is the Mexican state energy, fertilizer, refined product and commodity petrochemical monopoly. PEMEX's published policy is to maintain domestic prices for energy below world market prices. From the late 1970s through 1983, PEMEX was exporting natural gas to the U.S. at $4.94 - $4.40 per mcf, while charging its domestic ammonia industry anywhere from zero to 50 cents per mcf, including delivery. At the same time, Mexico was exporting significant amounts of its ammonia to the U.S. Gulf Coast and undercutting U.S. producer prices.

Today, Mexico's natural gas price for industrial users is $1.72 per mcf at the market exchange rate. The price has risen because international lending institutions have pressured Mexico to move toward market-based prices in the domestic economy. However, this is a <u>delivered price</u> to any location in Mexico. Most Mexican natural gas comes from the south of Mexico in the Campeche region. Deducting comparable transportation expenses of about $1.00 per mcf from Campeche to the U.S. border, the wellhead price of Mexican gas is only about $.72 per mcf.

Mexico quit exporting gas to the United States in 1983 because Mexico would not lower the border price from $4.40. Unlike Canada, Mexico chose not to move with the market. As a result, Mexico has foregone much-needed revenue.

Note that $1.72 per mcf is the industrial use rate for PEMEX natural gas. We must seriously question whether this rate is the rate which PEMEX charges itself for natural gas. According to industry analysts, PEMEX's lifting and delivery cost of gas to its ammonia plants is only about 45 cents per mcf.

The 1982 countervailing duty case against Mexican ammonia discovered that PEMEX was supplying its ammonia plants with natural gas at "cost," which was slightly below the industrial user rate which PEMEX charged to non-state owned Mexican industries. In that case, the Commerce Department found that this constitued a subsidy to PEMEX. It was also discovered that PEMEX does not sell gas to itself, but merely transfers natural gas within the monopoly. Using the Commerce Department's findings and rationale, PEMEX is charging Mexican industrial users $1.27 per mcf more than PEMEX's own gas input costs. In other words, PEMEX is getting a subsidy of $1.27 per mcf. Since PEMEX uses about 38 mcf of natural gas to make a ton of ammonia, PEMEX ammonia is subsidized by the amount of roughly $48 per ton.

PEMEX also makes crude oil and other refined oils available in its domestic economy for less than the price at which it exports the same oils. The collapse of oil prices and devaluation of the peso against the dollar have not served to eradicate the difference between Mexican internal and export prices for fuel oils. Medium range fuel oil costs $8.42 per barrel domestically and heavy fuel oil costs $5.69 per barrel domestically. According to Platt's Oilgram, the average export price of light Mexican oil to the U.S. in April was $18.70 per barrel, #4 Mexican oil was $14.21 and Mexican heavy fuel oil was $10.95 per barrel.

As a result, products such as cement, carbon black and float glass, which require oil or natural gas as energy and feedstock, are imported from Mexico at very low prices. U.S. producers cannot compete with these Mexican products by importing PEMEX oils at PEMEX export prices. U.S. producers could compete if they could export PEMEX oils at the Mexican domestic price.

Our investigations into the resource issue have shown that resource subsidies are often used in conjunction with other forms of discriminatory assistance. The government may also provide low-cost or no-cost loans to subsidize the construction of its plants. The government may also have to bear considerable infrastructure improvement costs to serve its facilities. In addition, the government may impose huge tariffs on imports to prevent competition. For instance, Mexico's PEMEX enjoys a total monopoly in oil and natural gas production, as well as the production of basic petrochemicals and oil refining. Foreign investment is completely barred from these sectors by law. In addition, Mexico's tariff on imported ammonia is about 100 percent.

By contrast, some natural gas-rich nations do not have an export market to influence prices in their domestic economies. The island of Trinidad, for instance, sells natural gas at about $1.00-$1.20 per mcf to industry. Gas prices are negotiated at arms'-length. Trinidad cannot export gas except by liquifying it. Liquification is an expensive process and would render Trinidad's gas exports uncompetitive. Because Trinidad does not discriminate or establish two-tier pricing, it would not be subject to the proposed legislation. The fair market value of gas in Trinidad is low, but it reflects Trinidad's comparative advantage.

~~The same holds true for countries like Saudi Arabia. Saudi~~ Arabia has abundant natural gas, and apparently makes it available to its industries for about $.50 per mcf. Saudi Arabia has no export market for its gas and, again, liquification would not be economic. Under the provision, Saudi Arabian natural gas is bringing its fair market value.

In the early 1980s, French and Belgian ammonia producers filed a complaint with the EEC over Dutch natural gas pricing practices. The French and Belgians alleged that the Netherlands was selling natural gas to its own ammonia producers at a discriminatory price. They described this practice as an "illegal state aid," a subsidy in EEC parlance. The Dutch reacted by lowering their prices to the French and Belgians. This complaint has not yet been totally resolved, but it is not much different than the problem we are talking about today.

An apparent option for U.S. producers is to move their operations offshore to low gas-cost countries. There are problems which make such moves uneconomic. It costs more to build plants in those countries, and efficient domestic plants would have to be shut down and written off. Transportation costs over long distances to the U.S. would add another disadvantage. Many fertilizer, refining and petrochemical plants in these countries are apparently not recovering their construction costs, much less providing a return on investment. It would not make sense to move from one loss situation to another. Many of these foreign plants can operate only because of low or no-cost capital financing. In the case of government facilities, they are not required to make a profit.

<u>3. The Provision is GATT Legal and GATT Consistent</u>

The GATT has long recognized that some subsidies are countervailable. In 1979, a Subsidies Code was negotiated to further define which subsidies would be countervailable. The Subsidies Code included the extension of an injury test for all Code signatories. Prior to 1979, the injury test was not required in the U.S. to countervail subsidies. The natural resource provision extends the injury test to all parties whether they are GATT signatories or not. A copy of Article 11 of the Subsidies Code is attached as Exhibit B.

The Code recognizes two types of subsidies. Export subsidies are those benefits granted contingent on export performance, or intended to directly stimulate export sales over domestic sales. Domestic subsidies are provided internally and are not necessarily tied specifically to export performance. Domestic subsidies are generally not intended to provide a specific incentive to promote exports over domestic sales. The issue in this case is not whether domestic subsidies are being used, but whether they are countervailable and what the test of countervailability should be.

The Code recognizes that domestic subsidies are "important instruments for the promotion of social and economic policy objectives," and does not restrict governments from using them to achieve such objectives. Paragraph 1 lists some of those objectives. However, in paragraph 2 of Article 11, it is also recognized that domestic subsidies "<u>may cause or threaten to cause injury to a domestic industry or another signatory or serious</u> prejedice to the interests of another signatory or may nullify or impair benefits accrued to another signatory under the General

Agreement, in particular where such subsidies would adversely affect the conditions of normal competition" (emphasis added). Signatories are obligated to "avoid causing such effects through the use of subsidies."

In addition to the internal objectives to be achieved, signatories "shall also weigh, as far as practicable, taking account of the nature of the particular case, possible adverse effects on trade." Signatories are also obligated to consider the conditions of world trade, production (e.g., price, capacity utilization etc.) and supply in the product concerned in the use of such subsidies.

Thus, the Code recognizes that domestic subsidies are legitimate tools to promote social and economic policy objectives. It does not say some are legal and some are illegal. What it says is that some subsidies may cause injury and adversely affect the conditions of normal competition. Signatories are required to avoid those effects, not the use of subsidies. The Code recognizes that, in some cases, those effects cannot be practicably avoided while achieving internal policy objectives. In such cases, the domestic subsidy may be countervailable. The Code also recognizes that domestic subsidies may go beyond their intended affect on internal development and cause the creation of excess capacity, incentives to export and an adverse price impact in trade with other countries. Those are some of the effects which signatories are supposed to avoid.

Paragraph 3 of Article 11 provides illustrative, non-exhaustive examples of forms of subsidies currently granted by a number of signatories. It does not say which subsidies are and are not countervailable. Countervailability is determined under paragraph 2. This paragraph recognizes that the legitimate objectives set out in paragraph 1 "may be achieved, inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises." It notes that the examples "are normally granted either by region or by sector." "Normally" does not mean exclusively granted by region or by sector.

The Department of Commerce has interpreted this provision and U.S. countervailing duty law as permitting countervailing duties only where government aid is limited by design and intent to a specific industry or group of industries. The Code does not apply or contain this exclusive, restrictive test.

The Code is silent on subsidies granted to a broader range of industries or enterprises, but generally recognizes that domestic subsidies are countervailable when they cause injury to producers in other nations. The natural resource provision clarifies this recognition with regard to a particular form of subsidy.

GATT article XVII addresses state enterprise and state trading, stating that state enterprises involved in competition with private enterprises should "act in accordance with commercial considerations" when they trade. The natural resource provision holds governments to commercial standards.

4. General Availability and Mirror Legislation

A major issue in the natural resources debate centers on the Commerce Department's use of the "generally available" test as the exclusive criterion to determine the countervailability of domestic subsidies. This exclusive test, which is not to be found anywhere in the GATT or in the U.S. Subsidies Code, has led to absurd trade case rulings in the past.

Commerce first formulated the "generally available" test in steel cases brought in 1982. This test restricts countervailable domestic subsidies to those granted explicitly to a specific industry or group of industries. The Administration first stated that the GATT Subsidies Code rules supported the "generally available" test in 1983, in testimony in opposition to the original natural resource subsidy legislation introduced that year.

This is a preposterous claim. Only a few governments engage in discriminatory natural resource pricing and access practices. Such practices are not internationally accepted. This legislation is designed to apply only to discriminatory state aids to resource intensive exports.

The Administration has argued that adoption of the natural resource legislation would result in the countervailing of all kinds of internationally-acceptable subsidy programs -- listing public health care, roadbuilding, public education, irrigation projects, electric generation and police and fire protection as programs at risk due to the natural resource legislation. This argument was never valid, but current events have clearly demonstrated its invalidity.

Opponents of the natural resource legislation have depended on the sanctity of the "generally available" test. They have continued to argue that the natural resource provision would violate this test, as if it were actually a part of the GATT or the Subsidies Code. This test is not part of either, and the Court of International Trade's decision in the Carbon Black case should end this game.

Opponents have told the U.S. agricultural community that their exports would be affected by passage of the provision because of this test. This is the "mirror legislation" issue.

Unfortunately, the agricultural community may now be in trouble because of the "generally available" test itself. Many U.S. agricultural programs are already countervailable under the "generally available" test because they are available only to farmers, and often, only to farmers in certain regions. Under current law and interpretation, irrigation programs in the West are regional and sector-specific, available only to farmers and, thus, countervailable by other countries. Canada has just filed a 71-count countervailing duty case against U.S. corn exports. Among the U.S. programs attacked in the complaint are an array of U.S. domestic subsidy programs for farmers.

Another question is whether the provision would make hydroelectric power countervailable. Electricity is not a natural resource. It is produced in this instance by falling water. The question of subsidy involves the capital construction cost of the dam and whether the rate charged for the electricity adequately recovers the cost. To the extent it does not and creates a competitive advantage for electricity-using industries which export, it may be countervailable. If the electricity were directly exported at a discriminatory price, it could be countervailable. It is clearly sector-specific in the such a case.

While Commerce's intent in making up this rule was to draw a line between countervailable and non-countervailable domestic subsidies, the test is fatally flawed. According to this rule's logic, if a resource is made "generally available" in an economy at any price, then no industry can be said to receive a countervailable subsidy because, in essence, they all receive a subsidy. By virtue of being "generally available," the subsidy does not provide an unfair benefit to a specific industry or group of industries. This tautological reasons succeeds only in ignoring the realities of the market and the effects of subsidies.

Thus, the Commerce Department's test has always been more concerned with counting the number of subsidized industries than with determining the impact of the subsidy itself. If only one industry is found to receive a subsidy, then it is countervailable. If many industries receive it, nothing is to be done. The potential for absurdity is self-evident.

The blinders on this test are many. Foremost among them is that a government may subsidize its entire energy-intensive export sector so long as the energy price is "generally available" to other nominal users with no incentive to export. This is particularly disturbing in cases where the government is a major energy user -- with a huge stake in the export performance of the energy-intensive sector by virtue of owning it.

The Court of International Trade recently ruled that the "generally available" rule is invalid because it does not comply with the intent of U.S countervailing duty laws; that is, to determine whether a benefit gives rise to a competitive advantage. The test is, what are the actual results or effects of assistance provided by foreign governments, not their purposes or intentions. Whether a subsidy has been bestowed must be decided on the facts in each case, not by an exclusive rule that is concerned with the nominal availability of government programs. The question is what aid or advantage has been received and what is its competitive effect, not its form or purpose (Cabot Corporation v. U.S., U.S.CIT, Slip Opinion 85-102, October 4, 1985, pp. 13-14).

The test outlined in this case and paragraph 2 of Article 11 of the Code provides a more pragmatic and sustainable standard for determining countervailability. It requires an examination of effects and results of the receipt of state aid, and whether such aid adversely affects the conditions of normal competition -- not just the form of state aid, or its nominal availability, or its purpose.

5. The U.S. Nitrogen Industry and U.S. Farmers

Nitrogen fertilizers are indispensible to high-yield harvests of corn, wheat, cotton and other commodity crops. Farmer-owned cooperatives have billions of dollars invested in nitrogen fertilizer production facilities and oil refineries. While these investments are in danger due to subsidized imports, the imports have served to depress prices, making fertilizer cheaper for farmers. However, if U.S. plants are shut down, this cheap supply will disappear. U.S. farmers cannot hope to continue buying fertilizer at less than its real production cost, even if subsidized imports shut down domestic capacity. Once enough U.S. capacity is shut down, the price of imports will rise.

In a host of nations, governments subsidize the price of fertilizer to farmers, either through production subsidies to producers or consumption subsidies for farmers. Our investigations show that, in countries which are dependent on imports of fertilizer, the governments are active in providing subsidies to defray fertilizer prices to farmers.

In many fertilizer exporting nations, the governments also subsidize fertilizer prices to farmers. U.S. farmers must realize that they are competing not only against subsidized exports, but subsidized farm inputs as important as fertilizer. Nations with large, competitive nitrogen fertilizer capacities have cheaper prices based on the market. The smaller the domestic industry, the greater the instance of the need for governments to subsidize their farmers.

ADDITIONAL WRITTEN COMMENTS TO SUPPLEMENT THE TESTIMONY OF
MR. L. L. JAQUIER ON BEHALF OF
THE AD HOC COMMITTEE
OF DOMESTIC NITROGEN PRODUCERS
AND
MR. GEORGE JANDACEK ON BEHALF OF
THE INDEPENDENT REFINERS COALITION
AT THE HEARING HELD JUNE 26, 1986
ON S. 1292 and S. 1356

During the hearing on June 26, Administration witnesses continued to voice concern that passage of the natural resource subsidy amendment may result in objections by some of our major trading partners under the GATT Subsidies Code. This concern revolves around the so-called "generally available" test or the specificity test. This test is an interpretation of U.S. law by the Department of Commerce in a series of countervailing duty cases involving imports of natural resource-intensive products. The issue is not whether such imports are benefited by domestic subsidies, but whether such domestic subsidies should be countervailable under U.S. law and the GATT Subsidies Code.

Most governments provide domestic subsidies in various forms to promote social and economic policy objectives. Every sovereign government has the legitimate right to engage in such programs, and neither U.S. law nor Article 11 of the GATT Subsidies Code restricts such rights. The key question to be resolved by the Congress is where to draw the line in determining which domestic subsidies or under what conditions domestic subsidies may be countervailable.

The Administration has been using the generally available test to make this determination. In its most recent review of this test, the Court of International Trade made it clear that the Department has misinterpreted and misapplied U.S. law. Mr. Kaplan, testifying on behalf of the Commerce Department, conceded that there has been a tendency by the Department to simply count the number of industries receiving a benefit and denying countervailability where the <u>availability</u> of the benefit is not limited to a "specific industry or group of industries." The Department determines countervailability exclusively on this test without any consideration of the subsidizing effect of the benefit to the particular industry involved in exporting.

The Court of International Trade in <u>Cabot Corporation vs. United States</u> (USCIT Slip Op. 85-102, Cons. Ct. No. 83-7-01044, Oct. 4, 1985) established an expanded test for determination of countervailability of domestic subsidies. The Court stated that <u>first</u> the Department must determine whether a bounty or grant gives rise to a "competitive advantage." <u>Second</u>, the Department must determine, in the case of domestic subsidies, whether the benefit is conferred upon "a specific enterprise or industry or group of enterprises or industries." The Court stated that "the determination of whether a bounty or grant has been bestowed must therefore be made upon the facts of each case. Since the enactment of Section 1303, the courts have recognized that they must examine the actual results or effects of assistance provided by foreign governments and not the purposes or intentions." (emphasis added) The Court further stated "nor is Section 1303 concerned with the nominal availability of a governmental program. The question is what aid or advantage has actually been received 'regardless of whatever name or in whatever manner or form or for whatever purpose' the aid was provided."

Testimony was received by the Committee that the GATT Subsidies Code does not restrict the right of governments either to provide domestic subsidies or to determine which subsidies should be countervailable. There are three key paragraphs in Article 11 of the GATT Subsidies Code relating to domestic subsidies.

Paragraph 1 recognizes that domestic subsidies are "widely used as important instruments for the promotion of social and economic policy objectives" and does not restrict the right of signatories to use such subsidies. This paragraph lists some of these objectives.

Paragraph 2 states that signatories recognize, however, that such subsidies "may cause or threaten to cause injury to a domestic industry of another signatory . . . in particular where such subsidies would adversely affect the conditions of normal competition." This paragraph states that signatories are required to "therefore seek to avoid causing such effects through the use of subsidies." Signatories are further required to weigh certain criteria when drawing up their policies and practices in this field. Thus paragraph 2 sets out the principal standard to be used in determining countervailability. That standard is that domestic subsidies may be countervailed which cause or threaten to cause injury to a domestic industry of another signatory, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories are to avoid causing these effects and where they do not, such subsidies may be countervailable.

Paragraph 3 recognizes that the objectives described in paragraph 1 may be achieved through the use of subsidies, forms of which are described in paragraph 3. The enumeration of forms of subsidies are illustrative and non-exhaustive. Paragraph 3 lists several forms of subsidies without stating whether they are countervailable or not countervailable. The forms listed could be bestowed widely or specifically. The paragraph states that "signatories note that the above form of subsidies are normally granted either regionally or by sector." (emphasis added) This paragraph does not state that only sectoral or regional subsidies may be countervailed.

The generally available test as applied by the Department has been made the sole determinant of countervailability. This test goes far beyond and is much more restrictive than the standards set out in Article 11 of the GATT Subsidies Code and previous cases determined by U.S. courts. It is clear that the standard to be applied is whether the benefit provides a competitive advantage or adversely affects the conditions of normal competition and whether it causes or threatens to cause injury. The determination of countervailability should be made on the competitive effect of the benefit to the specific industry or group of industries exporting products to the United States. The test currently being applied by the Department totally ignores the effects of the benefit in the form provided to a specific industry and looks only to whether the benefit is nominally available to more than a specific industry or group of industries.

This restrictive and exclusionary test will produce absurd, arbitrary and inequitable results as surely as a test that attempts to countervail all domestic subsidies. Such an aproach is almost certainly guaranteed to increase and leave unresolved trade disputes over the subsidizing effect of government programs. It can result in determinations of countervailability of sector specific programs which have virtually no trade distorting effect, while leaving untouched more widely available programs that have a very serious trade distorting effect or anti-competitive effect.

It has already produced inconsistent determinations. For instance, iron ore sold to steel products below its market value is countervailable, but energy resources sold below market value to energy-intensive industries is not. The natural resource subsidy amendment recognizes the criteria set out by the Court of International Trade and Article 11 of the GATT Subsidies Code by limiting countervailability to intensive users of the natural resource, but only where such subsidies cause injury.

Witnesses for the Administration also alleged that passage of the natural resource subsidy provision might result in foreign countries passing mirror legislation or taking action against U.S. subsidies. Specific examples of such U.S. subsidy programs that might be vulnerable were suggested, such as U.S. farm subsidies, U.S. natural gas price regulation, irrigation water, and hydroelectric power.

Mr. Holmer, General Counsel for USTR, testified that corn producers in Ontario, Canada had just recently filed a countervailing duty case on U.S. corn exports to Canada, citing over seventy U.S. farm subsidy programs as providing countervailable subsidies. Mr. Holmer stated that the Administration intended to assert that such programs were "generally available" and thus not countervailable.

An examination of the petition filed by the Ontario Corn Producers Association reveals that virtually every program listed is directed to the farm sector or to corn growers in particular. Many programs listed are generally available to farmers. The Canadian corn producers appear to give lip service to the specificity test or the generally available test. However, the petition draws a distinction on programs which are widely available "de jure" to all or many farmers, but argue such programs are a "de facto" benefit to U.S. corn growers. There appears to be little distinction between the position by the Canadian corn producers and the test to examine the competitive advantage and effect of domestic subsidy programs ordered by the Court of International Trade in its reversal of the Cabot case.

Mr. Holmer cited a dispute that arose in 1979-80 with the European Community, wherein the EC was alleging that U.S. regulation of natural gas prices below market value constituted a countervailable subsidy on U.S. exports of synthetic fibers and petrochemicals. It would certainly appear that the European Community did not draw a distinction on countervailability based on so-called "general availability" at that time. The Department of Commerce did not state such a test in any specific terms until 1982. On the best information available to us, it appears that the United States did not argue "general availability" at that time, but instead persuaded the EC not to bring such a case because the United States was phasing out its natural gas price regulation.

Under current market conditions, U.S. industrial gas users purchase natural gas at market clearing prices below remaining price ceilings. Thus natural gas is not sold at less than its fair market value. The natural resource subsidy amendment would not make price regulation per se countervailable. Such price regulation would be countervailable only if it set prices below fair market value to an energy-intensive user on a discriminatory basis to the extent the exported downstream products caused injury. Even under its price regulation program, the United States did not discriminate in the price or access to favor domestic manufacturers or energy-intensive users.

The provision by the U.S. Government of irrigation water at prices below its market value from federal water projects has been cited by the Administration and opponents to the legislation as the type of program that could become countervailable if this legislation were passed. Anyone familiar with federal water projects is aware that specific reservations are made in such projects for irrigation water. It is available only to farmers. It could thus be held to be sectoral specific even under current interpretations of U.S. law by the Commerce Department. It certainly is provided "de facto" to specific farmers or groups of farmers under the Canadian corn producers' petition. It may not provide a significant production cost advantage to U.S. farmers, however, in all cases. In such a case, it would have little subsidizing effect and provide little competitive benefit to specific farm exports. In such instances, it would appear that the natural resource subsidy amendment might well be more restrictive than current law.

A question was raised by Senator Heinz regarding how the natural resource subsidy amendment would apply to hydroelectric power. First of all, electricity is not a natural resource. The subsidy, if there is one, is created by the inadequate recovery of the capital cost of construction of the dam itself in the charges for electricity produced. Such electricity is generally provided on a regional basis. This is certainly the case with TVA, Bonneville Power, Hoover Dam, etc.

It can certainly be argued that the recent approval by the Congress of an extension of fifty year old electric rates from the hydroelectric project at Hoover Dam constitutes a domestic subsidy. It would be countervailable, however, under current law only if the electricity were exported directly at below market rates or if it were used to make products which were then exported. The countervailability of such products would be determined under the upstream subsidies provision approved by the Congress and enacted in the 1984 trade law revisions. Passage of the natural resource subsidies provision or mirror legislation would not change the result, whatever it might be.

The same kind of analysis can be conducted on almost any domestic subsidy provided by a government. This analysis does point out, however, that continued dogmatic insistence on the generally available rule being the sole determinant of countervailability will lead to arbitrary and inconsistent results. It indicates further that such a test would only create trade disputes not resolve them.

Examining the competitive effect of a benefit to a specific industry or group of industries without regard to its nominal availability to other industries offers a more rational and equitable approach to resolving trade disputes regarding domestic subsidies. This is clearly the criteria outlined by the Court of International Trade in the Cabot case. It is also fully consistent with paragraph 2 of Article 11 of the Subsidies Code, which looks at benefits which "adversely affect the conditions of normal competition" and which cause or threaten to cause injury.

It is ironic to note that in the late 1970's, when the GATT Subsidies Code was negotiated and U.S. countervailing duty law was amended, a major dispute between the Congress and the Treasury Department was that Department's refusal to countervail regional subsidies. It appears that the drafters of the GATT Subsidies Code clearly had this dispute in mind when they included the language in Article 11 that such subsidies are normally provided by sector or region.

Finally, several industry opponents to this legislation argued at the hearing that these amendments would countervail a "natural cost advantage" enjoyed by some natural resource rich countries. The issue of comparative advantage, which we assume the opponents were addressing, was not discussed extensively during the hearing.

One of the principal complaints of proponents of this legislation is that some countries which appear to enjoy a comparative advantage in energy resources, such as oil or gas, are using that comparative advantage in a highly discriminatory manner. In effect, these countries are providing oil, petroleum products or natural gas to their domestic industries through state-owned enterprises at their relatively low production costs. While such low production costs appear to represent a comparative advantage relative to demand in these countries, these governments or state-owned enterprises effectively deny access by competing industrial users to these natural resource at this same low price or cost.

It is this discriminatory pricing and access, usually exercised through state-owned enterprises, which is the basis of the complaint by some U.S. industries that these governments are providing an unfair subsidy that must be actionable. This form of discrimination provides an unfair and unbeatable competitive benefit to natural resource-intensive industries in such countries and adversely affects the conditions of normal competition by providing a huge incentive on the part of those industries to export downstream products made from natural resources. The proposed legislation recognizes comparative advantage in the "fair market value" standard in the bill. It would permit countervailing duties only when a government restricts its "natural cost advantage" to one class of industries -- domestic buyers -- but denies its "natural cost advantage" to other buyers -- competing producers in other available markets.

The proposed legislation directly addresses these discriminatory practices and the unfair competitive benefit provided to intensive users of natural resources like oil and gas in these countries. We do not dispute the sovereign right of such countries to promote internal economic development and other domestic social and political objectives through the pricing of their natural resources to their own industries. We do object when such practices are discriminatory; when they provide enormous incentives to export to certain industries to the exclusion of their competitors; when they unfairly distort competition; and when they injure U.S. producers.

The "fair market value" standard set out in the proposed legislation is the appropriate measure to determine the subsidizing effect of discriminatory pricing of natural resources. In most of these countries where these problems are occurring, the energy sector is owned or controlled by the state or through state enterprises. In these countries, there are virtually no internal domestic price benchmarks established by market forces. In these cases, it is appropriate to measure government-regulated internal prices against external market prices for the same resources or commodities. The use of such external benchmarks is not only the most realistic measure, but is explicitly recognized as an appropriate measure with regard to export subsidies. Annex A to the GATT Subsidies Code includes in its illustrative list of export subsidies one pertaining to preferential pricing of inputs. That item states:

> The delivery by governments or their agencies of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favorable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favorable than those commercially available on world markets to its exporters.

The refusal by the Department to use external market benchmarks to determine preferential rates for goods and services or whether capital or loans are provided on terms inconsistent with commercial considerations is irrational. It fails to recognize the realities of the marketplace and the subsidizing and competitive effect of these practices. It is inconsistent with the standards applied to measure export subsidies, even where the domestic subsidy has the same effect as if it were provided in the form of an export subsidy to the same industry.

STATEMENT OF GEORGE JANDACEK, VICE CHAIRMAN EMERITUS, CROWN CENTRAL PETROLEUM CO.; AND CHAIRMAN, INDEPENDENT REFINERS COALITION, BALTIMORE, MD

Mr. JANDACEK. Mr. Chairman, my name is George Jandacek, and I am chairman of the Independent Refiners Coalition and appear today in place of Mr. Dewey Mark of Diamond Shamrock who was unable to attend the hearing. I am testifying in support of S. 1292 and S. 1356.

Foreign governments with large crude oil reserves and little local demand in relation to their refining and production capacity now control about 50 percent of the free world refining capacity. The problems we face arise from the devices that these governments use to move their crude oil in a glutted marketplace. State oil companies can discount the price of crude oil to their own refineries and subsidize their operations. Although the refinery may lose money on every barrel it refines, the State oil company simply absorbs the loss in its profits from crude oil.

While the State oil company charges other oil buyers the market price for crude oil, their refineries get it for less. When they export refined products at lower prices this drives down the price of products in U.S. markets and prevent free enterprise companies from recovering their production cost. State oil companies also engage in processing deals with other refineries, which cause the same problem. Japan strictly controls gasoline imports and only refiners are allowed to import gasoline. The European gasoline tariff is about 100 percent higher than the U.S. tariff. The U.S. tariff was fixed in 1958 at 1¼ cents a gallon when gasoline was selling for a little over 11 cents a gallon and has never been adjusted to account for higher gasoline prices.

In addition, U.S. refiners face higher environmental costs than foreign refiners, and these costs give European and other foreign refiners a cost advantage of 6 to 10 cents per gallon of gasoline. As a result of these factors, U.S. gasoline imports have increased over 250 percent since 1982; and since 1983, over half a million barrels of U.S. refining capacity has been shut down by imports.

So much capacity has been shut down that the United States is becoming dependent on gasoline imports to meet domestic demands. State oil companies continue to add more excess refining capacity for export. The new capacity is simply not economical. You have to ask how they do it; and the answer is subsidized crude oil and subsidized capital. As more gasoline is exported into the glutted world market, gasoline prices will be further depressed and shut down more U.S. refineries. In order to defend ourselves against discriminatory crude oil discounting, we need legislation like S. 1292 and S. 1356.

These bills, while not solving the problem of inadequate U.S. tariffs, will give U.S. refiners their day in court to prove that state-owned oil companies are unfairly subsidizing foreign refineries. Thank you, sir.

Senator HEINZ. Thank you, Mr. Jandacek. Mr. Erb?

[The prepared written statement of Mr. Mark follows:]

STATEMENT OF DEWEY MARK
EXECUTIVE VICE PRESIDENT
DIAMOND SHAMROCK REFINING AND MARKETING COMPANY
ON BEHALF OF
THE INDEPENDENT REFINERS COALITION
BEFORE THE
INTERNATIONAL TRADE SUBCOMMITTEE
SENATE FINANCE COMMITTEE
U.S. SENATE

June 26, 1986

Mr. Chairman and Members of the Subcommittee:

I am Dewey Mark, Executive Vice-president of Diamond Shamrock Refining and Marketing Company. I am testifying today on behalf of my company and the Independent Refiners Coalition, a group of 32 independent U.S. refining companies, including the American Independent Refiners Association (AIRA), a trade association. Our coalition represents over two million barrels a day of U.S. refining capacity.

IRC Supports S. 1292 and Section 502 of S. 1356

We appreciate this opportunity to testify concerning the effect of discriminatory natural resource subsidies on our business. We also appreciate this opportunity to express our support for S. 1292, introduced by Senators Baucus and Long, and cosponsored by Senators Hollings, Symms, Cochran and Pressler. We also support the natural resource subsidy provision in S. 1356. This legislation is crucial to our companies and our employees.

We support S. 1292 and Section 502 of S. 1356 because these proposals address the natural resource subsidy problem which is one of the significant trade problems facing U.S. refiners. Under these bills, the discriminatory crude oil pricing practices which are being used by governments and causing injury to U.S. refining companies would be addressable under U.S. countervailing duty law.

Under these proposals, the "fair market value" of crude oil is the price a willing buyer would pay a willing seller, in an arms' length transaction, absent government intervention. The countervailing duty would be equal to the difference between the market price of crude oil and the discriminatory price. Because prices for oil are readily accessible in many world markets and denominated in dollars, this would be an easily administerable test with respect to refined products.

However, as necessary as these bills are, they will not completely or immediately solve the problems of domestic refiners. Also to be considered are problems of capital financing subsidies to build new export refineries, targeting of the U.S. market, inequitable tariff and non-tariff barriers which divert products to the U.S. market, and higher environmental costs borne by U.S. refiners that give an unfair competitive advantage to imported refined products, particularly gasoline and blendstocks.

The oil price collapse will result in higher levels of crude oil import dependence. While crude imports do not adversely affect U.S. refinery economics, imports of gasoline and other light products are damaging. If U.S. crude oil production drops by 1 million barrels per day or more, not all of the imports to replace it will be crude oil. Refined products will account for much of the increased import supply. U.S. refineries are geared to produce large quantities of gasoline for the demands of the U.S. market -- the world's largest consumer of gasoline, currently using about 6.8 million barrels a day or almost 50 percent of world gasoline consumption. Every barrel of imported gasoline displaces the need for about two barrels of U.S. oil refining capacity.

COMPETITION AGAINST GOVERNMENTS

The U.S. refining industry, like many energy-intensive U.S. industries, is increasingly competing against foreign governments. This is significant in itself, posing problems which are not purely problems of the marketplace.

Governments have tremendous power to alter the conditions of competition when they involve themselves in international trade as business entities. Many energy-rich foreign governments have nationalized the ownership of energy resources, and in the last few years have extended this monopoly ownership by building refineries.

In 1973, only 15 percent of free world refining capacity was government owned. This year, government ownership and control will extend over about 50 percent of free world refining. Including the non-market economy (NME) nations of the Soviet Union, Eastern Europe and China, the percentage of government ownership of world refining operations is overwhelming. Most of the projected additions to world refining capacity are also government-owned.

Many of these state oil companies simply run their crude oil into their refineries and sell the products for whatever they can get in the market. After deducting operating and transportation costs, the net return on the crude may be less than what they sell it for directly. If these refineries deduct depreciation and a return on investment, their net return on the crude input is even lower.

Even if the OPEC governments agree to production controls on crude oil this week, they can still supplement revenues by selling refined products without undermining the price of crude oil for a period of time.

In some cases, foreign export refineries were built with capital which was provided in low or no-interest loans by the governments. In addition, other concessions have been provided which give incentives to private oil companies to act as joint venture partners with governments. These factors characterize the activity of some OPEC governments in the Middle East. Some large new refineries, such as Saudi Arabia's Yanbu refinery, are dedicated to exporting products to the consuming nations, particularly the United States.

Energy-rich governments have also acted to ensure the movement of their crude oil by engaging in a variety of processing deals with selected refineries. These deals characterize the relationship between OPEC governments and many refining companies in Europe.

The third major factor has been the purchase of refineries and marketing chains in Western Europe and the United States by foreign governments. By doing so, governments have extended their control of product distribution directly into foreign markets.

Foreign governments, particularly in Europe and Japan, also exercise power by the erection of or threat of tariff and non-tariff barriers which divert product exports from their own nations and directly influence competitive conditions in the United States' refined products market.

The net result of these activities has been the rise of discriminatory crude oil pricing arrangements which have eroded the normal conditions of competition and worked to the disadvantage of U.S. domestic refiners. We see this disadvantage reflected in the increase in gasoline and gasoline blendstock exports to the United States, U.S. market prices for gasoline and other light refined products which do not recover refining costs and the cost of the crude used to make them, and the shutdown of U.S. refining capacity.

Independent U.S. refiners are particularly vulnerable to these practices, despite the fact that they are as modern and efficient as major integrated oil company refiners. If a refining company does not own crude oil production, then below-cost product prices cannot be offset by the profits made on crude oil sales. Under normal competitive conditions, refining companies compete on the basis of efficiency and market access. In the world energy market of the last few years, however, refining companies have been competing on the basis of their ability to withstand financial losses and their ability to strike deals with government oil suppliers.

While independents are most vulnerable, major integrated U.S. oil companies also experienced significant refining operation losses in the 1980s. The U.S. refining business was profitable in the last half of 1985 and the first quarter of 1986, after a long period of losses, but we must emphasize that the basic conditions which injured U.S. refiners over the course of several years have not changed at all. Margins are being squeezed again. With the volatility of both crude and product markets today, there is no way to assure a positive margin through efficiency of operation. Keep in mind that a refiner must buy crude oil 30 to 60 days in advance of the time he plans to run it into the refinery. These days, crude prices can change dramatically over that period of time. Product prices tend to follow the crude price up or down more quickly.

For these reasons it is essential that the Senate adopt S. 1292 or include it in a larger trade package. The U.S. policy of maintaining a free energy market must be supported against the discriminatory acts of foreign governments. When U.S. companies are injured by discrimination, they should be given the opportunity to prove the existence of unfair subsidies. Current trade laws are inadequate to address the problem. Attached to our testimony is a memorandum explaining the inadequacies of current law.

CRUDE OIL SUBSIDIES

Discounted Crude Oil

The general problem of crude oil discounting focuses on the OPEC governments in their dealings with their own state-owned refineries and joint-venture private partners. Not only is the practice unfair, it moves U.S. refining operations offshore.

In testimony last year before the Senate Energy Subcommittee on Energy Regulation and Conservation, Chairwoman Paula Stern indicated that energy feedstocks were being transferred by government agencies to state-owned refineries at prices substantially below world market prices. We have no information indicating that this practice has been stopped.

The Middle Eastern OPEC nations embarked on a massive wave of refinery construction in the late 1970s which is scheduled to be completed this year. In an internal EEC report released in June, the EEC Council of Ministers estimates that the new OPEC plants use one-third of their output for domestic consumption. Of the remainder, 40 percent is earmarked for the EEC, 25 percent to the United States, and 35 percent to the Far East and developing countries. The amount slated for sale in the Far East is unlikely to be achieved before 1990 due to restrictions by Japan. If Europe cuts off new imports at 40 percent, the balance will come to the U.S. or it will not be sold at all. Most of the gasoline is likely to come here, since primary European demand is for middle distillates, and because Europe already exports surplus gasoline to the United States. More gasoline exports to Europe will simply back out more European gasoline to the United States. The effect will be the same as if the gasoline were exported here directly from OPEC.

In 1985, Saudi Arabia was selling crude oil to joint-venture refinery partnerships, ostensibly at the Official Selling Price. These partnerships then sold the refined products to individual partners at PLATT's reported price. Based on reported prices in June 1985, for instance, the refined product prices were producing negative refining margins of over $2 per barrel. Clearly, the joint venture partnerships were selling refined products at prices which did not cover refining costs or produce any return on investment. Apparently, losses in such operations are absorbed by a lower return on crude oil.

Processing Deals

Processing deals are most prevalent between government suppliers in the Middle East and refineries in Europe. For instance, Italian refiners process a large quantity of Libyan crude oil on such deals. Essentially, the supplier consigns a crude oil to a refinery, which refines it into products and sells them on the market at whatever price can find a buyer. The refiner then deducts his "processing fee," which covers refinery operating costs (whether this fee covers profit cannot be determined), and pays the oil supplier the balance. Such deals are especially favorable to less efficient refineries which might not remain in business without guaranteed income in a depressed refined products market.

The same government oil supplier, however, is oftentimes selling oil on the open market at a higher price than is received from the return on the processing deal. In a glutted world market, oil suppliers have used such deals to ensure that more of their crude oil is sold while still maintaining higher market prices. This is a blatant form of discrimination.

The difference, of course, is that a refiner <u>buying</u> oil from the supplier is not <u>guaranteed</u> that his product prices will recover the cost of refining plus the price paid for the crude. If a refiner must sell at a price which recovers his costs, but is competing against a refiner whose cost recovery is guaranteed regardless of the price at which it sells, it is not hard to see which refiner will be hurt.

Governments As Marketers

Governments have also moved beyond the refining stage and purchased outlet chains in Europe and the United States. Kuwait has purchased a large chain of outlets in Europe. Petroven, the Venzuelan state oil company, recently bought into the Citgo oil company, a subsidiary of Southland Corporation, which owns the "7-11" chain of convenience store/gasoline outlets and operates gasoline refining operations.

EFFECT ON U.S. REFINERS

U.S. refiners have experienced several years of losses on refining operations based on market prices of crude oil. The government practices described above have contributed to a slow but sure erosion of U.S. refining capacity and an ever increasing import market share and dependence.

During the 1980s, the U.S. refining industry spent $12 billion to upgrade its facilities to make more light products out of heavier crude oils. The U.S. industry has been acknowledged in the trade press as being the most modern and flexible refining industry in the world today. According to a Pace Company study conducted in 1985, the only way that the new export refineries of the Middle East could penetrate the U.S. market consistently was by using subsidized or discounted crude oil.

President Reagan's total decontrol of the U.S. oil market in 1981 resulted in the closing of small refineries in the United States which had been built to take advantage of entitlements. This reduced total operating U.S. refinery capacity from about 18 million barrels a day to about 15 million barrels a day by 1983.

Since 1983, about 500,000 b/d of U.S. capacity has been shut down by low-priced gasoline imports. Current operating refining capacity in the United States is about 14.5 million b/d. These shutdowns have occured despite increasing U.S. gasoline demand.

The reason for the shutdowns is simple: the revenue from selling a barrel of refined products has been falling below the cost of refining operations and the cost of the crude oil input. This held true not only for U.S. refiners but also for foreign refiners. Netback analysis of the prices of imported gasoline between mid-1983 and mid-1985 showed that foreign refiners were also losing money on sales in the U.S. market based on official and spot prices for crude oil. Yet imports continued to increase.

Imports of gasoline and blendstock have increased significantly as a percentage of U.S. total gasoline demand. In 1980, these products accounted for only 2.6 percent of total U.S. gasoline demand. In the first quarter of 1986, they account for 6.6 percent of demand, running at roughly 500,000 b/d, up from 5.6 percent of demand in the year-ago quarter. However, a shift has occured in the composition of these imports. While imports of leaded gasoline and blendstocks have decreased, imports of finished unleaded gasoline have increased. Year to date March data shows that finished gasoline imports are up by 48 percent over the year-earlier quarter.

Europe as a whole is the largest refined product import supplier to the U.S. gasoline market, followed by Venezuela, Canada and Saudi Arabia. There is a good possibility that Libyan crude oil and product, which are banned from importation, are being shipped to the United States as gasoline and other refined products from European refineries. In addition, the EEC is a major importer of OPEC crude oil and many refineries are operating under OPEC processing deals.

The internal EEC report previously cited says that the utilization rate of EEC refineries has climbed to 70 percent in 1985 from only 59 percent in 1982. This means that there is still substantial EEC overcapacity, estimated by the EEC at 50 million tons (about 1 million b/d) compared to the 80 percent utilization goal for EEC refineries. The EEC plans to reduce its refinery capacity by at least 40 million tons (800,000 b/d) by 1990. Refined product imports from the new OPEC export refineries are expected to increase by a comparable amount. As a result, European refinery capacity utilization may not improve.

PRODUCT DIVERSION CAUSED BY FOREIGN TARIFF AND NON-TARIFF BARRIERS

U.S. refiners also face another government-based competitive disadvantage based on tariff and non-tariff barriers in the other major consuming regions of the world, Western Europe and Japan.

U.S. gasoline tariffs have not changed since 1958, when they were set at a flat rate of 1.25 cents per gallon. At that time, gasoline was selling for about 11.55 cents wholesale. On an *ad valorem* basis, the U.S. gasoline tariff in 1958 would have been 10.8 percent. Failure to increase the tariff as gasoline prices have increased has effectively reduced it. At today's gasoline prices, the flat rate tariff would be equivalent to 2.5 to 3 percent.

Western Europe places a 6 percent ad valorem tariff on any gasoline imports from the United States, while allowing the OPEC producers in the Middle East duty-free entry of product up to GSP limits. However, the threat of a tariff on shipments over the GSP limits acts to hold down imports from these nations.

At a price of 50 cents per gallon, the European ad valorem tariff on U.S. gasoline would be about 3 cents per gallon, over twice as high as our tariff. As the price goes up, so does the tariff, while our tariff remains flat. This has the effect of stopping two-way gasoline trade between Europe and the United States. European importation of refined products on a duty-free basis also serves to back European production out of Europe and into the U.S. market. This allows European refineries which otherwise might have closed to remain in operation by exporting to the U.S. market.

Japan has bowed slightly to pressure from the International Energy Agency to allow some gasoline imports. Imported gasoline can now enter the Japanese market, but it may only be purchased by Japanese refiners and will not be allowed to injure Japan's refining industry. Imports are less than 50,000 b/d and projected to hold at that level until 1990. MITI has announced a reduction in Japanese refining capacity on a planned schedule, not to be completed until 1990 or later. This controlled entry power enjoyed by Japanese refiners is not exactly an equitable policy. It will tend to divert products, especially gasoline, to the U.S.

U.S. REFINERS BEAR HIGHER ENVIRONMENTAL COSTS

U.S. refinery pollution abatement costs are estimated at $2.5 billion a year. These costs are not born by foreign refiners, and are equivalent to a net cost of 44 cents per barrel. Imports of refined products do not carry an equivalent cost.

U.S. lead phasedown requirements have created a cost advantage for foreign refiners in relation to U.S. refiners. This advantage will last until European refiners are also required to reduce lead -- possibly several years. Because gasoline is produced as components which are then blended together, refiners in countries which allow higher lead use rates can produce less expensive unleaded gasoline for export. Other nations allow up to 3.18 grams of lead per gallon for domestic use, while U.S. requirements allow only .1 gram of lead. In essence, foreign refiners can use the high octane portion of their total gasoline pool to make unleaded gasoline for export, while using more lead to enhance the lower octane components for use at home. This gives them a cost advantage estimated at 5.4 cents per gallon to about 9 cents per gallon. This advantage is not offset at the U.S. border on incoming gasoline shipments and there is nothing U.S. refiners can do to offset it in the short term.

Superfund taxes on refinery feedstocks also increase U.S. refiner costs and are about to increase again.

The net effect of these higher costs is to give foreign refiners, particularly in Europe, a 6¢ - 10¢ per gallon cost advantage on gasoline. It costs a European refiner about 3¢ per gallon to ship gasoline to the U.S. It is tariffed at 1.25¢ per gallon. This leaves the European refiner with a 1.75¢ to 5.75¢ advantage. In this low-margin business, that is enough to return a profit.

Clearly, U.S. gasoline tariffs have not kept pace with gasoline prices over the years, and don't come close to offsetting increased environmental costs imposed on U.S. refiners since 1958.

CONCLUSION

U.S. refiners cannot today use the countervailing duty laws or the anti-dumping laws to defend themselves against what are clearly unfair trade practices. Other laws, such as Section 301, also offer little hope of relief. The President has total discretion to decide whether to find these practices unfair; even if he decides they are unfair, he does not have to provide relief. The same holds true with regard to the effects of the tariff and non-tariff barriers, including the threat of tariffs by Europe or Japan. As any student of gasoline import figures knows, U.S. tariff classifications and schedules do not even accurately identify gasoline blendstocks, much less recognize the gasoline price increases since 1958 or serve to offset cost disadvantages imposed on U.S. refiners under our environmental laws.

S. 1292 and S. 1356 both provide an essential tool that U.S. refiners need to defend themselves. These bills will help in the long run, but we ask the Committee to consider more immediate and direct relief s well. We need immediate help to offset higher tariff and non-tariff barriers in Europe and Japan, as well as the higher environmental costs imposed by law. Otherwise, many U.S. refining companies may not survive to use the natural resource subsidy legislation.

STATEMENT OF GUY F. ERB, PRESIDENT, GFE LIMITED, WASHINGTON, DC; ON BEHALF OF CONSEJO EMPRESARIAL MEXICANO PARA ASUNTOS INTERNACIONALES, A.C.

Mr. ERB. Thank you, Senator. I am Guy Erb, and I am here today in representation of the Mexican Business Committee on International Affairs. With me is David R. Amerine from Brownstein, Zeidman and Schomer, representing the Chamber of Commerce of the State of Nuevo Leon, Mexico.

The bills on natural resource pricing are in conflict with American international trade commitments, unnecessary, and potentially harmful to U.S. industries and exporters.

Moreover, the bills intend to reduce United States trade with Mexico, our third trading partner, a country facing a severe domestic recession and a 50 percent decline in its earnings from oil exports, a loss that severely hampers its debt servicing ability.

Our own interests require that we consider the impact of arbitrary United States actions on Mexico. The countervailing duties which are proposed in these bills could directly threaten about $2 billion of Mexico's exports. That is over 1 percent of Mexico's GDP, over 10 percent of Mexico's exports to the United States, nearly 30 percent of Mexico's nonoil exports, and about 20 percent of Mexico's interest payments last year.

Mexico's trade and investment record does not deserve that sort of punishment. In February 1985, the President of Mexico announced five trade policy objectives: negotiations on a dispute with the pharmaceutical industry, signature of the subsidies agreement, accession to GATT, participation in the MTN, and consideration of a bilateral agreement with the United States. By November of last year, the Mexican Government had delivered on all those commitments.

In addition, Mexico has taken a number of steps to open its economy and create a vibrant financial sector. In addition to signing an agreement with the United States to reduce or eliminate export subsidies, Mexico has unilaterally reduced its tariffs and a wide range of domestic subsidies.

At this time, Mexico is negotiating with the United States on GATT accession, on its access to the U.S. Generalized System of Preferences, and is discussing a bilateral agreement on trade and investment with our Government. The Mexican Government and political and private leaders must constantly build in their country the political concensus that is necessary to sustain those policies. Unilateral United States action could weaken the Mexican constituency for a more open trade and investment regime, which is very much in our interest, and disrupt the policies that Mexico has followed since 1982.

We should not jeopardize with natural resources legislation the progress that both of our Nations have made toward a more open and efficient commercial relationship. Thank you.

Senator HEINZ. Mr. Erb, thank you. Mr. Blatchford?

[The prepared written statements of Messrs. Erb and Amerine follow:]

NATURAL RESOURCE PRICING LEGISLATION
TESTIMONY OF GUY F. ERB
JUNE 26, 1986

Mr. Chairman, I am grateful for the opportunity to appear before you today on behalf of CEMAI, Consejo Empresarial Mexicano para Asuntos Internacionales. CEMAI is an independent civil association supported by voluntary contributions from its members, which are 260 Mexican private companies. CEMAI's purpose is to promote the international economic relations of Mexican business.

Mr. Chairman, the natural resource subsidy proposals embodied in Senate bills S. 1292 and section 502 of S. 1356 would amend the U.S. countervailing duty law to treat as countervailable subsidies foreign government practices that provide natural resources to domestic producers at prices that differ from international prices.

The natural resource provisions in S. 1356 and S. 1292 would be an exercise in unilateral rulemaking by the United States, contrary to a well-established international consensus which the United States has helped to build and on which other countries have justifiably relied. The provisions are unnecessary. And they place America's own exporters at risk.

1. Trade Bills Would Violate Principle Of General Availability

The broad international consensus is that government programs of general availability are not domestic subsidies that will be treated as countervailable duties.

As the Deputy Trade Representative stated one year ago in testimony before the House Trade Subcommittee on H.R. 2451, a bill containing an identical natural resource provision:

> "The bill represents a fundamental departure from the policy developed jointly by Congress and the Executive Branch. This policy, which is clearly and specifically embodied in our law, is designed to separate out selective trade-distortive governmental actions

from general government measures. This policy represents the only rational countervailing duty procedure that can be administered by the U.S. and our trading partners. To depart from this policy brings the risk of dismantling the international consensus on countervailing duties which has been of such benefit to our domestic industries, both in protecting them from unfairly traded imports and in shielding our exports from harassment abroad."

The Deputy Trade Representative added that the proper test of the countervailability of a domestic subsidy is whether a government is providing benefits to a specific industry or specific group of industries, so that the subsidy is not "generally available" within the country. This is the standard that was enacted in the Trade Agreements Act of 1979 and is reflected in the GATT. Virtually every government in the world, in forging domestic economic programs, has relied on the principle that generally available subsidies do not violate the rules of international trade.

There is absolutely no basis for inferring that foreign officials have acted improperly or with any intent to take unfair advantage of the United States when they made their natural resources generally available to all domestic users at prices which did not follow the gyrations of world commodity markets. These resource programs have long been viewed as an effort to make use of a natural comparative advantage, and are wholly consistent with international trading rules. Under the proposed legislation the United States would be radically and unilaterally surcharging the export of countries that have sought in good faith to compete internationally on the basis of comparative advantage as widely understood.

The proposed trade bills are also inconsistent with the GATT and with Article 11(3) of the Subsidies Code, which states that domestic subsidies "granted either regionally or by sector" in the conduct of government economic policy are acceptable.

Moreover, if the United States were found to have violated the GATT, other countries would have a legal right to retaliate against our exports or enact mirror legislation. Although Mexico is not yet a GATT signatory, Mexico and CEMAI would regard unilateral U.S. expansion of the scope and applicability of countervailing duty law as a thinly disguised excuse for a tariff increase. At a time when Mexico has established a timetable to reduce many tariffs, it seems especially inappropriate for the United States to be, in effect, raising tariffs on Mexican exports.

2. Trade Legislation Is Unnecessary

Natural resource legislation is unnecessary. Present U.S. trade law already provides a remedy for the complaints that are at the heart of the present proposals. For example, the United States already has a right under its laws and Article XIX of the GATT to impose quotas or a tariff increase if imports are the substantial cause of serious injury or the threat of serious injury to a U.S. industry.

3. Negotiation Would Be a Better Means To Address U.S. Concerns

Given the importance of predictability and reliability in trade relations, if the United States seeks to change the rules of the game, it should do so through bilateral or multilateral negotiations with the country or countries that would be affected by such a change. In recent years Mexico has shown a new openness to trade and investment initiatives. If Congress believes that a given trade consensus or understanding is no longer useful, it should direct the President to explore the issue through discussions and negotiations with U.S. trading partners. But unilateral actions rejecting accepted and reasonable principles are arrogant as well as harmful to international trading relationships.

4. The U.S. Government Regularly Grants Generally Available Subsidies

The proposed Senate bills, in eliminating the general availability standard for subsidies, contradict time-honored U.S. practice. The U.S. government, like every other government in the world, provides many generally available subsidies. The United States government provides tax breaks, investment credits, price supports for agriculture, and various educational subsidies. Through government spending on defense, scientific research and space programs, high tech industries are heavily subsidized. The United States should not violate international rules for one sector and expect international reaction to be limited to that sector.

Even in the area of natural resource input subsidies, United States government programs are vulnerable to counter measures; a Congressional Research Service study concluded that the benefit from programs that support American industries and agricultural development could be considered natural resource subsidies. The U.S. government grants oil depletion allowances, special tax breaks for the timber industry, and other resource subsidies including Tennessee Valley electricity and various water projects. In the 1970s, the United States controlled oil prices, conferring dramatic cost savings on companies that made products using petroleum feedstocks. The government defended this policy as non-countervailable. The United States should be willing to play by the same rules it would have govern the conduct of other nations.

5. The Bills Would
<u>Harm U.S. Industry</u>

Natural resource legislation aims at imports from some of the most important trading partners of the United States, and would raise prices of industrial and agricultural inputs. A study by the Congressional Budget Office reports:

> "In general the effect of the legislation would be to cut off U.S. consumers from many of the lowest-priced suppliers of some goods and to shift sources of these products to higher-priced producers, both domestic and foreign. This effect would change U.S. employment and output in two ways. Duties might increase domestic production and employment in these and related industries. However, shifting U.S. consumption to more expensive sources of supply would reduce consumer income, which would, in turn, reduce the demand for both the good in question and many other goods. Hence, U.S. output and employment in other areas would decrease."

American agricultural, petrochemical and forest products industries, to name but a few, all utilize natural resource-derived products to produce downstream goods for export. If the prices of these basic products are driven up by duties, the export prices of the finished goods will also increase, thereby undermining their competitiveness in world markets. Therefore, the Senate bills are counterproductive for many U.S. industries even in the absence of likely retaliation by U.S. trading partners.

The enactment of natural resource legislation would negatively affect not only the U.S. economy, but that of Mexico, our third largest trading partner. Mexico bought nearly $14 billion worth of U.S. products in 1985. Each $1 billion of U.S. exports is estimated to generate about 25,000 jobs in the United States. Mexico purchases an average of 60% of its imports from the United States and depends heavily on its ability to export to the U.S. market. The legislation would cause a serious loss in Mexico's exports. The impact of the bills would be extremely detrimental to the Mexican economy and to U.S.-Mexico relations.

6. <u>Mexican Economy Is in Crisis</u>

The Mexican economy is currently experiencing one of the worst crises in its history. Mexico's $97 billion foreign debt, high unemployment, and negative growth rates have received much attention in the North American press recently. In its efforts to regain economic stability and growth, Mexico must look increasingly toward non-oil exports. The recent drop in the price of oil as well as the government's wish to achieve balanced development and service its debt all point to the importance of exports.

Apprehension exists in the United States regarding Mexico's ability to service its debt.

Mr. Chairman, Mexico's long-term ability to meet its external obligations and restore growth hinges on its access to U.S. markets for goods. At this time more than any other, it is crucial to keep those markets open to Mexican exporters. If the United States genuinely desires to give debtor nations an opportunity to repay, it must not deny Mexico this opportunity.

Mexico's standard of living has dropped 40% since 1982, and purchasing power is at 1972 levels. Government revenues have fallen 25% as a result of falling oil prices. By impeding Mexico's ability to export, the United States would cause a further deterioration in conditions in Mexico and so exacerbate the problems which already plague the bilateral relationship.

7. Mexico Has Demonstrated Flexibility on Trade Matters

Although Mexico is not the sole target of the proposed subsidy legislation, the Senate bills are especially ill-advised at the present moment in Mexican-U.S. relations. Mexico must have access to export markets if successful resolution of the external debt crisis is ever to be achieved. Moreover, Mexico has taken great strides in the past several years to open up its economy to the world, and especially to the United States, Mexico's largest trading partner.

Just over a year ago, Mexico entered into a bilateral subsidies agreement with the United States. Mexico is in the process of negotiations to further conform its trade practices to international norms through accession to the GATT. In addition, Mexico has slashed its import licensing program, and tariffs have been reduced on numerous items. Over a 30-month period Mexico has committed to a program of further tariff reductions.

President de la Madrid and others in his administration have expressed Mexico's willingness to enter into a bilateral trade and investment framework agreement with the United States to help resolve any outstanding bilateral issues. Given this recent history, the ill-advised proposals, apart from violating the rules of international trade, would penalize Mexico at a time when Mexico has demonstrated a spirit of cooperation on trade issues despite Mexico's economic woes. Passage of U.S. natural resources legislation would set back those in the Mexican government and private sector that support the gradual liberalization of the Mexican economy, increased trade with the United States, and the improvement of investment relations with U.S. companies.

8. Conclusion

S. 1292 and S. 1356 would be counterproductive to U.S. international trade policy. The proposed legislation is inconsistent with the principles underlying U.S. trade law and obligations under the GATT. It would harm U.S. exporters by inviting retaliation and reducing the revenue and hence the purchasing power of U.S. trading partners. The legislation would add to the depression of the Mexican economy, making debt service more difficult and bilateral relations more tense. For these reasons, CEMAI respectfully submits that the proposed natural resources legislation should not be enacted.

STATEMENT OF THE
CAMARA DE LA INDUSTRIA DE TRANSFORMACION
DE NUEVO LEON

(THE CHAMBER OF COMMERCE OF TRANSFORMATION INDUSTRIES
OF THE STATE OF NUEVO LEON, MEXICO)

Presented By
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Irwin P. Altschuler
David R. Amerine

June 24, 1986

I. INTRODUCTION

We are pleased to submit this statement with respect to S. 1292 and Section 502 of S. 1356, and similar proposed legislation concerning natural resource pricing policies, on behalf of the Camara de la Industria de Transformacion de Nuevo Leon ("CAINTRA," the Chamber of Commerce of Transformation Industries of Mexico's State of Nuevo Leon).

For the information of the Subcommittee, 75 percent of CAINTRA's 8,169 member companies are manufacturers; the remaining members are service-oriented firms. The companies comprising CAINTRA exported approximately $600 million worth of goods in 1984, while, during the same period, imported approximately $400 million worth of raw materials and equipment from the United States. CAINTRA member companies accounted for approximately 7.5 percent of the total value of exports of all Mexican manufactured goods, and its members accounted for approximately 10 percent of Mexico's total industrial production. CAINTRA members provide employment for some 200,000 workers, or 35 percent of all workers in the state of Nuevo Leon, which includes the major industrial city of Monterrey.

II. SUMMARY OF REMARKS

In considering the propriety and desirability of legislation designed to counteract certain perceived foreign producers' advantages stemming from foreign natural resource pricing practices, this Subcommittee will, of course, consider the broad implications of such legislation, as well as the specific impact which such legislation would have on certain U.S. industries. As explained in detail below, CAINTRA respectfully submits that legislation which would allow the imposition of countervailing duties with respect to foreign natural resource pricing (that is, the imposition of countervailing duties to offset the difference between the prices at which natural resources are sold to domestic industrial users and the prices at which such resources are sold for export) would be contrary to the overall policy interests of the United States. Moreover, it is submitted that, in many cases, the proposed drastic change in U.S. law would only provide an unwarranted windfall to financially healthy U.S. industries which have continued to enjoy prosperity and significant growth despite foreign competition, and regardless of the natural resource pricing practices of foreign governments. The views of CAINTRA may be summarized as follows:

(1) The intent of this legislation is inconsistent with general U.S. trade policy and fundamentally inconsistent with U.S. obligations under international law.

(2) The legislation unilaterally imposes price standards upon foreign government sales of natural resources contrary to U.S. government policy and practices.

(3) The legislation invites the possibility of retaliatory measures by U.S. trading partners -- measures which would make exported U.S. products more expensive in foreign markets, thus harming U.S. export-oriented industries and further increasing the U.S. trade deficit.

(4) Many U.S. trade partners, notably Mexico, depend on exports to generate U.S. dollars which in turn are used to purchase U.S. products. A reduction in exports to the United States would lead to decreased foreign purchasing power and, ultimately, to decreased sales of U.S. products abroad (particularly in Mexico).

(5) Mexico, which only recently experienced a partial recovery from an extreme economic crisis, is presently reeling from the effects of the dramatic collapse of the world market price for oil. Decreased revenue from manufactured exports, in combination with the decline in foreign exchange revenues from oil exports, would slow or reverse this economic recovery and impair Mexico's ability to honor loan obligations to banking in the United States.

(6) Central America is the site of increasing political unrest. An economically weak Mexico may destabilize the overall situation in Central America, further exacerbating the volatile situation in our hemisphere.

(7) The imposition of countervailing duties as a result of natural resource pricing practices of foreign governments would provide an unnecessary benefit to certain financially healthy and growing U.S. interests which, despite their proven ability to compete effectively against foreign competition, are nonetheless pressing for the proposed legislation.

III. STATEMENT OF CAINTRA

A. S. 502 and S. 1356 Contravenes U.S. Trade Policy And U.S. Obligations Under International Law

As the Subcommittee is well aware, international law distinguishes between generally applicable government programs and practices, on the one hand, and subsidies which are specifically related to export performance or directed toward specific industries or geographical regions. This distinction has been incorporated into U.S. trade policy and is specifically embodied in the United States' countervailing duty law. 19 U.S.C. § 1677(5). This distinction has its origin in the recognition of the fact that every nation has "comparative advantages" in certain economic areas, based on natural resources, climate, and location, and that trade law should promote the most efficient use of such comparative advantages.

Consequently, only those governmental programs which are specifically designed to confer benefits upon a particular industry or group of industries within a country are countervailable, since only such programs artificially shift the allocation of scarce resources within a country's economy and create advantages which otherwise would not exist for industries in a favored sector of the economy. It is only against these specifically directed programs, which tend to disproportionately benefit favored sectors of a country's economy, that the imposition of countervailing duties is justified and, to a certain extent, logical.

It is an internationally accepted function of government to establish generally applicable policies and programs for the utilization and development of a country's resources. Thus, a government must be expected and permitted to develop its country's natural resources and make them available to its people. Only when resources are provided to a specific sector of the country's economy on a preferential basis vis-a-vis other sectors, conferring advantages on such favored sectors which otherwise would not exist, that foreign governments should seek to adopt reactionary policies or laws.

In this context, all governments, including the government of the United States, play significant roles in developing and distributing their countries' resources and infrastructure. Each nation has the fundamental sovereign right under recognized principles of international law to establish domestic policies with respect to natural resources in order to promote the country's economic and social growth.

It is against this background that a rational international consensus has developed, distinguishing those programs which are permissible from those which are properly the subject of countervailing duties. This consensus is recognized in the GATT and the Subsidies Code, and has been incorporated into U.S. trade policy and law. (While Mexico is not a member of GATT, the recent U.S.-Mexico Bilateral Agreement on Subsidies and Countervailing Duties establishes rights and obligations similar to the principles embodied in GATT and its Subsidies Code. Moreover, Mexico is now negotiating its entry into GATT.) General recognition of these factors by all cooperating nations provides consistency and predictability in international commerce and trade policy. The creation of authority under U.S. law to impose countervailing duties with respect to natural resource pricing practices would directly contravene these recognized fundamental principles on which the international trading system is based.

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B. The Provision of Natural Resources at Less Than Prevailing World Market Prices Is Neither Unfair Nor A Subsidy

The proponents of natural resource subsidy legislation argue that foreign governments which provide natural resources to their domestic industries at less than prevailing world market prices are subsidizing their domestic industries. However, proponents of such legislation have overlooked the fact that governments throughout the world including the government of the United States, are motivated by broad general welfare considerations that may result in behavior different from that of a private company.

The United States Government has undertaken many large scale projects to develop natural resources and have provided the benefits of such projects to the United States public at prices less than that which would have been charged if the government intended to maximize its profit. For example, the Federal Government has been instrumental in developing the Tennessee Valley Authority, massive irrigation projects in the West including the Imperial Valley, and the construction and operation of hydroelectric power stations throughout the West and Northwestern regions of the country. Recently, Congress considered the extension of contracts that provide power generated at Hoover Dam at prices far below market rates. (Hoover Power Plant Act of 1984, Pub. Law 98-381). Numerous defenders of the Hoover Power Plant Act, from both parties and in both House of Congress, argued that the contracts would allow the government to charge enough to recover production costs and possibly earn some profit. Fundamentally, it was argued that throughout the history of the United States, the role of the Government in developing this nation's natural resources has never been that of a profit-maximizing entity.

The bill reauthorizing below-market pricing of hydroelectric power from the Hoover Dam passed both houses of Congress with substantial margins. The numerous statements in support of the legislation would certainly apply with equal force to the provision of natural resources by foreign governments to their own people:

> "The primary purpose of the Federal hydropower program is not to maximize revenue at taxpayer's expense but to sell power at the lowest possible rates ... and recover the Government's investment and operating expenses." (Rep. Jerry Patterson, D-Cal.)
>
> "[T]he whole concept of public power was one in which we said Government was

not going to make a profit on the power." (Rep. Allan Swift, D-Wash.)

"There is no subsidy involved. What is involved here is that the whole philosophy of Federal power production is that [sic] get cost recovery". (Rep. Mo Udall, D-Ariz.)

"The Federal Government is not in the power business to make a profit -- but to stimulate private development of energy resources. The purpose of the Federal power program has never been to maximize revenue but to sell power from public projects at the lowest possible rates that would recover the Government's investment and pay all operating expenses. The projects should pay their own way -- and Hoover does." (Rep. Howard Berman, D-Calif.)

"There is no subsidy inherent in the concept of tying the price of power to its cost of production. This is the way 98 percent of all power in America is priced." (Sen. Chic Hecht, R-Idaho).

"The Federal Government is not in the business to make a profit ... [I]n each of [its] investments we have done it at the lowest possible price in order to give the people of this country ... an opportunity to better themselves... [T]he policy which has been held in this country, in my view, for virtually all of its 200 year history ... [is] to build this infrastructure for what it costs and to regain those costs, but not to make a profit beyond that ... I think it has been a good policy, it is a good policy, and will continue to be a good policy." (Sen. Daniel Evans. R-Wash.)

"While some will argue that we should not be selling Federal power at below-market rates, the primary purpose of the Federal power program is not to maximize the Government's revenues but to sell power from public projects at the lowest possible rates to consumers

> that will recover the Government's investments and pay the operating expenses." (Sen. Dennis DeConcini, D-Ariz.)

In summary, it has long been recognized by Congress that the regulation and development -- and pricing -- of the United States natural resources are within the scope of legitimate, sovereign government activities, and that such development does not constitute a "subsidy". For the United States to have benefited during its 200 year history by opening up the natural resources of this country to development, and then refuse to recognize this legitimate right on the part of other countries, and in particular our neighbor to the south, Mexico, can only serve to undermine the position of the United States as the leading advocate of free and fair international trade.

C. U.S. Trade Partners Could Be Expected To Retaliate By Imposing Countervailing Duties With Respect To U.S. Programs

If S. 1292, section 520 of S. 1356, or any similar bill, were to become law, providing authority to impose countervailing duties with respect to natural resource pricing practices, the international consensus among U.S. trade partners concerning the underlying principles of countervailing duties would be broken and any reciprocal obligations on the part of these nations could not be enforced. The U.S. would be violating international trade norms, thus inviting U.S. trade partners to do likewise with respect to the United States.

Like every other government in the world, the United States has many generally available programs such as tax incentives, a system of price supports for farmers, and a highly developed water resource system. Also, through defense, scientific research, and space programs, the U.S. spends large sums of money on high technology industries. Thus, the United States currently provides numerous benefits to its industries on an across-the-board basis. Contravention of generally accepted international trade principles is a two-way street. The United States cannot unilaterally modify accepted international rules and expect the rest of the world to continue to abide by them. Thus, breach of the generally accepted trade policy for natural resources could have a far-reaching, and to some extent unforeseeable, impact for U.S. industry.

Even if foreign governments were to follow the general approach of S. 1292, and its like, and limit themselves to natural resource inputs, U.S. trade partners could impose countervailing duties with respect to a number of U.S. government programs, including oil depletion allowances, price controls on natural gas, Tennessee Valley Authority electricity, Western dams and irrigation projects, and government coal and oil leases.

The imposition of countervailing duties on U.S. goods sold in foreign markets with respect to the U.S. programs mentioned above would make U.S. exports more expensive, and therefore less marketable in external markets, thereby harming U.S. export industries. If enacted this legislation could set in motion a process which would ultimately harm U.S. producers. Moreover, the expected harm to U.S. export-oriented industries would further increase the U.S. trade deficit, undercutting one important purpose of this legislation.

D. A Healthy Mexican Economy Is Important To U.S. Interests

There is no question that one of the main targets of natural resources pricing legislation is Mexico. However, passage of natural resource pricing legislation with the possible resultant imposition of countervailing duty on imports from Mexico could have devastating effects on United States-Mexico relations. The imposition of countervailing duties with respect to natural resource pricing practices would result in higher prices on products imported into the United States and would decrease foreign access to U.S. markets. As a result, exports to the United States would decrease, accompanied by a corresponding reduction in revenue earned by foreign interests. Many U.S. trade partners, and especially Mexico, depend on dollars earned from exports to the United States to purchase imported products from the United States. Thus, higher U.S. duties and decreased exports to the United States would ultimately result in significant harm to U.S. export-oriented industries.

Mexico represents a perfect illustration of the inter-relationship between U.S. exports and U.S. imports of foreign products. Mexico is the third largest trading partner of the United States -- the United States is both Mexico's leading supplier and biggest customer. In 1984 Mexico earned $18 billion in revenue from exports to the United States. The significance of this fact is clear when one considers that approximately 66 percent of the revenue which Mexico obtains from exports is used to purchase goods from the United States.

However, as officials have frequently been quoted, Mexico will only be able to maintain its imports insofar as [it] generates the means to pay for them. Mexican President de la Madrid, during an interview in 1983, succinctly put the problem in the following perspective:

> Our foreign debt is very high and its servicing is a heavy burden. Consequently, our capacity to import, to buy from the United States, is going to depend on the possibility that Mexico increases its exports to the United States.

The consequence to the U.S. economy from decreased Mexican revenue from exports is significant. In 1982, due to a lack of foreign exchange, Mexico was forced to cut its imports from the United States by one-third, resulting in the loss of thousands of jobs in the U.S. economy. The Bank of Mexico reported that in 1983 Mexico imported approximately $10 billion fewer goods and services from the United States than in 1982. A study prepared by the Office of Trade and Investment Analysis of the U.S. Department of Commerce has found that approximately 25,200 U.S. jobs are generated by each billion dollars of exports. Therefore, <u>the $10 billion decline in U.S. exports to Mexico translates into over one-quarter million lost U.S. jobs</u>.

Mexico was only recently recovering from the near economic collapse in the last half of 1982. This economic crisis was brought about by Mexico's staggering foreign debt, and was further aggravated by the decline in world oil prices and the worldwide recession which reduced the demand for Mexican exports. The beginning of Mexico's recovery was brought about only by drastic cuts in public spending and reduction in borrowing. The fragile state of this recovery is evident by the grave concern over the ability of Mexico to maintain its admirable record of payment of the interest on its massive foreign debt now that its oil export revenues have been sliced in half. In early 1985, prior to the recent collapse in oil prices, Mexico cut its budget by $1.25 billion to compensate for a decline in export earnings and an increasing inflation rate. The precarious state of Mexico's economy could be pushed beyond bearable limits by a further decrease in export revenues caused by the imposition of countervailing duties as a result of natural resource pricing policies. As stated previously, such a drastic downturn in the Mexican economy would have a substantial negative impact on the U.S. economy.

E. <u>The Mexican Government Has Implemented A Policy Of Drastic Increases In Natural Resource Prices For Mexican Domestic Industrial Users</u>

CAINTRA believes it is important to stress that, over the past few years, the Government of Mexico has implemented a policy of drastically raising prices for natural resource inputs. Proponents of natural resource pricing legislation often point to the Mexican Government's domestic and export pricing of oil and natural gas as an example of the type of practice that would be potentially countervailable under the proposed legislation. As explained below, such contentions are greatly misplaced since the Government of Mexico has implemented a policy of increasing domestic prices of oil and natural gas in line with their export prices.

The rate of increase in the prices paid by Mexican manufacturers for natural resource inputs has risen dramatically since 1982, the year of Mexico's major economic crisis. As Table A1, attached hereto, illustrates, from December 1982 to December 1984, the prices charged Mexican industrial users for natural gas increased 687.65 percent, from 1.70 pesos per cubic meter to 13.39 pesos per cubic meter. Similar increases in prices during this period occurred with fuel oil -- prices for Nos. 2 and 6 fuel oil rose, respectively, 685.01 percent (from 1224.55 pesos to 9612.85 pesos) and 692.15 percent (from 1054.55 pesos to 8353.60 pesos).

These price increases are not only substantial, but also ongoing. As Table A2 demonstrates, during the last quarter of 1984, prices for natural gas increased 9.84 percent, and prices for fuel oil 7.84 percent (No. 2) and 7.74 percent (No. 6), over a three-month period. Table A3 demonstrates that the price increases which began in 1982 continued throughout 1984 and 1985. In 1984, prices for natural gas for industrial uses increased by 97% and oil prices increased by 60 % over 1983 price levels. In 1985, both natural gas and oil prices increased by almost 115% over 1984 price levels.

Such large price increases for energy supplies are reflected in Mexico's national consumer price index (see Exhibit B), which shows the overall index of prices for petroleum products and their derivatives increasing from an indexed price of 621.3 in January 1983 to an indexed price of 1,290.1 in December 1984. Thus, notwithstanding the inflationary impact to its domestic economy, Mexico has demonstrated its commitment to eliminate policies which have caused growing concern in the United States.

It may be asked, in light of Mexico's unilateral price increases for natural gas and oil, why CAINTRA and others in Mexico remain so strongly opposed to passage of S. 1292 or similar legislation. In response to such a question CAINTRA would like to stress two points. First, since Mexico has unilaterally acted to eliminate the source of concern for U.S. law makers, why should Congress persist in enacting legislation which the administration and the major trading partners of the United States find so objectionable to internationally accepted concepts of countervailable domestic subsidies? Is the national interest of the United States well served by the passage of legislation which offers other nations the unassailable right of retaliation against U.S. exports?

Second, Caintra believes the establishment of a "fair market value" concept for foreign natural resource pricing in the United States countervailing duty law establishes a potential source of trade disputes that could be triggered by forces beyond the control of the Mexico, the United States or any foreign country.

Proposed natural resource pricing legislation would require the administering authority to calculate a "fair market value" by referring to the prices "a willing buyer would pay a willing seller" from the exporting country in an arms-length transaction, taking into account among other functions:

(i) the export price of the product;

(ii) the prices at which the product is generally available in world markets,

(iii) the current market clearing price at which the product can be sold competitively by the exporting country in the market of other, non-state controlled economy countries.

Implicit in the statutory definition of "fair market value" is the requirement that foreign governments must maximize profits on the sale of natural resources, regardless of what impact such pricing strategies may have on domestic development. Clearly, such U.S. mandated pricing determinations are contrary to the pricing practices of the United States government and represent an intolerable interference in the right of sovereign nations to expoit their natural resources in accordance with national needs. Second, calculation of fair market value is subject to uncontrollable changes in foreign exchange rates. For example, reference to "world market prices" will typically require reference to prices of commodities expressed in U.S. dollars. For a country facing sudden or even prolonged currency devaluations, domestic natural resource prices would have to be adjusted on an almost daily basis simply to avoid price differentials and the possible imposition of countervailing duties upon exports to the United States. Clearly, such daily pricing decisions for basic raw materials is impractical, if not impossible. However, legislation pending before the U.S. Congress makes no allowance for changes in the "fair market price of material resources caused solely by exchange rate fluctuations.

F. Repayment Of Mexico's Foreign Debt <u>Is Dependent Upon Earnings From Exports</u>

One of the most difficult problems facing Mexico continues to be its foreign debt, which, during the period 1980 - 1982 swelled by $47 billion, increasing Mexico's total indebtedness to $88 billion in 1985, and which now stands at almost $100 billion. In August 1982, Mexico was forced to ask for a 90-day moratorium on its principal repayments, which was twice extended, and ultimately ran through August 1983. By the summer of 1983, Mexico had succeeded in refinancing its foreign debt, which alleviated some of the most pressing economic problems facing the Mexican economy. However, interest payments on its foreign debt in 1984 were projected to account for $12 billion, or approximately 75 percent of all revenue from oil exports, and accounted for approximately 22.7 percent of Mexico's total 1985 budget.

Much of Mexico's foreign debt is held by U.S. banks. In order to continue to service and repay this debt, Mexico must continue to earn substantial sums of foreign exchange. The primary source of this necessary foreign currency is and must continue to be exports to the United States. Thus, the proposed legislation would seriously hamper Mexico's ability to repay its debts, with obvious negative consequences for the United States.

G. The Continued Stability Of Mexico Is Dependent Upon Its Economic Health

Mexico's continuing economic crisis has been, and should be, a cause of concern for U.S. policy-makers, due to the potential impact of this crisis on Mexico's overall stability. Mexico's impressive# record of stable civilian government had long been thought to be dependent upon the consistent, and often spectacular, rates of economic growth experienced by Mexico over the past years. As the Mexican economy began to falter in 1982, many observers anticipated increased political and social unrest, with its concomitant destabilizing effect on the government. Mexico has managed thus far to stabilize its economic crisis and maintain political stability. However, even absent passage of natural resource pricing legislation and its intended decrease in imports from Mexico, its economy remains in precarious condition, and its continued political stability a source of continued concern in the United States.

Central America has increasingly become a major focus of U.S. foreign policy. Economic instability leads to political instability, and Mexico, located on the U.S. southern border, stands not only as one of the few remaining democratic states, but also as the most stable nation in this troubled area. It is in the United States' best interest to help Mexico maintain this stability. The imposition of countervailing duties with respect to natural resource pricing practices, as stated previously, would only serve to weaken the Mexican economy. Thus, while this measure might prove of some short-term benefit to a limited sector of the U.S. economy, its ultimate effect will be harmful both politically and economically. Conversely, a stable Mexican economy enhances the political stability of the government and benefits both the economic and national interests of the United States.

H. H.R. 2451 Would Provide An Unnecessary Windfall To Healthy U.S. Industries -- The Flat Glass Industry Example

A number of U.S. industries have been active in seeking passage of the proposed natural resources pricing legislation, even though it is clear that they are experiencing no difficulty whatsoever in competing against imports. One good example of this is the U.S. flat glass industry.

During the last two years, the U.S. flat glass industry has benefited from a resurgence in demand for automobiles and housing. As a result, companies comprising the U.S. domestic industry have continued to grow. The health of this industry is best reflected by U.S. manufacturers' shipments of flat glass which increased 46.33 percent from 1982 to 1984.1/ In 1983, imports of flat glass from Mexico accounted for 0.38 percent (by value) of total U.S. manufacturers' shipments; in 1984 this figure rose to 0.59 percent.2/ To argue that such imports could have any impact on U.S. manufacturers, or the U.S. market for flat glass, is untenable. Indeed, U.S. manufacturers' performance over the past two years clearly illustrates that they have been unaffected by imports of flat glass from Mexico.

PPG Industries, Inc. ("PPG"), the largest flat glass manufacturer in both the United States and the world, during the 1982-1984 period saw its net sales on its flat glass operations increase 19.43 percent, while the operating earnings on its flat glass operations increased a remarkable 114.09 percent.3/

AFG Industries, Inc. ("AFG"), the second most significant flat glass manufacturer in the country, has seen its phenomenal financial performance continue in 1984. Since 1978, AFG 4/

1/ Bureau of the Census, Current Industrial Reports: Flat Glass (MQ32A (84)-4).

2/ Bureau of the Census, IM 146.

3/ PPG Industries, Inc., SEC Form 10-K (1984).

4/ AFT Industries, Inc., SEC Form 10-K (1984) and 1983); November 26, 1984 Progress Report, J.C. Bradford & Co.

has been the fastest growing glass producer in the United States; sales have risen at an annual rate of 23 percent, earnings per share at a 55 percent rate, and return on equity has averaged 22 percent. Revenues in 1984 were up 30.84 percent over 1983 (a record year), and 53.33 percent over 1982. Net income in 1984 was up 66.57 percent over 1983 and 149.00 percent over 1982. This performance earned AFG a rank of 15 out of 1,200 companies in Business Week's "Corporate Scoreboard" in 1984.

From this brief survey of leading U.S. flat glass manufacturers, it is clear that their operations are, and will remain, unaffected by imports from Mexico. Any argument to the contrary is refuted by the facts as presented above. The U.S. manufacturers' claim of being at a competitive disadvantage as a result of the Government of Mexico's natural resource pricing policies is likewise without merit. As recently acknowledged by Eugene Mosier, PPG Glass Group Vice President, "to compete in today's market, it is important to be close to customers in every sense of the word." Geographic proximity is a major advantage that U.S. producers will always have over Mexican and other foreign producers of flat glass. This proximity to its customers is an advantage which will offset any advantage, real or imagined, from which the U.S. industry believes foreign manufacturers benefit.

CAINTRA respectfully submits that even if the proposed legislation would benefit certain specific U.S. industries, it is clear that such benefit may well be an unnecessary windfall for U.S. industries which are actually at no competitive disadvantage whatsoever.

IV. CONCLUSION

S. 1292 and similar bills would be economically and politically counter-productive to U.S. international trade policy and U.S.# export-oriented industries. The proposed legislation is inconsistent with U.S. trade law and obligations under the GATT. The legislation would harm U.S. export-oriented industries by inviting U.S. trade partners to adopt similar measures, and by reducing earnings of U.S. trade partners from exports to the United States, thus reducing available revenue to purchase U.S. products.

With specific regard to Mexico, the proposed legislation would further depress the Mexican economy, making it difficult for Mexico to honor its substantial loan obligations to United States creditors. Moreover, an economically weak Mexico would be vulnerable to political destabilization, further exacerbating an already troublesome situation in Central America. Finally, the benefits which would be conferred upon certain U.S. industries as a result of the proposed legislation represents an unwarranted windfall, inasmuch as these U.S.

industries have demonstrated their ability to compete without difficulty against imported merchandise.

For all of the reasons set forth herein, CAINTRA respectfully submits that the proposed natural resources pricing legislation should not be enacted.

Respectfully submitted,

Irwin P. Altschuler
David R. Amerine

Counsel for CAINTRA

EXHIBIT A

TABLE A1

Pemex Pricing*
1982-1984
(Pesos/Cubic Meter)

	Natural Gas	Fuel Oil #2	Fuel Oil #6
December, 1982	1.70	1,224.55	1,054.55
December, 1983	6.19	4,706.95	4,041.10
December, 1984	13.39	9,612.85	8,353.60
% Change			
1982-1983	+264.12%	+284.38%	+283.21%
1983-1984	+116.32%	+104.23%	+106.72%
1982-1984	+687.65%	+685.01%	+692.15%

*Includes VAT

TABLE A2

Pemex Pricing*
October-December, 1984
(Pesos/Cubic Meter)

	Natural Gas	Fuel Oil #2	Fuel Oil #6
1984			
October	12.19	8,913.65	7,753.30
November	12.79	9,263.25	8,053.45
December	13.39	9,612.85	8,353.60
% Change			
October-November	+4.92%	+3.92%	+3.87%
November-December	+4.69%	+3.77%	+3.73%
October-December	+9.84%	+7.84%	+7.74%

*Includes VAT

TABLE A3

Pemex Pricing
1984-1985

	Natural Gas (Pesos/m3)		Fuel Oil (Pesos/Lt)	
	1984	1985	1984	1985
January	5.9043	12.1652	4.458	7.525
February	6.4261	12.6870	4.458	7.786
March	6.9478	13.2087	4.980	8.047
April	7.4696	13.730.	5.241	8.308
May	7.9913	14.2522	5.437	8.569
June	8.5130	14.7739	5.698	8.830
July	9.0348	15.2957	5.959	9.091
August	9.5565	15.8174	6.220	9.352
September	10.0783	16.3391	6.481	9.613
October	10.6000	16.8609	6.742	9.874
November	11.1217	17.3826	7.003	10.135
December	11.6435	26.1305	7.264	15.557

EXHIBIT B

PRESENTACION

El Banco de México, buscando informar mejor sobre los principales aspectos de la economía nacional, ha resuelto modificar la presentación de sus *Indicadores Económicos*.

La nueva presentación —en forma de carpeta con hojas sustituibles— concentra las cifras más significativas para medir el comportamiento económico, ofreciéndolas al usuario en una forma clara, sistemática y de fácil consulta. La actualización periódica de la carpeta permitirá al usuario disponer de la información con mayor oportunidad. Además, se amplía la cobertura de las estadísticas que se publicaban, y que se generan tanto en esta institución como en otras entidades del Sector Público. En el nuevo formato también se incluyen explicaciones metodológicas que aclaran la naturaleza de las cifras presentadas y facilitan su interpretación.

La publicación consta de un resumen general y de cuatro secciones en que se presentan los indicadores financieros y fiscales, los relativos a la actividad industrial, los de precios y los del sector externo. A su vez, cada sección se divide en dos partes: la primera detalla la información mensual más oportuna y la segunda, contiene un acervo histórico. Cabe advertir que algunos de los datos más recientes son preliminares y, por lo tanto, están sujetos a revisión.

BANCO DE MEXICO

Subdirección de Investigación Económica

INDICE NACIONAL DE PRECIOS AL CONSUMIDOR*

Base 1978 = 100

CUADRO III-2

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STATEMENT OF JOSEPH H. BLATCHFORD, O'CONNOR & HANNON, WASHINGTON, DC; ON BEHALF OF THE MEXICAN CEMENT AND CARBON BLACK INDUSTRIES

Mr. BLATCHFORD. Thank you, Mr. Chairman. I appear before you today on behalf of the Mexican carbon black and cement industries to put into perspective the true character of the damaging effect of the so-called natural resources subsidy legislation. The proposals which you are considering represent the most blatant form of special interest legislation. They are designed to protect four U.S. industries from foreign competition at the expense of the U.S. consumer and the U.S. worker.

These industries are the ammonia, carbon black, cement, and lumber industries. The legislation is the result of failed attempts by some of the industries to have the natural resource pricing policies of Mexico declared export subsidies. In fact, the Commerce Department has found that energy sold in Mexico is generally available for purchase and use by any industry or consumer, whether United States or Mexican owned and controlled. Thus, there is no preferential pricing policy in Mexico designed to aid industries which happen to export to the United States.

Now, if I could clear up some of the misconceptions being used by the U.S. industries to advance this protectionist legislation. First, whatever pricing advantages may have existed in Mexico several years ago when the natural resource subsidy bandwagon first got rolling have disappeared. World energy prices have dropped dramatically. At the same time, internal Mexican prices through a concerted effort by the Mexican Government have risen sharply.

For instance, the recent average price of natural gas sold in Mexico was a little over $2.00 per MMBtu, while the spot market price in the United States has been about $1.75 per MMBtu and has fallen as low as $1.35 per MMBtu.

Comparison to natural gas prices, however, has little relevance to the alleged resource subsidy benefit enjoyed by the Mexican cement industry over the United States cement industry. The reason for that is in the United States over 93 percent of all U.S. cement manufacturers use coal, not natural gas, not oil, and not electricity as their energy source. United States cement producers who use coal currently pay approximately $1.39 per MMBtu for their coal-produced energy, versus the cost of $2.00 per MMBtu paid by Mexican cement producers using Mexican natural gas.

Thus, Mexican cement producers can hardly be found to enjoy a natural resource pricing benefit in comparison with their United States counterparts. With regard to carbon black, the exports of Mexican carbon black to the United States are de minimus when compared to the total United States production. In addition the Mexican carbon black is generally lesser quality than United States produced carbon black, and the two Mexican carbon black producers buy their carbon black feedstock from the Mexican Government at a profit to the Mexican Government. In Mexico, the feedstocks are considered a waste product; they have no other use. This is not the case in the United States, and the U.S. carbon black producers may have to compete for carbon black feedstocks with other U.S. uses such as petroleum pitch.

I will shorten my testimony. I see the red light going on. But I think it is important to point out that PEMEX sells energy in Mexico at a price which affords it a profit and which reflects the market demand in Mexico. PEMEX exports petroleum products in the United States; it sells them at a competitive market clearing price in the United States as well. There is really no difference. It is no different, for instance, then the U.S. coal producers who sell coal for export higher than they sell it domestically.

I don't think that this is the time—as Mr. Erb said—and others will say this is not the time to kick Mexico when they have got great difficulties with their own economy and a great trade relationship with the United States.

Senator HEINZ. Thank you. Mr. Wurster?

[The prepared written statement of Mr. Blatchford follows:]

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE

Summary Statement
OF JOSEPH H. BLATCHFORD
on Behalf of
THE MEXICAN CARBON BLACK AND CEMENT INDUSTRIES

June 26, 1986

Legislation currently pending in Congress, such as S. 1292 and Section 502 of S. 1356, would impose duties and other trade sanctions on products exported to the United States that are produced from government-owned or controlled natural resources. Basically, this type of legislation will penalize foreign producers for utilizing a country's natural resource comparative advantage in the production of goods destined for the United States.

Traditionally, the United States and its trading partners have followed the policy established by the General Agreement on Tariffs and Trade ("GATT") that nations possess a sovereign right to regulate or control the price of their natural resources, provided no preference is given to an industry or group of industries. Current attempts to pass a natural resource subsidy law represent an attack on this widely recognized principle by certain isolated American companies.

The real effect of natural resource subsidy legislation would be to prevent any country from utilizing a natural resource cost advantage in world trade competition. Such an outcome would fly in the face of accepted principles of "general availability"/competitive advantage. In fact, other countries could use the natural resource legislation as a basis for justifying retaliation against United States government-provided benefits such as cheap hydroelectric power, tax benefits and federal highway aid.

The proposed legislation singles out Mexican industries in an attempt to protect market shares in the cement and carbon black industries and not to remedy an international trade unfairness. An analysis of Mexican-based competition to these industries demonstrates the _de minimis_ trade impact the importation of Mexican produced cement and carbon black has on United States markets and underscores the hollow and self-serving nature of the asserted needs for natural resource legislation.

While the Mexican government controls the production and price of its primary natural resources, it sells these resources above cost and at a profit. The simple economic facts are that costs of producing and distributing energy in Mexico are less than in the United States. The basic energy supplies in Mexico are greater than in the United States, but demand is much less in Mexico which has a lower standard of living and is not industry intensive. Even so, some current energy prices in the U.S. actually are lower than costs for the same fuel in Mexico, i.e. coal and natural gas.

STATEMENT OF WILLIAM H. WURSTER, PRESIDENT, CONAGRA INTERNATIONAL, BRYN MAWR, PA

Mr. WURSTER. Good afternoon, gentlemen. My name is Bill Wurster. I am president of ConAgra International, and I represent my parent company, ConAgra, Inc.

ConAgra employs 30,000 people in 48 States with annual sales of over $6 billion, and we operate across the entire food chain from the farm to the table. We are a major supplier of inputs to the farmer and we are a major buyer from that same farmer of all kinds of products. My particular company, ConAgra International, is a worldwide trading company with 35 offices in 25 countries. Among other things, we are involved in importing nitrogen fertilizer, and we distribute it throughout the United States; and we are also a major buyer from the American producers as well.

It is our strong belief that this proposed legislation will be harmful to the U.S. economy and devastating to the American farmer. The farmer is already on his back; why kick him further now? To put this into perspective, fertilizer is the largest item of the variable cost to most grain farmers.

For example, fertilizer accounts for as high as 26 percent of the corn farmer costs. U.S. duties will certainly invite retaliation by other countries to enact similar restrictions. Further, many fertilizer exporting countries are good customers for U.S. grain. This kind of protectionism will cause them to buy elsewhere. Surely, that is counterproductive. The inevitable result is that U.S. agricultural products will be less competitive in world markets as our competition utilizes cheaper fertilizer.

Exports will be reduced at a time when our agriculture exports are already down 36 percent from 1981. Real farm income will be reduced when it is already at an all-time low. All of us should be concerned about this kind of protectionism.

Why should you—why should we—be concerned about agriculture in particular? First of all, it is the Nation's largest industry. We account for over 20 percent of the jobs in this country and more than 50 percent of our assets. It is the largest contributor to our balance of trade. We are worried about our trade deficit with good reason, but why kick at one of the best sources of our income?

We account for more than $330 billion in the past decade. Two out of every five acres in this country which are being farmed are being exported—the product therefrom. This legislation, as it affects fertilizer, is anticompetitive. Furthermore, the chief beneficiaries of this proposed legislation, as to ammonia, would be two large domestic producers of nitrogen, which desire exemptions for their imports from Canada and from Trinidad. The House included this provision in its bill. This unfairly compounds the anticompetitive character of the legislation further.

I close with this thought: Nobody today has spoken for the farmer. I urge this committee to contact the large farm groups, for instance the wheatgrowers and the soybean growers. Soybeans don't use fertilizer, but they do export. I believe these groups also oppose this protectionist legislation.

Senator HEINZ. Mr. Wurster, thank you very much. Mr. Lippke?

[The prepared written statement of Mr. Wurster follows:]

Synopsis of Statement of
William H. Wurster
President and Chief Operating Officer
ConAgra International

I. IDENTITY

- I AM BILL WURSTER, PRESIDENT, CONAGRA INTERNATIONAL REPRESENTING MY PARENT COMPANY CONAGRA, INC.

- CONAGRA EMPLOYS 30,000 PEOPLE IN 48 STATES WITH ANNUAL SALES OF $6 BILLION AND OPERATES ACROSS THE ENTIRE FOOD CHAIN FROM FARM TO TABLE. WE ARE A MAJOR SUPPLIER OF INPUTS TO THE FARMER AND A MAJOR BUYER OF FARM PRODUCTS.

- MY PARTICULAR COMPANY IS A WORLD WIDE TRADING COMPANY WITH 35 TRADING OFFICES IN 25 COUNTRIES. AMONG OTHER THINGS, WE ARE INVOLVED IN NITROGEN FERTILIZER IMPORTING AND DISTRIBUTION AND ALSO PURCHASE PRODUCTS DOMESTICALLY.

- I HAVE BEEN IN THIS BUSINESS 36 YEARS, ACTIVELY TRADING FERTILIZER AND MANY OTHER PRODUCTS IN ALL PARTS OF THE WORLD.

- I REQUESTED THIS OPPORTUNITY TO TESTIFY DUE TO CONAGRA'S AND MY OWN DEEP CONCERN FOR THE NEGATIVE IMPACT OF PROTECTIONIST LEGISLATION FOCUSED ON NATURAL RESOURCES.

- IT IS OUR STRONG BELIEF THAT LEGISLATION IN THIS AREA WILL BE HARMFUL TO THE U.S. ECONOMY AND IS DEVASTATING TO U.S. FARMERS AT A TIME WHEN THEY ALREADY ARE IN CONSIDERABLE DIFFICULTY.

ConAgra International 937 Haverford Road, Bryn Mawr, PA 19010 (215) 527-3767

II. THIS LEGISLATION IS HARMFUL TO U.S. AGRICULTURE.

- IMPORT DUTIES WILL RAISE THE PRICE OF FERTILIZER TO THE FARMER BECAUSE THEY ESTABLISH A PRICE FLOOR FOR FERTILIZER INPUTS HIGHER THAN THE PREVAILING WORLD PRICE.

- TO PUT THIS IN PERSPECTIVE, FERTILIZER IS THE LARGEST ITEM OF VARIABLE COST TO MOST GRAIN FARMERS. FOR EXAMPLE, FERTILIZER ACCOUNTS FOR OVER 25% OF FEEDGRAIN FARMER COSTS.

- U.S. DUTIES WILL CERTAINLY INVITE RETALIATION BY OTHER COUNTRIES TO ENACT SIMILAR RESTRICTIONS. MANY OF THESE COUNTRIES PRODUCE FERTILIZER AS A GOVERNMENT INDUSTRY. FURTHER, MANY FERTILIZER EXPORTING COUNTRIES ARE GOOD CUSTOMERS FOR U.S. GRAIN. THIS KIND OF PROTECTIONISM WILL CAUSE THEM TO BUY ELSEWHERE.

- THE INEVITABLE RESULT IS THAT U.S. AGRICULTURAL PRODUCTS WILL BE LESS COMPETITIVE IN WORLD MARKETS, AS OUR COMPETITORS UTILIZE CHEAPER FERTILIZER. EXPORTS WILL BE REDUCED AT A TIME WHEN OUR AGRICULTURE EXPORTS ALREADY ARE DOWN 36% FROM 1981.

- HIGHER FERTILIZER PRICES AND LOSS OF EXPORTS HAVE BEEN ESTIMATED BY WHARTON ECONOMETRICS FORECASTING ASSOCIATES TO RESULT IN A DRAMATIC LOSS OF NEARLY 10% OF FARM INCOME AT A TIME WHEN REAL NET FARM INCOME IS THE LOWEST SINCE THE DEPRESSION OF THE 1930's. MORE LAND WILL NEED TO BE TAKEN OUT OF PRODUCTION AND FARMER EXPENDITURES FOR INPUTS, INCLUDING FERTILIZER, WILL DROP SHARPLY.

III. IN A BROADER SENSE, ALL OF US SHOULD BE CONCERNED ABOUT THE NEGATIVE EFFECT ON THE U.S. ECONOMY...OF THIS KIND OF PROTECTIONISM. WHY SHOULD YOU BE CONCERNED ABOUT AGRICULTURE IN PARTICULAR?

- IT IS THE NATION'S LARGEST INDUSTRY, ACCOUNTING FOR OVER 20% OF JOBS IN THIS COUNTRY AND OVER 50% OF ASSETS.

- IT IS THE LARGEST CONTRIBUTOR TO BALANCE OF TRADE, ACCOUNTING FOR $330 BILLION OF EXPORTS OVER THE LAST DECADE. TWO OF 5 ACRES FARMED ARE EXPORTED.

- THE U.S. BALANCE OF PAYMENTS WILL BE SERIOUSLY IMPACTED, SINCE AGRICULTURE IS THE LARGEST POSITIVE CONTRIBUTOR.

- MANY COUNTRIES AFFECTED BY THIS LEGISLATION ARE NATIONS WITH SERIOUS DEBT PROBLEMS, MUCH OF IT WITH U.S. BANKS. THEY NEED EXPORTS TO SERVICE THESE DEBTS. RAISES THE LIKELIHOOD OF DEFAULTS ON FOREIGN DEBT.

- RAISES COST OF FARM PROGRAMS DESIGNED TO INCREASE EXPORTS, WHILE THIS LEGISLATION REDUCES EXPORTS.

STATEMENT OF BRUCE R. LIPPKE, PRESIDENT, WHARTON ECONOMETRIC FORECASTING ASSOCIATES, PHILADELPHIA, PA; ON BEHALF OF THE COALITION TO PROMOTE AMERICA'S TRADE, ACCOMPANIED BY CHARLENE BARSHEFSKY, COUNSEL TO THE COALITION

Mr. LIPPKE. Thank you, Senator. I am Bruce Lippke, president of Wharton Econometrics, an international economic consulting company in Philadelphia. I have with me Charlene Barshefsky, counsel to the PAT Coalition, who will be happy to answer any questions.

This bill would have very serious negative impacts on the economy. Our simulations show the legislation will take away gains in our standard of living that have resulted from the free trade of products with natural cost advantages. The bill cannot distinguish between subsidy or a natural cost advantage, at the resource level or at the processing level. It cannot distinguish between cost differences for export distribution or domestic distribution. It establishes instead tariffs which eliminate any of these cost advantages.

Countries negatively impacted should be expected to retaliate. They are basically export dependent upon natural resource products. They have foreign exchange problems which require them to respond to restore any losses. We expect Canada and Mexico to be the most affected, and they are very unlikely to export surplus to countries of Asia and Europe, which have created our trade deficit problems.

Our analysis of the economic impact of the tariff, which we calculated for petrochemicals and other sectors, shows that the jobs gained by the protected sectors are only about 8,000 compared to job losses by the more labor-intensive users of natural resource products of as much as 185,000 jobs, even without retaliation, rising to something like 263,000 jobs with retaliation. With the higher costs that go with these tariffs, real disposable income by 1994 declines by $28 million in 1985 dollars, rising to as high as $41 billion with retaliation.

Farm income, the most severely impacted sector, would decline by some $5 million without retaliation and by as much as $16 billion under retaliation since it is the most easy to retaliate against. With lower income, unemployment compensation would increase transfer payments by something like $11 billion by 1984, rising to $13 billion with retaliation. Now, unfair trade laws are aimed at producers who do not rely on natural cost advantages.

This legislation overreaches and it taxes natural cost advantages which have been major contributors to both U.S. and world growth. The bill has inflationary and unstable economic implications for products where we are not resource self-sufficient. Thank you.

Senator HEINZ. Mr. Lippke, thank you very much.

[The prepared written statement of Mr. Lippke follows:]

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THE MACROECONOMIC IMPACTS OF IMPLEMENTING NATURAL RESOURCE TRADE LEGISLATION

Statement of

BRUCE R. LIPPKE
President

Wharton Econometric Forecasting Associates
3624 Science Center
Philadelphia, PA 19104

Before the
SUBCOMMITTEE ON TRADE
of the
SENATE FINANCE COMMITTEE

June 26, 1986

WHARTON ECONOMETRIC FORECASTING ASSOCIATES

THE MACROECONOMIC IMPACTS OF IMPLEMENTING NATURAL RESOURCE TRADE LEGISLATION

OVERVIEW

Mr. Chairman, I am pleased to appear before this subcommittee to discuss the views of Wharton Econometrics regarding the macroeconomic impact of implementing natural resource legislation.

Wharton's Long-Term Model of the U.S. economy was used to estimate over the 1986-94 period the direction and size of changes in output, employment, income, and prices which would result following the passage of natural resource legislation. Wharton's Long-Term Model has evolved over the years from the original research done by Professor Lawrence Klein--Nobel Laureate, the founder of our firm, and still our Professional Board Chairman. The Long-Term inter-industry model is uniquely able to simulate how the impact on one industry sector affects other sectors who purchase those intermediate goods and, ultimately, the final consumers who purchase finished goods. As a consequence, it allows us to test the total economic impact of policy changes such as tariff legislation on the different sectors of the economy and by consolidation, the total net impact.

The results of our analyses of natural resource legislation are extremely disturbing because the jobs which would be saved in the domestic ammonia, petrochemical, carbon black and soft lumber industry, which we looked at most thoroughly, are more than offset by job losses in other industries. The bottom line of this analysis is that there would be a net job loss of as much as 185,000 jobs while the protected industries would gain only about 8,000 jobs.

We have examined the effect of the natural resource legislation under two kinds of scenarios. The first is with no retaliation by the affected foreign countries, and the second including retaliation. In our view, the likelihood of retaliation is very high, but

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the exact form of that retaliation is certainly less well known. Hence, we have described these as separate cases.

With the assumption that the foreign countries which would be hurt by natural resource legislation would not retaliate, the key impacts on the U.S. economy of implementing the legislation were estimated--and we assumed it to be effective January 1st of 1986 with mid-1985 economic starting conditions. The U.S. output or GNP for all sectors would be reduced by $55 billion measured in 1985 dollars over the 1986 to 1994 period.

Economy wide, the job losses would reach 185,000 while the net job gains in the protected sectors would be 8,000. Due primarily to higher fertilizer prices net U.S. farm income would be reduced, on average, by some $600 million per year over that same period for a total loss of $5.4 billion. The reductions in farm income and output due to those higher fertilizer prices would reduce the number working on farms by as much as 26,000.

Real personal disposal income would be lower over that same period by some $28 billion (1985 dollars). Unemployment roles would be expanded by as much as 175,000 during that period.

And, of course, consumer prices would be higher as a consequence of the duties levied, on average, by .5 percent during the time period. Higher unemployment and lower personal income would cause Federal outlays for transfers, such as unemployment compensation, to increase by $11 billion over the same period. The Federal debt would be raised by about $5 billion due to the reduced receipts from other taxes and higher outlays.

The results obtained assuming no retaliation show that implementing natural resources legislation would have a high economic cost to the U.S. overall. We believe that the negative impact of the legislation would be even higher of course, because the countries which lost sales to the U.S. as a result of the legislation would be inclined to retaliate--some by necessity. Canada, Mexico, the Soviet Union, Saudi Arabia, Venezuela, are among countries likely to retaliate.

Before describing the economic impact on the U.S. arising from retaliation by foreign governments, let me explain why this legislation which is designed to protect several specific sectors is so counterproductive to the nation as a whole. It is important to see why duties related to natural resources are particularly ineffective as protectionist legislation.

During much of our nation's history, we have been resource rich, and over those years we have developed facilities to convert the abundant resources into products using less and less labor with more and more capital in the primary processing conversion industries. In the same time period, more labor was devoted to finishing processes and service sectors. As the economy grew and U.S. resources became in limited supply, low cost imports were also used in primary processing conversion to support the more labor intensive finishing processes.

Now, since the legislation only protects our capital intensive processing industries at the expense of industries that must consume these goods in more labor intensive finishing processes, the number of jobs that would be protected in response to increased prices and output would be quite low. And, these gains are small when compared to the jobs that would be lost by the more labor intensive sectors that have to pay higher prices for purchased intermediate products as inputs in the production of their finished products.

In this kind of analysis, we typically run several alternatives to test the range of key assumptions. We change some of the price assumptions and some of the supply responses. In this particular situation, varying those assumptions would only change somewhat the ratio of the jobs lost to the jobs gained. The dominant result would still be

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that far more jobs would be lost resulting from the higher prices than jobs gained by the protected sectors. The key is this: if there is no price impact, there is no gain to the protected sector. If there is a significant price impact, there are more downstream jobs lost than jobs protected.

I hope that makes it somewhat clearer why this particular legislation does not have an overall positive jobs impact.

Analysts at CBO who have reviewed our study and evaluated the impact of the legislation on specific sectors, while differing on certain specific price assumptions are in substantial agreement on the directional impact which this legislation would have, and the problems raised by the legislation including:

- The risk of causing substantial price increases in U.S. markets for the products subjected to a tariff under the legislation.

- The risk that the legislation would be applied to many products and countries thereby having a much broader impact on trade than the framers of the legislation may have intended. Products which the CBO (CBO study, p. 9) believes might be held dutiable include petrochemicals, refined oil products, nitrogenous fertilizers, carbon black, cement, softwood lumber, pulpwood, newsprint, plywood, lime, ceramic tiles, float glass, and some primary metals.

- The risk of applying the legislation arbitrarily due to the inherent and extreme uncertainty surrounding the definition and measurement of "fair market value".

- The risk that the legislation will help OPEC and other commodity cartels maintain world product prices above clearing levels.

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- The risk that the foreign countries which lose sales in the U.S. due to the legislation would retaliate against U.S. exports.

- The risk that other countries will enact similar (mirror) legislation to exclude from their markets the U.S. products which enjoy natural resource subsidies. The U.S. products at risk according to the CBO (CBO study, pp.27-28) include petrochemicals produced by firms outside the old intrastate gas markets, farm products produced with the help of federally subsidized irrigation projects, products such as aluminum, produced using low (below market) cost hydroelectric power from federal projects like BPA or TVA, and even products produced by firms gaining a cost advantage under federal tax laws from provisions such as the reforestation investment tax credit.

The CBO study admits that its conclusions are based on a narrow interpretation of the legislation's applicability which we believe to be inaccurate, hence they have underestimated several price effects and substantially underestablished the negative economic impact. In a more general context, they agreed that under broader interpretations, substantial price increases in some markets would be almost inevitable.

A point quite apart from the factors CBO considered is the additional point that as imports become more expensive, increased demand for U.S. supplied resources further increases U.S. prices and decreases the demand for the foreign resources. As a result, foreign prices decline. In effect, over time, the duty itself will increase the market price differential between U.S. product prices and prices in the countries exporting to the U.S. Since the legislation specifies that these price differentials be used to establish the magnitude of the duty, the apparent "subsidy" and duty will continue to increase until

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there are effectively no imports as a result of the legislation.

I believe the proposed legislation will have very unstable economic implications with very inflationary tendencies even beyond those CBO found or the initial impact of the duty on prices, which we have characterized. The U.S. could over time be forced to pay very high prices for any natural resource not in adequate supply within the U.S. Our estimates of the negative impacts on the economy could prove to be far too optimistic as we did not assume the market price differentials and resulting duties would continue to increase.

The proposed legislation is a direct attack on the benefits of trading in products for which countries have a comparative advantage and, hence, lower production costs.

In summary, there should not be any disagreement that:

(1) If the legislation does not have a significant impact on prices, it does not offer any protection for the U.S. producer.

(2) If the legislation succeeds in providing some protection to a U.S. producing sector, there will be a significant price impact and that in turn will affect consumers and other producers who must pay higher prices in their intermediate use of the products.

(3) If the impact is significant, there is good reason to believe that there will be retaliation. Indeed, some of the affected countries' foreign exchange position requires a policy response if their export opportunities are adversely impacted.

Now, I would like to describe the more probable situation of foreign retaliation. As I said, we believe that to be the likely case for many of those countries directly affected. If retaliation were to occur, the negative impacts on selected indicators would be from 20 to 30 percent worse than for our no retaliation case, ranging to more than a doubling of the loss in income on the farm sector, which we believe to be the most vulnerable sector to retaliation.

By our estimates, real GNP would be cut by $80 billion over the time period that

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we talked about before. Net economy wide employment losses would be as great as 263,000 while the gains to the protected sectors would actually decline. Job losses in agriculture would be as much as 35,000. Net farm income would be reduced by about $1.8 billion per year on the average for a cummulative impact over the time period from 1986 to 1984 of $16 billion. Real disposable income would be reduced by some $41 billion (1985 dollars).

Unemployed roles would be expanded by as much as 237,000 during that period. Federal unemployment compensation and other transfer costs would rise by almost $13 billion over this same time period, and the Federal debt would rise by $21 billion. By 1994, the cumulative U.S. trade balance would deteriorate under retaliation by $7 billion.

The ultimate costs of implementing natural resource legislation could be, of course, much greater than I have described, because we have not considered any retaliation of a comparable sort on the part of the European countries or any trade war that cascades from one country doing something, and another country having to do the same thing, and it spreading from one country to another. If that were the case, of course, you would basically unravel a considerable part of the world's growth over the past 10 to 20 years that has been derived from each country sharing their comparative advantages with other countries. Indeed, this legislation directly attacks a country's use of its comparative advantage.

Now, while we do not believe that the natural resource legislation is the solution, we do recognize that the U.S. has been at a serious disadvantage in the international marketplace, due primarily to the high value of the dollar. The dollar has been declining and export opportunities are just beginning to improve. Our analysis has shown an 18 month lag between major currency adjustments and a significant impact on product markets, and markets are now responding. Efforts at reducing the Federal deficit will contribute significantly to reducing the nation's need for capital inflow. Basically, a

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lower deficit would ease pressures on the credit markets, and lead to a decline in real interest rates. This would be a very good omen for the capital intensive sectors.

As interest rates decline, the value of the dollar declines, and this result would then make all of U.S. industries more competitive in the international arena. As a result, U.S. exports would be increased and imports to the U.S. would be less competitive with U.S. production, instead of becoming the target of increased protectionism.

Thank you.

The Honorable John C. Danforth
497 Russell Senate Office Building
Washington, DC 20510

Dear Senator Danforth:

During the hearings held on June 26, 1986 on natural resources tariff legislation (S. 1292), several references were made by other speakers contrasting the Congressional Budget Office study and a study done by Economic Perspectives, Inc. to the Wharton study. Since those statements were fundamentally misleading, I would like to share with you Wharton's analysis of these studies.

The Congressional Budget Office Study

The Congressional Budget Office (CBO) study entitled Effects of Countervailing Duties on Natural Resource Input Subsidies (CBO Staff Working Paper, September 1985; hereinafter CBO study) analyzes the probable impacts of implementing natural resource subsidy legislation which is now under consideration by Congress (H.R. 2451 and S. 1292).

We believe that the CBO has done an excellent technical job of identifying the risks and discussing the many problems associated with the proposed legislation, including:

- The risk of causing substantial price increases in U.S. markets for the products subjected to a tariff under the legislation.

- The risk that the legislation would be applied to many products and countries thereby having a much broader impact on trade than the framers of the legislation may have intended. Products which the CBO (CBO study, p. 9) believes might be held dutiable include petrochemicals, refined oil products, nitrogenous fertilizers, carbon black, cement, softwood lumber, pulpwood, newsprint, plywood, lime, ceramic tiles, float glass, and some primary metals.

- The risk of applying the legislation arbitrarily due to the inherent and extreme uncertainty surrounding the definition and measurement of "fair market value".

- The risk that the legislation will help OPEC and other commodity cartels maintain world product prices above market clearing levels.

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- The risk that the foreign countries which lose sales in the U.S. due to the legislation would retaliate against U.S. exports.

- The risk that other countries will enact similar (mirror) legislation to exclude from their markets the U.S. products which enjoy natural resource subsidies. The U.S. products at risk according to the CBO (CBO study, pp. 27-28) include petrochemicals produced by firms outside the old intrastate gas markets, farm products produced with the help of federally subsidized irrigation projects, products such as aluminum, produced using low (below market) cost hydroelectric power from federal projects like BPA or TVA, and even products produced by firms gaining a cost advantage under federal tax laws from provisions such as the reforestation investment tax credit.

Wharton's concern with the CBO study relates to the assumptions that CBO made in arriving at their summary conclusion that the "legislation could result in small increases in the price of many goods, but would not have substantial aggregate economic effects" (CBO study, p. 1). As the CBO itself states, this conclusion is based on a narrow interpretation of the legislations' applicability which we believe to be inaccurate, thereby substantially understating the negative economic impacts of the bills. In the body of their study, the CBO considers alternative broader interpretations of the legislation's applicability and concludes that, in some markets, substantial price increases would then be almost inevitable. This broader interpretation did not, however, form the basis for CBO's summary conclusions. It is, therefore, noteworthy that even under CBO's narrow interpretation of the bills' applicability, CBO states that the legislation would not provide the effects desired by its proponents. If low cost imports continue to be available from many countries and U.S. prices for these products do not rise significantly, then the profitability of U.S. firms would not be improved and no additional jobs would be created in these U.S. industries (see CBO study, p. 2 and p. 17). CBO did not do an economic impact analysis like the Wharton study. They simply inferred a wide range of results depending upon a narrow versus broad interpretationof the legislation.

When Wharton prepared its own analysis of the bills' impacts, we, unlike the CBO, did not assume that H.R. 2451 and S. 1292 would be narrowly interpreted. Our conclusion as to the potential scope of the bills was based on our reading of the language in the bills, legal advice concerning the interpretation of this language, and on numerous public statements made by sponsors and proponents of the legislation. The results of the Wharton analysis were presented to Congress (The Macroeconomic Impacts of Implementing Natural Resource Subsidy Legislation, Testimony by Bruce Lippke and George Schink before the Subcommittee on Trade of the Committee on Ways and Means, June 6, 1985; hereinafter Wharton study) and a revised study using more recent economic starting conditions were presented by Bruce Lippke before the Senate Finance Subcommittee, June 10, 1986. The key assumptions underlying the CBO and Wharton studies are as follows:

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CBO Assumptions	Wharton Assumptions
o The legislation would not lead to a duty on petrochemical or nitrogenous fertilizer imports from Canada or Saudi Arabia (only Mexico would be affected).	o The legislation would apply to imports of petrochemicals and nitrogenous fertilizer from Canada and Saudi Arabia.
o The legislation would not lead to a duty on nitrogenous fertilizer imports from the Soviet Union	o The legislation would apply to imports of nitrogenous fertilizer from the Soviet Union.
o The tariff on natural gas based products from Mexico would be computed on the basis of the difference between the now low Texas spot price and the Mexican internal price.	o The tariff on Mexican natural gas based products would be computed using the difference between the official Mexican export price and the Mexican internal price for natural gas.
o The tariff on imported petrochemical products (from Mexico) would not lead to higher U.S. prices for petrochemical products due to excess U.S. capacity and the continued availability of inexpensive products particularly from Canada and Saudi Arabia.	o The tariff on imported products would lead to equivalent increases in U.S. petrochemical product prices because: -- The duty would raise the prices of the least cost suppliers (the import suppliers) thereby allowing all prices to rise by an equivalent amount. /- The duty would apply to Canada and Saudi Arabia as well as to Mexico. -- Despite excess U.S. capacity in petrochemicals, prices would rise due to the oligopolistic nature of the market and because the price leaders would be restricted by tariffs.

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CBO Assumptions (continued)

- The increase in U.S. nitrogenous fertilizer prices would be small because of the continued availability of a substantial volume of low cost imports from Canada and the Soviet Union. The CBO states (CBO study, p. 18), however, that "sizeable price increases would become almost inevitable" if Canada and Soviet imports were held dutiable. The CBO goes on to state that these higher fertilizer prices would result in a "loss in farm income".
- A substantial increase will occur in U.S. softwood lumber prices due to the duty on Canadian softwood.
- The CBO does recognize the risk of retaliation by the countries directly impacted by the legislation, but does not factor this into its summary conclusion.
- The CBO considers the risk of mirror legislation but the potential impacts are excluded from its summary conclusion.

Wharton Assumptions (continued)

- Nitrogenous fertilizer prices would rise by an equivalent amount because:
  - the least cost suppliers (the import suppliers) would be subject to a duty thereby allowing all prices to rise by the amount of the duty due to the oligopolistic nature of the market.
  - two key importers, Canada and the Soviet Union, would be subject to a duty, thereby resulting in "sizeable price increases" as stated by the CBO.
- Softwood lumber prices will increase by the amount of the duty, which is very close to the CBO assumption.
- While Wharton presents a no retaliation scenario, the retaliation scenario is considered most likely. Wharton thus calculates the effects of retaliation in its study.
- Wharton did not consider the impacts of mirror legislation in its analysis, but considers such legislation a substantial risk. Mirror legislation includes not only retaliatory legislation against U.S. exports, but also parallel legislation enacted by European countries to prevent diversion of Mexican, Saudi, and Canadian products into European markets.

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Given the CBO's restrictive reading of the legislation and the assumptions that flow from such a reading, it is not surprising that the CBO expects small price increases and a small negative effect on the U.S. economy. Wharton's assumptions lead to substantial impacts. We concluded in our study that U.S. product prices would rise significantly and that the macroeconomic costs would be substantial; specifically Wharton concluded that the legislation would lead to a job loss of 275,000 if the foreign countries directly impacted did not retaliate, and a 385,000 job loss if retaliaton occurred.

The CBO (CBO study, p. 18) states that it believes that the "Wharton analysis appears to overstate the likely price and income effects of the bill" because the "Wharton study has taken a more pessimistic view than CBO with regard to a number of issues." These issues have been outlined above. As is evident from a detailed comparison of assumptions, however, we believe the CBO results understate the likely negative impact of the legislation. The CBO has taken a far more optimistic view than Wharton with regard to the issues outlined below, and we believe that our assumptions are more realistic than those adopted by the CBO.

Difference in timing of the two studies. The Wharton study, used as a basis for the testimony to the House Subcommittee, was begun in early 1985 and used 1984 average prices to calculate the duties implied by the language of H.R. 2451 and S. 1292. The CBO study was done in July and August 1985 and used mid-1985 prices in its calculations. Since energy prices softened between 1984 and mid-1985, duties calculated on the basis of mid-1985 prices for natural gas and petroleum based products would be smaller. We reevaluated the macroeconomic impacts of the bills using mid-1985 prices for natural gas and petroleum and selected an alternative external price for Mexican natural gas. The revised estimates based on mid-1985 prices were used as a basis for the testimony to the Senate Subcommittee. Mexican sales of natural gas to the U.S. dropped to zero in 1985, and therefore, we adopted a price below the official Mexican export price in computing the duty. However, unlike the CBO, we did not adopt the Texas spot price as the external price because the spot market price is not appropriate. If Mexico were to increase sales, it would negotiate large volume contracts, and the Texas spot price is considerably below the prices paid under current large volume contracts. In recalculating the duty on Mexican natural gas based products for 1985, therefore, we used the average price paid over the first 4 months of 1985 by electric utilities to pipeline companies for natural gas used in electricity generation. This is a representative large volume contract price. Using this contract price, rather than the spot price used by CBO, makes a substantial difference in the implied duty because the large volume contract price is $3.74 per mcf while the Texas spot price is in the $2.40 to $2.50 per mcf range (the official Mexican export price is $4.50 per mcf).

The Wharton Long-Term Model of the U.S. economy was then used to recalculate the macroeconomic impacts of H.R. 2451 and S. 1292 using tariffs calculated on the basis of mid-1985 energy prices. Under the no retaliation case, U.S. job losses would be 185,000 (versus 275,000 for 1984 prices), and job losses with retaliaton would be 263,000 (versus 385,000 for 1984 prices). Using the lower 1985 prices reduces the negative macroeconomic impacts as it reduces the magnitude of the impact in the petrochemical

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sector, but overall the impacts are still very substantial.

The exclusion of Canada from a duty. The CBO excluded Canada on the basis of what the CBO expected to happen to Canadian natural gas prices after November 1, 1985 when the Canadian natural gas market was "targeted" for decontrol. We believed it was inappropriate to exclude Canada on the basis of what might happen if natural gas decontrol occured. Indeed, the CBO indicated, based on existing (mid-1985) Canadian prices, that a duty would be applied to Canadian petrochemical and nitrogenous fertilizer products. Also, the CBO indicated it would use the same external and internal prices as Wharton did in computing a duty (CBO study, p. 11). The CBO further indicated that if a duty were applied to Canadian products, then substantial nitrogenous fertilizer price increases would occur (CBO study, p. 19), particularly if Soviet nitrogenous fertilizers also were subject to a duty. Finally, the CBO states that these higher fertilizer prices could lead to a loss in farm income (CBO study, p. 20). Under these circumstances, the CBO study appears to support Wharton's conclusion that H.R. 2451 and S. 1292 would have a substantial macroeconomic impact.

The exclusion of the Soviet Union from a duty. We believe that the exclusion of the Soviet Union from a duty under the bills by the CBO has little basis. The CBO indicates based on its estimates of internal and external prices for Soviet natural gas that a duty would be implied by H.R. 2451 and S. 1292. The USSR is not included in CBO's "narrow" most likely scenario for vague "diplomatic" reasons (CBO study, p. 12). We do not believe their analysis should presume actions by the U.S. State Department, but instead should simply apply the language of H.R. 2451 and S. 1292 to the Soviet factual situation. As with Canada, application of the bills to the Soviet Union would, according to CBO, lead to substantial price rises.

The exclusion of Saudi Arabia from a duty. Saudi Arabia is excluded by the CBO under its narrow interpretation of the legislation because Saudi Arabia could only sell its gas in liquified form, which would require a substantial capital investment. Under its "broad" interpretation of the legislation, however, the CBO calculates a duty identical to that found by Wharton.

The determination of the price response in U.S. markets to the imposition of a duty. The CBO and Wharton appear to be close to agreement regarding the effects on the prices of softwood lumber and, if Soviet and Canadian products are subject to duty, on the prices of nitrogenous fertilizer. The price response to a duty in U.S. petrochemical markets is the main area of dispute. The CBO argues that excess U.S. capacity and the continued availability of low cost supplies from Canada and Saudi Arabia will preclude significant U.S. price increases. Wharton's view is that Canadian and Saudi products would be subject to a duty under the bills (a view shared by many proponents), and that, given the oligopolistic nature of the U.S. market, U.S. prices would then rise by the amount of the tariff despite excess capacity. While one cannot "prove" with certainty the validity of either the Wharton or CBO view on the price response in U.S. petrochemical markets, the economic literature and recent evidence support the Wharton view. The economic literature demonstrates that models which relate changes in prices to changes in cost ("markup on cost models") do a good job of explaining pricing behavior in the chemical markets. This type of model is consistent with an oligopolistic

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market structure, and indicates that the increase in duty will cause an increase in prices. Recent evidence of oligopolistic behavior is provided by the fact that despite high U.S. excess capacity, polyethelane prices recently jumped by 5 cents per pound (20 percent) even with the availability of inexpensive imported product. Excluding the low cost imported products should encourage further price increases.

The Economic Persepctives, Inc. (EPI) Study

The EPI study does not provide an original analysis of the issues but selectively cites primarily the Wharton and CBO studies in support of EPI's view that natural resource subsidy legislation will affect neither commodity prices nor the U. S. economy. The concern of those supporting natural resource subsidy legislation is not an inability to sell their product at any price, but instead their inability to sell their products at a price consistent with earning a desired level of profit. If natural resource legislation does not lead to an increase in U. S. prices, the legislation's proponents will seek broader application of the legislation or additional stronger legislation. Therefore, if the legislation will not increase U. S. commodity prices, then the legislaion definitely should not be enacted because its main affect would be to encourage the target countries to retaliate thereby leading to a real economic loss without any real economic gain. At a minimum, we will strain politcal relations with important political allies such as Canada, Mexico, and Saudi Arabia and worsen relations with dangerous adversaries such as the Soviet Union.

The basic criticism levied by EPI of the Wharton study is that Wharton assumed tariffs and price increases that were too large. These assumptions, in turn, EPI states implied too large economy-wide losses in income and jobs. EPI supports their position mainly by restating the points initially made more clearly in the CBO study. The EPI study consistently cites the CBO estimates of the tariffs and associated price increases under the CBO's "narrow" interpretation of the legislation's applicability. Unlike CBO which clearly recognized that the inherently vague language of the legislation could permit a much broader application, EPI merely cites the smaller CBO tariff and price increase estimates and make no reference to the CBO estimates under the "broad" interpretation of the legislation's applicability. Wharton's tariff estimates, in certain cases, are conservative. In the case of lumber, there are a number of sources, including testimony at the recent ITC hearings, that suggest the tariff should be twice as large as Wharton estimated. Since the impact on the lumber sector was substantial and could be much larger than the Wharton study estimated, claims that our study grossly overstated the impacts are simply not justified.

Further, the "tariff can be expected to increase over time due to the legislation's affects on the natural resource markets. The tariffs estimated by Wharton (and the CBO) are based on the difference between the "opportunity price" for the natural resource commodity for a given country and the price of natural resource to manufacturing firms within the country. This "opportunity price" is affected in all cases, to some degree, by movements in the U. S. price for the natural resource. In some cases, such as the case of softwood lumber imported from Canada, the U. S. natural resource (stumpage) price is the "opportunity price".

WHARTON

Once a tariff is levied, it will increase the U. S demand for the natural resource and reduce the foreign demand for the natural resource. The increase in U. S. natural resource demand will cause U. S. prices for the natural resource to rise while reduced foreign demand will depress the internal prices for a natural resource within foreign countries. Even in the case where the "opportunity price" for the natural resource is a world price, the calculated tariff would increase due to the depressed prices within the foreign country. In a case like softwood lumber, the tariff would increase by an amount consistent with the full increase in the gap between the U. S. and foreign prices. These increased tariffs would cause a further widening of the gap between U. S. and foreign natural resource prices and further increases in tariffs. This inflationary spiral of tariffs would put continuing upward pressure on downstream product prices.

When Wharton prepared its study, we did not build in the above upward spiral of tariffs but instead kept them constant at initial levels. The EPI study criticizes Wharton for maintaining the initial tariffs over the 1986 through 1994 period presumably inferring the tariffs would move towards zero over time. Wharton's approach, in fact, is conservative and increasing tariffs over time is the most likely consequence of introducing natural resource subsidy legislation.

The EPI study claims that, due to excess supplies of natural gas and excess capacity in the nitrogenous fertilizer and petrochemicals industries, a tariff would not lead to price increases for petrochemicals or for nitrogenous fertilizer in U. S. markets. The EPI study cites "comments" supplied by Blue, Johnson, and Associates to support EPI's arguments related to the situation within the U. S. fertilizer industry.

EPI attempts to count all the participants in the U. S. nitrogenous fertilizer market ending with the fact that there are 2.5 million farms in the U. S. and Canada. Presumably, this is an attempt to demonstrate that the U. S. nitrogenous fertilizer market is not oligopolistic in nature, because there are many market participants. The appropriate and relevant test is how market prices are determined and not how many entities participate in the market.

EPI then goes on to document the fact that the nitrogenous fertilizer market is in a depressed state. Again, EPI seems to believe that this fact precludes price increases due to imposing tariffs. Finally, EPI compares prices for ammonia imported from the USSR versus U. S. spot prices for four months, observes that these prices don't move together, and concludes that changes in prices of imported products will not affect the U. S. market. In fact, the data provided demonstrate nothing.

EPI argues that the inability of U. S. ammonia producers to pass on natural gas cost increase during 1980-83 period are an indication that a tariff would not be reflected in higher product prices. They don't discuss the fact that ammonia prices jumped in 1980 by 64 percent and that in 1983 prices were still 38 percent above 1979 levels. Also, during this period world ammonia production capacity was expanding and the major agricultural crop prices were falling. Under this combination of radically changing circumstances it is not surprising that producers were unable to pass on the approximately 9 percent increase in costs due to higher natural gas prices.

WHARTON

EPI also focuses on the inability of U. S. ammonia producers to pass on cost increases as an indication that a tariff would not increase U. S. product prices. U. S. producers are not the lowest cost producers in the market. Instead, U. S. firms, on average, are apt to have relative high costs because U. S. production facilities are older and less efficient that new foreign facilities, U. S. labor costs are higher, U. S. capital costs may be higher, and U. S. raw material costs are higher. U. S. natural gas prices are higher than the "opportunity price" for Canadian, Mexican, Soviet, or Saudi Arabian producers. In an oligopolistic market, the lowest cost producers typically are the price leaders. In the case of ammonia, the lowest cost producers will be targets of the proposed natural resource subsidy legislation. These lowest cost producers can pass higher costs through in the form of higher product prices even if the higher cost U. S. producers have been unable historically to pass on their cost increases

Conclusions

Since the CBO study showed that under several possible interpretations of the legislation the natural gas and fertilizer duties could range from much higher to a small fraction of that used in the Wharton study it is certainly not correct to claim the Wharton study overstates the impact. It is correct to state that the tariff and therefore the impact on the economy can be larger or smaller depending upon how the legislation is interpreted and enforced. If the tariff affords significant protection to any U. S. industrial sector, the tariff will have a significant impact on the economy.

In summary, we believe that Wharton's results represent the most realistic assessment of the macroeconomic effects of the proposed legislation. The CBO conclusions, on the other hand, and EPI's assertions, are premised on an extremely narrow and, we believe, incorrect reading of the bills. Even with the differences in view between CBO and Wharton, however, it is clear that CBO shares our concern that the legislation could trigger substantial price increases, could be broadly applied, is difficult to administer due to the inherent uncertainties surrounding the definition and measurement of "fair market value," could help maintain cartel (e.g., OPEC) prices for commodities, could trigger retaliation by countries impacted by our legislation, and could foster mirror legislation against U.S. products enjoying a natural resource subsidy.

Sincerely yours,

Bruce R. Rippke

Bruce R. Rippke, President

BRL:cmh

cc Messrs. William V. Roth, Jr., John H. Chafee, John H. Heinz, III, William L. Armstrong, Steven D. Symms, Charles E. Graffley, Malcolm Wallop, Lloyd M. Bentsen, Spark M. Matsunaga, Daniel P. Moynihan, Max F. Baucus, David L. Boren, Bill Bradley, George J. Mitchell, and Bob Packwood

The Honorable Russell B. Long

Senator HEINZ. Let me ask Mr. Jandacek and Mr. Jaquier: Why should we dispense with the general availability test in the case of natural resources but not in other cases?

Mr. JAQUIER. I beg your pardon, Senator?

Senator HEINZ. The provisions of the legislation that we are discussing only apply to natural resource inputs. Why should they just single out natural resource inputs? Why shouldn't they more broadly apply?

Mr. JAQUIER. Senator, in the case of petrochemicals, we have two major inputs: capital and energy or raw materials. In the case of most petrochemicals, and certainly in the case of ammonia and urea, the cost of natural gas represents about 65 to 70 percent of the cost of the finished product. Also, we have in this case a capital-intensive product and very high cost plants. We have an energy-intensive product. Energy is a natural resource. If that resource is subsidized, if the raw materials of the nitrogen plant are subsidized, then there is no way a U.S. free enterprise producer can be competitive with a State-owned enterprise with very low or free natural gas.

Senator HEINZ. So, the answer is that if it is a substantial component, that is the rationale.

Mr. JAQUIER. Absolutely. Substantial, not minor.

Senator HEINZ. A major component?

Mr. JAQUIER. Right.

Mr. JANDACEK. In the case of petroleum products, crude oil represents very close to 90 percent of the cost of the finished product.

Senator HEINZ. Now, how do you distinguish between the kinds of natural resource subsidies you are concerned about, say, from cheap electricity in the Pacific Northwest that has been produced from Government-financed hydroelectric projects? How do you distinguish between those two?

Mr. JAQUIER. Are you addressing that to me?

Senator HEINZ. I am afraid so.

Mr. JAQUIER. Let me give you a good example. I want to talk to you about Russian urea imports into the United States; and we will compare that with a company that wants to go to the Pacific Northwest and build any kind of plant.

Any company in the world, to my knowledge, if they want to put in the capital can go to the Pacific Northwest and establish a plant and buy electricity. Now, in the case of, say, Russian urea, I can't go to Russia and build a plant. I can't get the Russians to give me natural gas which they are giving their own industry.

Senator HEINZ. So, your argument is that power in the Pacific Northwest is generally available—with the plain meaning of the term as we would use it as nonlawyers—whereas in the case of natural gas in Mexico, it is not. Is that what you are saying?

Mr. JAQUIER. In the case of natural gas in Mexico, it is not. In the case of natural gas in Russia, it is not. In the case of natural gas in most every one of these state-owned enterprise countries, we don't have the freedom to go in and establish facilities.

Senator HEINZ. Let me ask the opponents of the legislation. What do you have to say to that? Mr. Erb?

Mr. ERB. I will limit my remarks, Senator, to the case of Mexico. Natural gas and other energy inputs in Mexico are available in

Mexico to companies that operate in Mexico, whether they are wholly owned by Mexican nationals, by the Mexican state, are joint ventures with foreign nationals, or wholly owned by foreign companies. There are both types of companies in the cases we have before us.

Senator HEINZ. Now, Mr. Jaquier, I guess, has a rebuttal or something.

Mr. JAQUIER. May I comment on that?

Senator HEINZ. Yes. Comment.

Mr. JAQUIER. I went to Mexico. I negotiated with the Mexican Government and with Pemex. The Mexicans will not allow any foreign company to establish what they call a "first tier industry" in Mexico. And that is an industry that uses as a raw material natural gas or oil. Further, they won't allow you to establish a second-tier industry because I went down there and tried to buy cheap ammonia from the Mexican Government and said I would build a urea plant to use that ammonia and export it. United States companies or any other outside companies are absolutely restricted by the Mexicans, and you cannot do it.

Senator HEINZ. Mr. Erb, what do you say to that?

Mr. ERB. I will make one comment, and then I will ask my colleagues to make comments on that as well.

The first-tier comment is essentially correct. However, the Mexican Government is in the midst of a program of what has been called industrial reconversion, in which they have said: We, the Mexican Government and our state enterprises, together with our private sector, are going to look at a number of areas such as petrochemicals, fertilizers, steel, and sugar, to rationalize the operation of state-owned companies. They have already closed a steel plant. I am confident that the points raised here will get a serious hearing. Now, I can turn to my colleagues.

Ms. BARSHEFSKY. Senator, may I respond to your question, please?

Senator HEINZ. Yes, but I will need to yield to Senator Long.

Ms. BARSHEFSKY. Thank you. If I may respond briefly.

Senator HEINZ. Yes.

Ms. BARSHEFSKY. The issue that is involved here is not sales of a natural resource at below cost. If it were, there is a remedy, and that is the antidumping law which attacks sales below cost. The issue is not the building by governments of uneconomic plants, plants which cannot recover their capital costs. If that were the issue, the current countervailing duty law covers this practice, as you well know, from the precedents established in the European steel cases in 1982, and again in 1984.

The issue here is not a traditional unfair trade issue. The issue is, as Mr. Jaquier has just pointed out, access. It is a trade reciprocity issue. By implication, if Mr. Jaquier were allowed to establish an ammonia facility in Mexico and buy natural gas at the low internal price, as he claims foreign subsidiaries located in the United States are allowed to do for hydroelectric power, natural resources legislation would not be an issue. If the Mexicans were selling natural gas through a pipeline to the United States at the low internal Mexican price, natural resource legislation would not be an issue any longer.

The issue is one of access to natural resources and trade reciprocity. We have a trade law, amended in 1984, called section 301 to deal with reciprocity. It has been further amended in H.R. 4800, and proposed for amendment in S. 1862. Access is what the issue is. The issue is not a subsidy issue.

Senator HEINZ. On the previous panel some of them contended that, even though an American company in Canada could buy lumber in Canada, Canada's stumpage was ridiculously low, didn't provide for reforestation, didn't cover any reasonable definition of costs, and contended—contrary to your argument—that it wasn't simply a question of whether it was available to other companies. I just want the record to show that there is disagreement on that issue. Senator Long?

Senator LONG. Let me just direct this to Mr. Brewster who is at the table here. I have heard people argue that this Nation should not be concerned about foreign governments using natural gas and other products priced far below the price for which they are selling those products on the world market in order to subsidize those products and put our producers out of business in the United States. Can you see that it makes any difference whether, from our point of view, they are discriminating among their own Mexican citizens or whether they are discriminating against us as compared to them?

Mr. BREWSTER. Senator Long, I am here representing the Southwest Regional Energy Council, as you know, which is made up of Texas, Oklahoma, New Mexico, Louisiana, and Arkansas. We all are significant gas producers with Texas, Oklahoma, New Mexico, and Louisiana being the top four in the Nation, and Arkansas 17th. What we mainly have exported in the petrochemical area is jobs the last few years. We recently finished a session in Oklahoma where we cut $467 million from a $2.3 billion budget to balance it. We are in a posture in many of our areas where many of the farmers, as was mentioned a moment ago, can't buy fertilizer now because they can't sell the natural gas on their place. So, if we are buying ammonia from outside, we are cutting down on actual farm income in Oklahoma, Texas, Louisiana, et cetera.

I have always been a supporter of the free market, anywhere in the world. I believe the American industry can compete with anyone, if we can play on a level field. The field is not level at this point. Foreign governments are competing directly with American industry. Our Government does not have the benefit of our industry. It does not have the benefit of our Government selling cheap gas because gas here is owned by individuals.

If we are going to succeed in keeping jobs in America and selling American gas, we must do something to cut out foreign subsidies and prevent them from taking over the market. As far as I am concerned, a government's only reason for existence is to protect and represent its people. If our Government loses its economic and manufacturing base, all the—in the world won't help us.

Senator LONG. I want to present a question to Mr. Jaquier, too. We were discussing some years ago with one of America's pipeline companies their efforts to reach an agreement with the Soviet Union back at a time when we were talking about importing natural gas from the Soviet Union. Can you recall when those negotiations were being considered?

Mr. JAQUIER. Yes, I can.

Senator LONG. And the chief executive officer of that company told me that in negotiating with the Russians about transportation costs and the rest of it, he became convinced that the Russians would be selling their natural gas at the wellhead at zero cost to make this deal feasible. And he told me that he thought he had better tell the Russians about that because, if the Russians found out that they were selling it for nothing—zero at the wellhead—that they might feel they had made a bum deal and they might want to get out of it. So, he explained it to them. According to our estimates and the way we had this thing figured, we were satisfied that they would be selling the gas at the wellhead for zero—a zero price. And the Russians said, "Well, that is because you do not understand how we keep our books."

Now, if you are having to compete with that and they are putting it in at zero cost, at about two-thirds of the product or more, how are you going to compete with that?

Mr. JAQUIER. Senator, I can't compete with it. And I agree with you; I don't know how they keep their books, but I will give you a good example. The Russians produced urea about 1,400 miles inland. They took this urea to the Black Sea, put it on a boat to ship it to the United States to sell it on the gulf coast below the cash cost of the most efficient U.S. producer. Using what I would consider normal economics, we back calculated what the Russians were getting for that gas—not at the wellhead—delivered to their ammonia-urea plant. And it was something like a minus 60 cents. I can't compete. This is the kind of thing that I think this legislation should address.

The current trade laws just don't work in the case of nonmarket economies. The industry in your State and my plants really are in jeopardy because of this type of action.

Senator LONG. Now, in any emergency where this Nation has its back to the wall, how much of that Russian gas is going to be available to us?

Mr. JAQUIER. Well, I think from two standpoints, ammonia or nitrogen fertilizers are a necessity to America or any other developed country. Also, ammonia is the raw material for nonnuclear explosives; and if we had a national emergency, I think we would get very little ammonia or other fertilizer from the Russians.

Senator HEINZ. One last question to you, Mr. Jaquier. If Mexico, or for that matter Saudi Arabia, made its cheaper petroleum or natural gas available to United States producers for the production of downstream products in those countries, wouldn't this just encourage more people to move to Mexico and Saudi Arabia and manufacture there and cause more job losses here?

Mr. JAQUIER. Certainly it would encourage people to move to those countries who were subsidizing internally a cheap raw material. You would have to abandon the capital investment in this country. You would have to discharge all your employees. You would have to extend your logistical supply line halfway around the world.

These things just are not, in my judgment, in the best interest of America.

Senator HEINZ. The test that you mentioned a moment ago as to general availability, on the example between Northwest public power and the energy situation I have just described was that you really don't have any problem as long as it is generally available—the subsidy is generally available. And we do subsidize power in the Pacific Northwest.

Mr. JAQUIER. I would have a problem on the general availability in the Pacific Northwest if some foreign government built a plant there, gave it free capital, free labor, absorbed losses, and undercut the cash cost of an American producer—generally available or not.

Senator HEINZ. Suppose somebody from either this country or some other country went in there, didn't use subsidized capital, but because it had cheap power was able to export a product that put people out of work someplace else?

Mr. JAQUIER. Are you asking me if I think that is all right?

Senator HEINZ. What I am trying to do is figure out in my own mind what the distinction is here. Is your test a general availability test, or is it something else?

Mr. JAQUIER. Well, I think if you ask me my test, I think general availability to all comers is one of the tests. I think that the playing field should be level on the amount of capital, on the interest charge——

Senator HEINZ. We are not arguing that, although countries are going to have different interest rates. We are going to have a higher rate because we have a bigger deficit than a lot of countries because we borrow a lot of money, the Federal Government spends more than it takes in, and other countries don't do that. You are not advocating that we should countervail against that because they don't spend themselves into the poorhouse today? You are not advocating that?

Mr. JAQUIER. Let me specifically then answer your question. In those areas where natural resources are freely available to private enterprise, we have no quarrel with such countries. We have no quarrel, for example, with Canada, even though the gas is cheaper; but it is cheaper to everyone, and it is being developed by private enterprise rather than State enterprise.

Senator HEINZ. Very well.

Ms. BARSHEFSKY. Senator, if I may interject? There is no distinction between cheap hydroelectric power in the Pacific Northwest or Federal irrigation water or Federal coal leasing or livestock raising fees or U.S. regulation of oil and gas from natural resource practices in other countries that are at issue here. They are all generally available within the economy and, for that reason, have always been considered internationally not to be countervailable subsidies.

The Congressional Research Service did a study recently in response to natural resource legislation and examined potential programs in the United States that would be countervailable if the general availability rule were abandoned. And the CRS in 1986—February 1986—came up with the following: that Federal irrigation water, there would be a subsidy applied against it of $1 billion to $1.6 billion.

Senator HEINZ. We did get similar testimony earlier today from others. So, I thank you for that.

Ms. BARSHEFSKY. Thank you.

Senator HEINZ. I have to be a little careful on time here because we have a vote on the floor, and we have a number of other witnesses. I want to thank all of you——

Mr. LIPPKE. Senator, could I respond to the claims that the CBO study is different than the Wharton study for a moment?

Senator HEINZ. For the record.

Mr. LIPPKE. For the record?

Senator HEINZ. For the record, but I don't want to get into that now. You can send us some written comments on that.

Mr. LIPPKE. I have sent comments in before. Generally, they are in agreement with our study. They did pick several different prices that they thought would be lower than ours, and they admitted that they made a very narrow interpretation of the bill in coming to those conclusions; but in general, we are in agreement.

Senator HEINZ. If you would augment those observations for the record, Mr. Lippke, I would be very happy to make sure it is part of the record.

Mr. LIPPKE. I will be happy to.

Senator HEINZ. I like to see another Pennsylvanian down here. You do live in Pennsylvania as well as work there?

Mr. LIPPKE. Yes.

Senator HEINZ. Good. Thank you all very, very much.

Our last panel consists of Thomas Van Arsdall, Delmar Kloewer, Thomas Bronson, John Plunket, and William Foster.

If you would all please come forward and take your places? As you are taking your seats, I want to apologize to our witnesses, but I am going to have to disappear in about 6 or 7 minutes to go and vote. I am not sure if my relief is going to be here in time; so in the interest of making sure that we do make the most of the time, I may very well have to adjourn or ask staff to keep the discussion going until one of us gets back. Senator Danforth actually has an amendment that he has up right after this vote, so I know that he is really between a rock and a hard place. And I apologize to all the witnesses for his other responsibilities. Let me ask Mr. Van Arsdall, who is in the middle there, to please proceed.

STATEMENT OF THOMAS VAN ARSDALL, VICE PRESIDENT, AGRICULTURAL INPUTS AND SERVICES, NATIONAL COUNCIL OF FARMER COOPERATIVES, WASHINGTON, DC

Mr. VAN ARSDALL. Thank you, Mr. Chairman. Farm supply cooperatives have been experiencing problems similar to those in the business of marketing agricultural commodities facing—unfair competition in the form of foreign government subsidies. While the agricultural commodities side has generally seen the loss of export markets, fertilizer and petroleum have seen penetration of domestic markets at the expense of the U.S. industry through foreign nations' use of natural resource subsidies.

The National Council strongly supports S. 1292, as we believe that this measure would permit those who believe they are being injured to finally have their day in court. Let me highlight just a couple of points.

First, I would like to emphasize the unique nature of the cooperative farm supply system. It is farmer owned and controlled, and consumers of these products are also the owners of the system. Board members who make decisions are farmers elected by their peers. Our organization certainly carries as much credibility as any group to speak out on this issue for American farmers.

Second, farmers have invested several billion dollars of their own funds into building their delivery system. Subsidized imports threaten these assets at a time when farmers certainly do not need additional crises.

Third, the National Council has a highly diverse membership, including cooperatives who market and export almost every commodity—grain and specialty crops—produced by the American farmer. The National Council's endorsement of S. 1292 is based upon a thorough review within our membership.

Fourth, the mood of agriculture has changed dramatically over the past several years. Almost every commodity group has sought relief from unfair trade practices. We have visited with other agriculture organizations. While I would not pretend to speak on their behalf, I believe it is accurate to characterize their response as being sympathetic to the problems being experienced by petroleum and fertilizer supply cooperatives.

Fifth, the Wharton study raised earlier portrays massive adverse impacts upon U.S. agriculture. When we first saw this report last year, it gave us great cause for concern. We certainly could not support any legislation counter to the interests of farmers. However, an analysis conducted by Economic Perspectives, a highly respected agricultural economics firm, concluded that the assumptions were designed in such a manner as to preordain massive negative impacts, and that these assumptions were implausible. A copy of this summary is attached to our statement, and I have with me for the record copies of the full analysis. This conclusion was reinforced by the analysis conducted by CBO in September 1985.

Finally, cooperatives are not Johnny-come-latelies in the farm supply business. They have remained in rural America through good times and bad, serving as reliable suppliers to their farmer owners. They have weathered a lot of crises over the past 50 years. These cooperatives can continue to do so in a fair and competitive market. But foreign subsidies pose a much larger threat. Cooperatives are not asking for protection, rather they are seeking access to due process as S. 1292 would provide. Thank you, Mr. Chairman.

Senator HEINZ. Mr. Van Arsdall, thank you. Mr. Kloewer?

[The prepared written statement of Mr. Van Arsdall follows:]

National
Council of
Farmer
Cooperatives

Before the
Subcommittee on International Trade
Committee on Finance
U.S. Senate
Washington, D.C.

Dual Pricing of Natural Resources

Presented by
R. Thomas Van Arsdall
Vice President, Agricultural Inputs & Services

June 26, 1986

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Before the
Subcommittee on International Trade
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Dual Pricing of Natural Resources

INTRODUCTION

Mr. Chairman, members of the Subcommittee, my name is R. Thomas Van Arsdall and I am Vice President of Agricultural Inputs and Services with the National Council of Farmer Cooperatives (National Council). We appreciate very much this opportunity to share our views regarding the unfair use of natural resource subsidies by foreign governments to penetrate the U.S. market. The National Council is deeply concerned about unfair trade practices generally and the adverse impact of such practices on agriculture as well as our nation's balance of trade.

Consistent with these concerns, the National Council would like to take this opportunity to express its strong support for S. 1292, legislation introduced by Senators Russell Long and Max Baucus of the Finance Committee and cosponsored by a number of Senate colleagues. This measure is essential to address the use of such unfair trade practices by our foreign competitors and to allow affected U.S. industries, including farmer cooperatives, to seek relief under existing trade remedies and procedures.

INTEREST OF THE NATIONAL COUNCIL

The National Council of Farmer Cooperatives is an association of cooperative businesses which are owned and controlled by farmers. Our membership includes 92 major marketing and farm supply cooperatives, the 37 banks of the cooperative Farm Credit System, and 32 state councils of farmer cooperatives. The National Council represents about 90 percent of the 6,100 local farmer cooperatives in the nation, with a combined membership of nearly two million farmers.

Members of the National Council are engaged in the manufacture and marketing of nitrogen fertilizers, and in petroleum refining and marketing, on behalf of their farmer-owners. Cooperatives have entered into these two enterprises on behalf of their farmers over the past half century in order to provide secure and competitively priced supplies of critical fertilizer and fuel inputs.

Today, supply cooperatives own and operate five efficient refineries possessing an aggregate production capacity of 337,700 barrels per stream day. Farmer cooperatives market petroleum products in more than 40 states and supply almost 40 percent of all on-farm fuel and a large portion of rural system needs. Cooperatives also have joined together in the operation of world-class nitrogen manufacturing facilities, and distribute fertilizer products in almost every state in the continental U.S. and supply almost half of American farmers' fertilizer needs.

Both nitrogen manufacture and petroleum refining are resource-intensive with the raw material input comprising a high proportion of production costs. Natural gas is a feedstock in the manufacture of nitrogen fertilizer, typically representing about three-fourths of the cost of production. Crude oil, of course, is the raw material feedstock into refineries. Refining costs are typically $5 to $6 per barrel. So, even at today's relatively low crude oil prices, this input still comprises more than two-thirds of a refiner's cost of production.

The cooperative farm supply system represents the only segment of the industries which supply fertilizer and petroleum products to farmers **in which the consumers of these products are also the owners of the system.** This feature carries with it a **unique accountability in terms of commitment of supply, service and price.**

No cooperative has the option of abandoning its farmer member-owners for more lucrative markets or when supplies are tight. For example, cooperative fertilizer suppliers provided every ton of fertilizer that they produced to their members back in the early 70's, when wage and price controls were in place and supplies of anhydrous ammonia were limited. Other suppliers responded to price premiums overseas and exported considerable quantities. Cooperatives have also maintained their petroleum supply commitment to farmers through two oil emergencies, in 1973 and 1979.

THE PROBLEM

Nitrogen manufacturing and petroleum refining industries in the United States face an emerging practice by energy producing nations who are using their **state-owned energy monopoly to subsidize state-owned, energy-intensive industries downstream for export**--including nitrogen fertilizer manufacture and petroleum refining. Those same nations offer natural gas and crude oil for export at much higher prices set by the world market.

The National Council does not object to this form of dual pricing of energy by other nations to encourage their own domestic development. However, we strongly object when those governments export such domestic **subsidies as a means of penetrating and disrupting the U.S. market.** In both the nitrogen fertilizer and petroleum refining industries, small volumes of subsidized imports can have a large effect on price because the **incremental** unit offered in the market will set the price for the rest of the market.

Unfortunately, the International Trade Commission (ITC) has made a determination that under existing trade law, such dual energy pricing by another country cannot be treated as an unfair trade practice if the energy input is made available to all industry in that country at the same price. Yet, the ITC issued a lengthy report last year (USITC Publication 1696, May 1985), which documents in considerable detail that this form of dual pricing is all too frequently practiced.

Such dual pricing of energy as a means of subsidizing energy-intensive manufactured goods for export generally did not exist just a few years ago. This view has led the National Council to conclude that **modernization** of U.S. trade law is necessary in order that the ITC may consider such practices.

S. 1292 accomplishes this objective. It would only impose countervailing duties if it is found that:

- A government entity provides the resource to itself or its domestic industry at less than fair market value;
- The resource is available for export to competing U.S. producers at the same domestic price without discrimination;
- The resource, at its fair market value, constitutes a significant portion of the production cost of the product; and
- If the U.S. industry is injured.

By establishing these three criteria as part of U.S. trade law, cooperatives in the fertilizer manufacturing and petroleum refining businesses would at least have an opportunity for their **"day in court"** in the event that natural resource subsidies are used as a means of unfair competition. The **new standards would leave a considerable burden of proof concerning unfair trade practices upon the affected industry,** while maintaining the benefits of competition where it exists fairly. Any remedies would be country-specific.

IMPLICATIONS FOR AGRICULTURE

Farm Input Costs:

Some apparently have hesitated to support any remedy to the natural resource subsidy problem. It seems that their hesitation is not based upon a consideration of whether such trade is "fair" or not, but rather that they regard such imports as a source of "cheap" supply for farmers and other consumers.

In response, the National Council would point out that "cheap" is likely to apply only during the market penetration phase, when the importer is attempting to capture a market share and drive U.S. industry out of business. Over the longer run, displacement of domestic nitrogen manufacturing and petroleum refining capacity by subsidized imports would mean that **American farmers will be increasingly dependent upon foreign sources for their critical** inputs--nations whose interests have proven all too frequently to be incompatible with our own.

Farmers may well pay dearly once domestic capacity has been displaced by such practices. For example, prices for those "cheap" nitrogen fertilizer imports jumped 50 percent in the fall of 1984 when the PIK Program ended and the market tightened. Evidence is even more dramatic on the petroleum side. In no other industry has this nation experienced two foreign embargoes which curtailed a resource so vital to our economic and national security. In no other industry did such action result in an 800-percent increase in prices, perpetuated by the presence of a cartel. The threat of future disruptions remains all too real. Indeed, increasing dependence on imported petroleum products generally can shift the tone of debate from the semantics of "fair" vs "unfair" trade to a focus upon national security considerations.

The National Council would also point out that farmers are hurt in the short term. **Farmers have literally invested several billion dollars of their own funds into building the cooperative farm input supply system.** At risk on the refining side alone are assets in the form of plants and equipment totaling $675 million. The total assets for nitrogen manufacturing facilities are over $2 billion. Should subsidized imports continue to undercut the farmer cooperative supply system, the farmer suffers in the form of the write-off by his cooperatives of these considerable assets, with potentially devastating consequences. Indeed, the ability of this complex delivery system to serve farmer-owners' needs could be seriously eroded. Certainly, farmers do not need additional problems in these extremely difficult times.

If the cooperative farm supply system can't serve its owners on a competitive basis, then that is one matter. But it is quite another matter should unfair trade practices be permitted to damage or destroy this system.

Flawed Wharton Study:

The National Council was particularly concerned by conclusions contained in the study conducted by Wharton Econometric Forecasting Associates regarding the impact of S. 1292, when the study was first released over a year ago. Wharton's dire predictions of massive losses in farm income, GNP and agricultural jobs caused us, in the interest of our farmer-members, to examine our position more closely. We certainly could not support any legislation counter to the interest of farmers.

On our first reading of the Wharton study, however, a number of aspects raised serious questions about its findings. Therefore, we asked consultants with expertise in the fertilizer industry and in the dynamics of the agricultural economy to examine the Wharton study and provide for consideration a "second opinion."

The Wharton study has been analyzed by Economic Perspectives, Inc. (EPI), a highly respected economics firm. A summary of that analysis is attached. Among sources examined by EPI was the Congressional Budget Office (CBO) September 1985 study on the natural resource legislation.

EPI concluded that the assumptions used in the Wharton study were designed in such a manner as to preordain massive negative impacts, and that these assumptions were implausible. In part, EPI stated, "The Wharton study appears to overstate the likely impacts of the legislative proposal for another reason. Overall, its projections depend on the occurrence of each of the assumptions in succession, and the persistence of each through 1994. If any one does not occur, or does not persist, the total impact is greatly changed. The duties must be as large as assumed; domestic price increases must directly reflect the increases in duties; the impacts of retaliation must be as large and direct as assumed; and all of these must persist through 1994 in order for the Wharton estimates to be realized. The likelihood of all those events happening in that order and continuing that long appears quite small. Thus, it is probable that the Wharton study very sharply overestimates the impacts of the proposed legislation."

As a result of the EPI analysis, the National Council regards the Wharton study as seriously flawed. We would urge members of the Subcommittee to take the EPI analysis into consideration when examining the merits of the Wharton study.

CONCLUSION

In closing, I would like to emphasize again the unique nature of the cooperative farm supply system. It is farmer-owned and controlled. Farmers have not joined together in an attempt to "get rich" in the supply business; rather they did so to enhance the viability of their farming operations. Farmers are "price takers," in that the market sets the prices they receive for their products. And agriculture is, to put it mildly, a risky business--highly subject to the vagaries of nature. Timing is critical. Even a disruption of short duration can be devastating. Farmers' efforts to become basic in farm supplies evolved because alternatives failed to get the job done that farmers required--that is, delivery to the farmer of critical inputs when needed, and at a competitive price.

Perhaps I should let those who have the most at stake speak for themselves. Attachment I is an August 1985 article from Co-op Country News. It describes CF Industries, an interregional cooperative which manufactures fertilizer and is owned by 16 U.S. supply cooperatives, who in turn serve over one million farmers. These quotes from farmers and local managers in one cooperative reflect the importance to farmers of the cooperative farm supply system generally.

Mr. Chairman, Members of the Subcommittee, Congress now has the opportunity to act decisively in modernizing U.S. trade law, so that those U.S. industries who believe that they are being injured by such abuses might at least have their "day in court," before Commerce and the ITC. No such access to trade remedies presently exists. The natural resource subsidies provision contained in S. 1292 accomplishes this objective.

The National Council urges the members of this Subcommittee and the full Committee to report S. 1292 favorably, whether separately or as part of more comprehensive fair trade legislation. I appreciate this opportunity to share our views on this critical matter, and would be pleased to respond to any questions that members of the Subcommittee may have.

STATEMENT OF DELMAR KLOEWER, VICE PRESIDENT, FERTILIZER DIVISION, CARGILL, INC., MINNEAPOLIS, MN

Mr. KLOEWER. Yes, Mr. Chairman, members of the subcommittee, I am Del Kloewer, vice president of the fertilizer division of Cargill, Inc.; and until recently, I was Northwest region manager for Cargill's grain merchandising division. My company opposes legislative proposals to permit the imposition of countervailing duties on imports that have benefitted from low-priced natural resource inputs. Let me first say that Cargill has a corporate interest in natural resource legislation. However, Cargill first became concerned about natural resource trade legislation because of the many ways in which such legislation would harm U.S. agriculture.

First, new duties on fertilizer imports will establish a price floor higher than the prevailing world price, increasing U.S. grain production costs at a time when the U.S. farmer is already noncompetitive in the world marketplace.

U.S. agriculture exports are down by over 30 percent since 1981. This legislation will only exacerbate this trend.

But there is a much greater problem. This legislation represents a unilateral expansion of the internationally accepted definition of what constitutes a subsidy. In fact, as recently as 1979, the European Community complained that U.S. price controls on oil and gas constituted a subsidy to synthetic textile exports from this country. U.S. officials persuaded the European Community to drop its complaint by arguing that energy prices, though lower than prevailing world prices, were generally available throughout the U.S. economy and thus did not constitute a subsidy.

This legislation would reverse this now universally observed trade definition, prompting our trading partners inevitably to retaliate against U.S. exports, agricultural exports chief among them. Retaliation is a real problem, not just an idle threat. Current trade disputes with the European Community, Canada, and Brazil demonstrate clearly that it is agriculture that gets caught in the middle.

It is equally likely that other countries will follow the U.S. lead and adopt similar legislation. The Congressional Research Service has developed an extensive list of U.S. practices that could be labeled countervailable subsidies by other countries in such an event and has quantified those programs to be in the billions of dollars annually.

Senator HEINZ. Mr. Kloewer.

Mr. KLOEWER. Yes.

Senator HEINZ. I am going to have to ask you to withhold the remainder of your testimony. I have to go and vote. Senator Long will be back, I think, relatively soon. I will be back as soon as I can. I will take the transit over there, vote, and come back; but we are going to temporarily recess the committee until Senator Long or one of the members of the committee returns. I apologize to you.

[Whereupon, at 4:55 p.m., the hearing was recessed.]

AFTER RECESS

Senator LONG. Mr. Kloewer, would you care to continue with your testimony?

Mr. KLOEWER. OK. Thank you. Most natural resource proposals now before Congress, like other protectionist proposals, fail to address the major causes of the Nation's trade deficits.

Mr. Chairman, if Congress is to adopt a natural resource measure, we support the approach incorporated in S. 1860 and its related legislation, which would raise the natural resource issue in the context of a new round of multilateral trade negotiations.

Given the broad range of products and the large number of countries that this issue affects, the issue begs for a multilateral solution. The unilateral approach embodied in countervailing duty proposals will only create new problems for an already beleaguered U.S. industry—agriculture.

Mr. Chairman, I appreciate very much having the opportunity to appear before you today. Thank you.

Senator LONG. Next I will call Mr. Thomas E. Bronson, president and chief executive officer, Ideal Basic Industries, Denver, CO, and chairman of the Board of American Cement Trade Alliance, Inc.

[The prepared written statement of Mr. Kloewer follows:]

Statement of Delmar Kloewer
Cargill, Inc.

Before The
Subcommittee on International Trade
Senate Committee on Finance

June 26, 1986

Mr. Chairman and members of the committee, I am Delmar Kloewer, Vice President for the Fertilizer Division of Cargill, Inc., and until recently I was Northwest Region Manager for Cargill's grain merchandising division. I am here today to express the opposition of my company to legislative proposals to permit the imposition of countervailing duties on imports that have benefited from low-priced natural resource inputs in their country of origin or manufacture.

My company has been active individually and as a member of the PAT Coalition in opposing such natural resource trade legislation. In fact, my appearance here today represents the fourth time in the past three years that a representative of Cargill has appeared before congressional hearings to argue against such legislation. In this regard, we are very pleased that this subcommittee is holding this in-depth hearing on natural resource pricing practices and that we have the opportunity to participate here today.

Natural resource legislation provides a good illustration of the costs, especially for agriculture, of many of the trade measures now receiving attention in Congress. In general, such proposals, including natural resource legislation, both fail to address the problems experienced by particular industries and ignore the real, macroeconomic causes of this country's growing trade deficits.

Let me first clarify that Cargill has a parochial interest in natural resource legislation. Among other fertilizer operations, Cargill is involved in nearly every phase of nitrogen fertilizer importation and distribution and is also a domestic producer.

However, by far our greatest concern is over the many harmful ways in which imposition of countervailing duties under natural resource legislation, if enacted, would affect U.S. agriculture and our agricultural exports.

Natural resource legislation would expand the scope of U.S. countervailing duty laws to impose duties on imports of a wide range of products simply because they are produced from low-cost natural resources in foreign nations. Under the bills, countervailable subsidies would arise when a foreign government provides a low-cost natural resource to its local producers of downstream merchandise at prices below some presumed "fair market value" of the resource.

Sponsors of natural resource legislation maintain that the difference between the domestic sales price and that fair market value constitutes an impermissible export subsidy.

In general, under the General Agreement on Tariffs and Trade (GATT), a government may confer a benefit, including low-cost inputs, on its industries. However, the price of the benefit must not be below its cost to the government, and the benefit must be generally available -- that is, not targeted to a particular industry or to exports.

Natural resource legislation was designed originally to counteract Mexico's GATT-consistent practice of selling natural gas to domestic consumers, regardless of the purpose for which the domestic consumer used that gas, at a price much lower than it sells gas for export. In fact, Mexico's internal gas price is now very close, if not perhaps even higher than, the U.S. spot market price for gas. Moreover, the several bills before Congress would reach far beyond Mexico, as more and more nations, particularly lesser-developed countries seeking to relieve huge debt burdens, seek to add value to their exports.

In effect, the legislation attempts to dictate internal pricing decisions to our international trading partners. If foreign countries export a resource for less than the domestic price, they would be subject to an antidumping action. If the price is higher, then the new countervailing duties would be imposed. That does not leave much flexibility.

The price of enacting natural resource legislation will be high, especially for U.S. agriculture. In its recent study, Wharton Econometrics has projected that in all, enactment of this legislation will cost the U.S. economy some 345,000 jobs over the next five years, while creating only 8,000 new jobs, as a result of increased prices and reduced exports. U.S. farm income alone would be reduced by some $24 billion over that time as a result of higher fertilizer prices and trade actions, according to the Wharton study.

Economists and other experts may quibble over methodologies or assumptions, but the Wharton figures undeniably show a clear trend. Jobs lost would vastly outnumber jobs saved or created under such legislation.

U.S. farmers, in particular, will suffer as countervailing duties establish a price floor for fertilizer inputs higher than the prevailing world price, increasing grain production costs at a time when farmers already are noncompetitive in the world marketplace. In fact, it is no secret that U.S. agricultural exports are down by over 27 percent from 1981.

Moreover, because of the serious GATT implications of such legislation, it is inevitable that countries whose exports are affected by new duties will retaliate against U.S. exports, agricultural exports chief among them.

Mr. Chairman, the threat of retaliation is not an idle one. Our very recent experience with the European Economic Community, Canada, Brazil, and other trading partners demonstrates just how vulnerable agriculture is to retaliation arising from trade disputes.

In the dispute with the EC over new U.S. quotas on semifinished steel, the EC responded by slapping restrictions on inedible beef tallow, fertilizers, and paper from the United States, all agriculture-related products.

When Spain and Portugal were admitted to the EC, the EC imposed new import duties on U.S. corn and sorghum into Spain and on oilseeds and oilseed products into Portugal. In response, the United States is imposing "nonrestrictive" quotas on its own list of EC agricultural and other products. And, if that were not enough, the EC has threatened to respond in turn against U.S. exports of corn gluten feed, honey, sunflower seeds, beef fat and citrus juice.

More recently, when President Reagan announced the imposition of tariffs on Canadian cedar shakes and shingles, Canada responded by announcing it will impose tariffs on U.S. oatmeal and rolled oats, among other products.

It is equally likely that other countries will follow the U.S. lead and enact similar legislation, which would affect numerous U.S. products that benefit from government-subsidized hydropower, irrigation, and a host of other practices. The United States itself has long distorted its domestic energy prices through price controls and special tax incentives.

As if to underscore this latter point, Canada has under consideration a petition alleging that a broad range of U.S. practices constitute subsidization of our domestic corn production. The charges allege that U.S. corn producers receive as many as 70 subsidies -- including non-recourse commodity loans, income supports, water and power assistance, and more.

In fact, the United States has a long and extensive history of providing benefits to sectors of its economy that this legislation would redefine as subsidies -- if another country behaved in a similar manner. In the late 1970's, for example, the EC complained that U.S. synthetic textile exports were benefitting from oil and gas price controls that kept those input prices below the world price of oil and gas. The EC ultimately withdrew its complaint when it agreed with the United States' position that such practices are permissible -- that is, not countervailable -- when they provide generally available benefits to an economy at large.

Now, just seven years later, this legislation would take exactly the opposite position and make such generally available practices countervailable.

Just this winter, the Congressional Research Service conducted a study of some of the U.S. practices that would be subject to trade challenges if other countries enacted similar legislation. The study reveals again the vulnerability of agriculture to such challenges, as irrigation benefits, hydropower in the midwest and west, and a host of other practices could in the future be classified as countervailable subsidies.

The point of all this is clear. In a trade dispute, attempts to shift a burden off one sector inevitably unfairly burden another. And, odds are that the newly burdened sector will be agriculture.

Finally, it is not unreasonable to expect that U.S. exports of the same goods subject to the new duties will be backed out of foreign markets as the lower-priced foreign goods, denied access to the U.S. market, seek a home.

Like other measures, natural resource legislation fails to address the fundamental causes of the problems that the domestic nitrogen fertilizer industry has experienced in recent years. The low nitrogen fertilizer prices that gave rise to complaints against imports stemmed in fact from cyclical, temporary demand factors.

At one point, three major factors combined to reduce demand. The 1982 recession, a severe drought, and acreage reduction under the PIK (payment-in-kind) program precipitated a roughly one-quarter decline in nitrogen use.

Similarly, during last year's fall fertilizer season, prices were somewhat soft. But questions over acreage setaside programs under the unfinished farm bill and a late harvest -- again, cyclical factors affecting demand -- contributed to this price softness.

Moreover, lower natural gas prices -- recently lower than $2.00 on the spot market -- are serving to bolster the domestic industry, even in face of slack demand.

Thus, the domestic nitrogen industry is characterized in the short run by volatile swings in demand, influenced by a wide variety of factors affecting fertilizer consumption trends. In the long run, a further shift in production capabilities is occurring as new, more efficient plants are coming on line and older plants are being modernized both in the United States and in other countries that desire to utilize better their comparative advantages in abundant natural resources.

Therefore, the countervailing duty approach contained in the various natural resource measures before the 99th Congress is fundamentally inappropriate as a response to the problems faced by the industry that those measures seek to protect.

The unilateral approach to pricing advantages embodied in most current natural resource proposals runs the very real risk of violating our international obligations. If indeed Congress makes the decision to change the treatment of natural resource cost and pricing advantages, there are certainly other, more responsible courses of action to pursue.

One approach, for example, is contained in the bipartisan Senate trade package proposed in S. 1860 and related measures. This legislation would direct the president to raise natural resource cost advantages, along with some 10 other issues, in the context of a new round of Multilateral Trade Negotiations. In fact, the controversial House-passed trade package implicitly acknowledges that multilateral discussions are a sound way to address this issue by including a similar provision.

Multilateral, or even bilateral, negotiations seem a far more preferable approach than unilaterally imposing countervailing duties to offset a legitimate price/cost advantage.

Mr. Chairman, Cargill last fall joined a group of 20 agricultural interests on a letter to each member of Congress in opposition to legislation that targets specific countries or specific industries. Natural resource legislation is just such a proposal.

And, like most other trade measures before this Congress, it is unilateral in nature and fails to address both the particular problems being faced by the industry it seeks to protect and the major causes of the nation's trade deficits -- including the federal budget deficit and the value of the dollar in recent years; the slower rate at which our trading partners are recovering from the recent economic recession, and the critical need of third-world nations to reduce their debt burdens.

In conclusion, Mr. Chairman, I appreciate very much having the opportunity to appear before you today to express both my company's concerns and those of agriculture in general over efforts to enact legislation to protect various U.S. industries. Natural resource legislation provides but one example of how inappropriate such measures are for the problems they seek to address.

Thank you.

STATEMENT OF THOMAS E. BRONSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, IDEAL BASIC INDUSTRIES, DENVER, CO, AND CHAIRMAN OF THE BOARD, AMERICAN CEMENT TRADE ALLIANCE, INC.

Mr. BRONSON. Thank you, Mr. Chairman. The American Cement Trade Alliance is comprised of 21 U.S. cement companies, representing more than 70 percent of the U.S. production capacity. I serve as Chairman of the Board of the Alliance. I appreciate this opportunity to testify in support of the natural resource subsidy legislation as a vehicle to restore free and fair trade to the U.S. cement industry.

Mr. Chairman, although I have more than an adequate working knowledge of the arguments dealing with the GATT issues as they relate to natural resource subsidies and the related economic and legal intricacies of international law, I shall leave those arguments to be covered in my written testimony. Instead, I would like to discuss that which I know with certainty—the manufacturing and sale of Portland cement, as well as the impact that unfair imports are having on the U.S. cement industry.

Making Portland cement is an extremely energy-intensive and capital-intensive process involving the mining, crushing, grinding, and blending of raw materials, heating the mixture of raw materials to 2,700 °F, and regrinding the product with gypsum to a consistency finer than face powder. About 40 to 50 percent of the cost of manufacturing cement is energy cost. Although concrete is one of the most essential and widely used construction materials, cement costs constitute only about 2 percent of the cost of construction. Excluding the transportation cost of delivery to the consumer, it is sold for less than 3 cents a pound.

More importantly and on point with the current debate is the fact that the U.S. Portland cement industry can produce cement as cheaply as anyone in the world. This fact is the result of, one, the extensive capital investment and plant modernization and the conversion to energy-efficient technology using domestic coal has resulted in production facilities comparable to those anywhere in the world.

Second, the U.S. cement industry, although capital and energy intensive, is not labor-intensive. Third, high quality raw materials are abundantly and locally available in the United States. Given these facts, one would not suspect any significant import penetration from great distances, even across the oceans of the world. Yet, in spite of these facts, cement imports have risen from 4 percent of U.S. consumption in 1982 to 17 percent in 1985, and imports through April of this year are running 9 percent above last year.

The facts are clear. Our trading partners are suddenly circumventing and exploiting the U.S. commitment to free trade. Consequently, the rapid escalation of import penetration is occurring, not because the U.S. cement industry can't compete on a head-to-head basis, but only because our Government refuses to enforce the principles of fair trade in the matter of cement imports. This escalating penetration of the domestic market is being accomplished in two ways. The first is by foreign governments directly subsidizing cement production costs to their producers. The second, although not the subject of today's hearing, results from dumping.

Mounting foreign competition from heavily subsidized and unfairly traded, that is dumped imports, has suppressed prices that result in one of the lowest return on investment in the U.S. manufacturing industries. I am here today to respectfully request that you correct these inequities.

In conclusion let me say that any fair examination of the facts shows that the Mexican Government institutes its energy pricing policy with the intent to create a de facto export subsidy, which is having the effect of rendering United States cement companies, which are among the most efficient in the world, unprofitable. Mexican cement imports have increased 19-fold since 1972. These imports are increasing despite the fact that the U.S. cement industry is operating at less than 80 percent capacity. The subsidized cement imports have and will continue to cause layoffs, plant closures, lost earnings, and virtual cessation of planning for new or expanded facilities within the U.S. cement industry.

The long-term effect will be to eliminate permanently a substantial portion of U.S. cement-making capacity. I should not have to remind you that cement is not only basic to the U.S. economy, but also vital to any national—any required national—defense effort. New rules and laws are needed to address this practice, and action is needed now on the bill before you in order to provide redress for this inequitable trading situation. The harm being done to the U.S. cement industry is serious, immediate, and permanent, not temporary.

These imports have been massively increasing since 1982, now some 4 years. The cement industry cannot wait another 2 to 5 years for another round of GATT to rectify these unfair trade distorting practices. Mr. Chairman, thank you very much.

Senator LONG. Thank you, Mr. Bronson. Now, Mr. John T. Plunket, past president and board member of the Association of American Chambers of Commerce in Latin America, American Chambers of Commerce in Mexico, and Director of Transmisiones y Equipos Mechanicos, S.A. de C.V., Mexico City, Mexico.

[The prepared written statement of Mr. Bronson follows:]

Statement of Thomas E. Bronson

I am Tommy Bronson, President and Chief Executive Officer of Ideal Basic Industries, headquartered in Denver, Colorado. Today, I am addressing you on behalf of the American Cement Trade Alliance, (ACTA), a recently formed national trade association comprised of 21 cement companies in the United States representing more than 70% of the U.S. clinker production capacity. I serve as Chairman of the Board of the Alliance which is located in Washington, D.C. I appreciate this opportunity to testify in support of the resource subsidy legislation.

I. Increase in Imports

The United States cement industry is being buffeted by an unprecedented penetration of its domestic markets by imported cement. Since 1982, imports have increased from 4% to 17% of the U.S. consumption and imports through April 1986 are 9% above 1985. Currently, approximately 55% of the Florida cement market is imports. The sharp increase in imports is accompanied by developments -- the construction or acquisition of cement import terminals by foreign-owned cement brokers, and the acquisition of ready-mix dealers, silos and other local distribution facilities in the United States by foreign cement producers -- indicating that the importers and their foreign suppliers intend to be permanent factors in the United States market and that the market share erosion suffered by the domestic industry may be a long term loss.

Due to a continued world-wide decrease in construction activity, there is a world surplus of cement and few makers are available because local cement industries recently have been established in countries which traditionally imported cement -- particularly Middle East countries. The U.S. is a prime target for dumped and subsidized cement because foreign producers are confident that our government will not take any action against these unfairly traded imports. For example, Korea has a new 8 million ton cement plant located 125 miles from Japan which has a 70 million ton annual market. Japan, however, does not permit Korean cement to be sold there, so Korea intends to dump its cement in the U.S. which is located thousands of miles away. Similar situations exist in other cement producing countries.

II. Injury to U.S. Cement Industry Caused By Unfair Imports

Mexican cement and clinker shipments to the U.S. increased from 132,000 tons in 1982 to 2,502,000 in 1985, a 19 fold increase in 3 years. These large increases occurred despite the fact that the U.S. domestic industry operated only at 65% of capacity in 1983, 75% of capacity in 1984, and 78% in 1985. The domestic cement industry is a cyclical business which, primarily due to the negative effect caused by subsidized and dumped cement imports, is not fully experiencing the recovery that it must achieve if it is to survive the next cyclical downturn without serious damage and dislocation. Indeed, in two cases particularly heavily hit by imports, Florida and Texas, domestic producers closed one plant and ceased integrated operations at another in 1984, despite local increases in consumption. Investment in new cement production facilities in the United States has virtually ceased, no steps are being taken to implement once-planned new plants, and layoffs are occurring, particularly at facilities located in border states.

Several U.S. cement companies recently have begun to import cement not because they are not able to supply the market with their own product, but they cannot compete with imports which receive a massive subsidy. These cement imports do not have a natural competitive advantage over the U.S. product but many of the imports are sold in the U.S. by being subsidized by their respective governments.

Our domestic cement industry is energy intensive with approximately 50% of the cost of production due to the cost of energy. During the 1970's energy crisis, a majority of the U.S. cement industry invested hundreds of millions of dollars modernizing its facilities and consequently, we operate some of the most efficient plants in the world. We have no fear of fair competition. But even with the most advanced technology, we cannot compete against cement imports produced with virtually no-cost, government-supplied energy. Such a massive energy subsidy is provided to Mexican cement producers. We need a remedy against imports which have a significant portion of their manufacturing cost subsidized by their government.

III. Inadequacies of Existing U.S. Trade Laws

The U.S. cement industry has sought to remedy this inequity within current law. However, our recent experience with an anti-dumping petition and countervailing duty case has convinced us that, as interpreted by the Department of Commerce and the ITC, current U.S. trade law in inadequate to deal with the serious threat from the cement imports which faces the U.S. cement industry. In 1983, representatives of the U.S. cement industry filed a countervailing duty petition asking the Commerce Department to investigate the subsidies, including energy pricing subsidies, received by the Mexican cement industry, and to impose offsetting duties. In September 1983, the Commerce Department, following precedents it recently had set in cases involving Mexican ammonia and carbon black, declined to countervail against the basic Mexican fuel pricing subsidy. It is essential that the CVD statute be amended so that effective action against this unfair trade practice can be taken.

While we recognize the necessity for effectively competing with foreign producers, it never occurred to us that our government, while espousing the necessity for increasing international trade, would turn its back and ignore unfair trade subsidies such as the energy subsidy provided to the Mexican cement producers. This fact has made it impossible for us to compete and thus could render our investments worthless if the Mexican penetration of our markets continues at the current rate due to Mexican government subsidization of cement production.

Although it is not the subject of my testimony today, I also must note that we adamantly oppose ITC's narrow application of the injury test requirement which has been employed during ITC's recent decisions. We urge Congress to review the ITC's recent interpretations of the injury test, particularly for those anti-dumping and countervailing duty petitions involving industries producing commodity products.

In this regard I should note that the House of Representatives, with the concurrence of the International Trade Commission (ITC) included language dealing with the problem in its version of the Trade Bill.

IV. Mexican Energy Subsidy Distorts U.S. Trade

We believe that the Mexican fuel subsidies are, in effect, an export subsidy and a domestic production subsidy which are contrary to the spirit of current U.S. trade law and the GATT. In discussing this statement, I first want to emphasize the sheer size of the Mexican energy subsidy. The Mexican government-owned oil company, PEMEX, operates a 2-tier pricing system for energy and sells heavy fuel oil to domestic cement and other manufacturers for a fraction of the price the same oil is sold for export by PEMEX. The domestic price is not available to U.S. manufacturers. The overall benefit of this natural resource subsidy to Mexican cement producers is approximately $10 - $20 per ton depending on the world market at that time. The average U.S. price realization is approximately $53 per ton. This tremendous artificial advantage created by Mexico's fuel price subsidy enables Mexican industries to enter markets in which they could not ordinarily compete. For example, markets for cement normally are regional, since transportation over long distances (more than 200 miles over land) is comparatively expensive. However, the cost advantage provided by the fuel subsidy enables Mexican cement companies to absorb higher transportation costs than would be acceptable to a cement company purchasing energy at market places. Indeed, the Mexican company that produces most of the cement exported from Mexico to Florida is located near Tampico, which is hundreds of miles away from Florida.

Mr. Chairman, what I am saying is that this problem is not limited to the Southwest. It is not limited to Florida. With their artificial cost advantage, Mexican companies can push their subsidized cement into any of our coastal states, up the Mississippi River, and even into the Great Lakes. And based on our experience in Florida -- a four thousand five hundred percent increase of Mexican cement imports since 1982 -- I believe that the Mexicans will go after some or all of those markets unless this country and this Congress decide that American industry should not be the victim of this type of subsidy program.

The Mexican National Industrial Development Plan (NIDP) "adopts as an explicit policy the principle of maintaining, at a lower level than the international one, the domestic price of industrially-used energy sources and basic petrochemicals." The plan states that this policy is connected with, among other objectives, "the promotion of exports and the efficient substitution of imports." Industrial Development Plan, 1976-1982-1990 (Abridged English Version) at 54.

The NIDP expressly states that:

> [The Mexican Government's] explicit policy of maintaining internal prices of energy sources for industrial use below that of the international market . . . allows for the strengthening of industry by giving it a substantial margin of protection via imports. In contrast to other forms of protection which tend to make such costs more expensive and access to external markets more difficult, this mechanism constitutes a direct incentive to exports. (Emphasis added).

NIDP at 30 (translation).

In 1976, the Mexican cement industry entered into a Coordination of Action agreement with the Government of Mexico, under which the industry agreed to guarantee national and regional cement supply in the 1977-1982 period and to generate a surplus for a substantial increase in cement exports. An even more ambitious Development Program for the Cement Industry was formulated jointly by the Government of Mexico and the industry in 1980 which called for increasing the annual production of cement by 15.3 million tons (from an annual total of about 19.9 million tons to 35.2 million tons) over the period of 1980-1983 -- a 77 percent increase in capacity in four years. In 1983, the Mexican cement industry had a excess capacity of over 16 million tons of cement, and the U.S. is the primary export market for its surplus cement.

One of the goals of the Mexican government's 2-tier energy pricing policy -- to stimulate exports -- certainly is being realized. Another goal of this fuel pricing policy -- to preclude imports -- also is being accomplished because the Mexican cement producers enjoy the lower price effect for the fuel subsidy. Mexico also imposes a 10% duty on imported cement in addition to requiring a government permit which is close to impossible to receive. As a consequence, there are virtually no exports of U.S. cement to Mexico.

Thus, this massive energy subsidy serves as an export subsidy, as well as a domestic production subsidy. Such subsidies violate fair trading practices and should not be permitted. Since the Department of Commerce has been allowing these unfair trade practices to continue despite protests from the injured industries, Congress needs to change the law to make it clear beyond any doubt, that such subsidies are to be countervailed.

V. Analysis of Opponent's Arguements

I would like to discuss some of the points presented by the opponents to the natural resource subsidy legislation. Previously, there have been claims that similar legislation approved by the House last year was in violation of GATT. Richard R. Rivers, former General Counsel of the Office of Special Trade Representative and head of the team that negitiated the Subsidies Code on behalf of the Untied States in 1976, testified at the Trade Subcommittee hearing on October 20, 1983, that:

> "Accordingly, in my opinion there is nothing in the GATT or the Subsidies Code that would preclude the United States from recognizing that a two-tiered energy pricing system can constitute a form of subsidization and from using any reasonable basis for measuring that subsidization."

At the same hearing, when Claude Gingrich, testifying on behalf of USTR, was asked if the natural resource subsidy provision contained in H.R. 4784 was a violation of the Subsidies Code which interprets the GATT, he replied "Specifically, no. It is not a violation." Proposed Amendments to the Countervailing Duty Law: Hearing Before the Subcommittee on Trade of the House Committee on Ways and Means, 98th Cong., 1st Sess. 109 (1983).

Arguments also have been made that if other countries enacted mirror legislation, U.S. products would be potential targets for foreign countervailing duties. This position reflects fundamental misunderstandings of the proposed legislation. The resource input subsidy would apply only when the price of a natural resource product is manipulated by a government to be lower than the export price or fair market value of the resource. Price regulation would not give rise to a potentially countervailable subsidy so long as it did not function to artificially lower prices below fair market value.

Opponents have raised objections to previous legislation of this type claiming that since the Mexican fuel subsidy is generally available to all industries, it is not countervailable. As noted in Cabot Corporation v. United States, et el (USCIT Consolidated Court No. 83-7-01044 decided October 4, 1985) this "generally available" argument fails to recognize that the effect of the subsidy is to confer a preferential grant to those particular industries that either use petroleum products as a basic feedstock or a manufacturing process requiring large amounts of energy relative to other constituents.

Significant benefits to the Mexican fuel pricing policy are received by specific industries. The effect of the fuel subsidy is to stimulate energy intensive industries with the express purpose of encouraging exports. The Mexican government in its NIDP explicitly states its two-tier fuel pricing policy "constitutes a direct incentive to exports" (NIDP at 30). Thus Mexico's fuel subsidy has the intent and effect of being an import subsidy which allows Mexican cement imports to distort trade in the U.S. Such a subsidy is a violation of fair trade which the U.S. should not tolerate.

It is alleged that the bill would "strike at the heart of comparative advantage". In other words, it would deprive certain less developed countries from capitalizing on the resource in which they have a natural advantage. This is an empty argument.

The theory of comparative advantage, from Ricardo down through the years, rests squarely and wholly on the conceptual foundation of free play of market forces. Only in such a free, uncontrolled market can comparative advantage prove itself and be justified economically.

To argue that Mexico or other like countries are using their comparative advantage in its generally accepted sense is a wholly specious argument. Their natural resource advantage is operating in a context of a controlled world price which bears no relation to production cost and, in addition, there is an artificial, contrived two-tier price which operates within that controlled price.

Furthermore, the classical theory of comparative advantage do not envision the stark realities of today's power balance. Regardless of economic theory, a major power of today cannot risk the erosion or disappearance of domestic industry essential to its national interest and strength. Nor can it be at the mercy of foreign supply for its basic needs.

It is alleged that enactment of the bill will precipitate retalitory action by our trading partners.

It is a fact that the Commission of the European Communities has already ruled that a similar two-tiered pricing practice initiated by the Dutch Government for natural resources constitutes an illegal subsidy. With such precedent it is difficult to accept the argument of retaliatory action.

Lastly, it is alleged that U.S. cement producers' energy costs are similar or in some cases even lower, than Mexican cement manufacturers' energy costs and, therefore, no subsidy exists. First of all, determination of a subsidy is not based on the costs for that product in the U.S. but on the fair market value of that product in the exporting country. Second, that data used to arrive at this false conclusion is inaccurate. A study conducted by the International Trade Commission* states that the average cost of coal in 1984 delivered to U.S. cement plants is $45-$65/ton. The Mexican cement producers claim that the U.S. coal costs are $29-$50/ton. Actually, the coal costs are even higher than the ITC states because neither the ITC nor the Mexican cement producers' statistics include the additional costs of grinding, pulverizing, storing and transporting the coal to the burner pipe in addition to the capital and depreciation costs associated with processing the coal which is an additional $6-$10/ton, thus increasing the cost of coal to $51-$75/ton.

VII. Conclusion

Mr. Chairman, I have just testified about the plant closures, layoffs, loss of profits, and lack of capital investments which are occurring within our domestic cement industry due to the impact of the increasing imports of subsidized cement from Mexico. It is critical that Congress act now to help restore fair trade to U.S. cement markets before irreversible injury occurs to this industry.

*USITC publication 1696 published in May, 1985 (this investigation was conducted under Section 332 (B) of the Tariff Act of 1930).

STATEMENT OF JOHN T. PLUNKET, PAST PRESIDENT AND BOARD MEMBER, ASSOCIATION OF AMERICAN CHAMBERS OF COMMERCE IN LATIN AMERICA, AND AMERICAN CHAMBERS OF COMMERCE IN MEXICO; AND DIRECTOR, TRANSMISIONES Y EQUIPOS MECHANICOS, S.A. DE C.V., MEXICO CITY, MEXICO

Mr. PLUNKET. Thank you, Senator. My name is John Plunket. I am a U.S. citizen and resident of Mexico City for the past 25 years. I am here as representative of the American Chamber of Commerce of Mexico and the Association of American Chambers of Commerce in Latin America, usually known by its acronym AACCLA. I am a past president of both organizations and at present chairman of the U.S. Legislation Committee of the American Chamber of Mexico and of the Trade Investment Committee of AACCLA.

Basically, both organizations are composed of U.S. and national ~~businessmen~~ resident in Latin America who make and manage U.S. investments in that area and to a large extent do the international trading between this country and the Latin American nations. My purpose in being here today is to express our opposition to proposed legislation aimed directly at the natural resource pricing policies of Mexico.

We have submitted a paper which explains our position, and I shall confine myself to mentioning two points which we consider particularly important from our point of view. Now, let me make it clear that I am not speaking for the Mexican cement, ammonia, or carbon black industries. Petroleum products and natural gas are almost the only industrial fuels used by Mexican industry. We believe that this bill would affect many more industries than the competitors of those companies which the bill seeks to protect. These additional companies which would be affected include many which are either wholly or partially U.S. owned.

There is almost $6 million of United States direct investment in Mexico, and those companies account for approximately one-third of Mexico's manufactured exports. Those companies also pay dividends, interest, and technical assistance fees to the United States. They usually buy their machinery and equipment from this country. We believe that the effect of this bill could seriously reduce Mexico's ability to buy and pay for United States exports and to service Mexico's debts to United States banks.

In 1985, Mexico's purchases from United States exporters totaled $13.6 billion. I would also point out that trade relations between the United States and Mexico have been improving materially in recent years. Last year an agreement was signed under which Mexico agreed to discontinue export subsidies. Later, negotiations were begun and are continuing toward an agreement which would provide structure to United States-Mexican trade relations and would increase and facilitate that trade.

Since GATT was created in 1948, the United States has been urging Mexico to become a party to the GATT agreements. Our American Chamber in Mexico has participated modestly in trying to convince the Mexicans that joining GATT would be in their interest and that they would gain protection against unfair trade practices of other nations.

Some months ago, Mexico decided we were right, and negotiations are now in process which would make Mexico a party to the GATT. Naturally, we find it disappointing that at this moment the Nation which supported Mexico's decision to join GATT for Mexico's own protection is seriously considering legislation which the administration in Washington believes would violate the United States' own obligations under the GATT agreement. In considering this proposed legislation, we urge the Congress to weigh the harm which it might do against the benefits which it seeks to achieve. Thank you, sir.

Senator LONG. Thank you, sir. And now, finally, we will hear from Mr. William C. Foster, manager, supply and distribution, Carbon Black Division of Cabot Corp., Atlanta, GA.

[The prepared written statement of Mr. Plunket follows:]

BEFORE THE UNITED STATES SENATE
COMMITTEE ON FINANCE
SUBCOMMITTEE ON INTERNATIONAL TRADE

Statement Opposing Natural Resource Legislation
Submitted by John T. Plunkett
On Behalf Of
The American Chamber of Commerce of Mexico
and
The Association of American Chambers of Commerce
in Latin America

June 26, 1986

Mr. Chairman and Members of the International Trade Subcommittee, I am honored today to have the opportunity to appear before you on behalf of the American Chamber of Commerce of Mexico ("AmCham") of which I am past president and currently chairman of the United States Legislation Committee. AmCham is the largest American Chamber of Commerce in the world outside of the United States, with a total of 2900 corporate members who represent 90% of the direct American private investment in Mexico and exemplify the $33 billion of trade transacted in 1985 between the United States and Mexico. The Association of American Chambers of Commerce in Latin America ("AACCLA"), of which I am also past president and currently chairman of the Trade and Investment Committee, is very concerned about the issue of natural resource legislation which your Subcommittee is examining today. AACCLA is composed of 21 American Chambers of Commerce in Latin America and represents approximately 17,000 United States and host country businesses.

Over the past thirty-three years, I have worked as an international lawyer and business executive in seven countries in Latin America. Having spent the last twenty-five years in Mexico, I have come to know Mexico's economic policies and have an in-depth appreciation of the significance of Mexico-U.S. trade relations. I traveled from Mexico to Washington yesterday to appear before your Subcommittee, and I hope I can make a constructive contribution to your deliberations.

I am here today to oppose legislative initiatives being considered by the Congress which are aimed directly at the natural resource pricing policies of Mexico. The natural resource subsidy provisions in various pending bills would make certain products of Mexico countervailable if they are produced with the benefit of one of Mexico's most valuable natural resources -- petroleum and its derivatives. As I will explain more fully in a moment, such natural resource subsidy legislation could not come at a worse time for further development of improved United States-Mexican trade relations.

Protectionist natural resource legislation by the United States, one of the most powerful and resource-rich countries in the world over the long term, would go far to cancel out the full use of one of the few significant comparative advantages of Mexico, a developing country struggling to find its place in the international trading system. Moreover, the legislation would reach into a neighboring, friendly, sovereign country -- one that supplies the United States with half of its exports in petroleum -- and would penalize its own domestic allocation of resources for its own complex, developmental purposes.

Natural resources legislation would penalize Mexico, in effect, for attempting to combine optimum domestic use of natural resources with the normal profit of overseas sales. It would apply with equal force to export products of Mexican companies wholly or partially owned by U.S. interests. It also would create the additional risk that Mexico and others could very well retaliate.

But there is a new and very powerful argument against this legislation. The natural resource legislation could put at risk the beginnings of what may well be a new era in trade relations between these two countries.

By entering into the recent bilateral agreement on subsidies with the United States, Mexico has broken new ground in the first commercial agreement in 40 years. Mexico has demonstrated that it is trying to move away from the inward-looking policies of the past and that it is embarking on a long journey towards opening up the Mexican economy to foreign trade and investment. The subsidies agreement demonstrates the disciplined and responsible manner in which Mexico is prepared to pursue its trade relations with this country. Equally, if not more significantly, its statement of intent to negotiate a framework of principles and procedures for trade and investment is, to my mind, a quantum leap for a nation which previously has been reluctant to talk publicly with us about significant reductions in restraints, nondiscrimination in foreign investment consultations with the United States, and dispute-settlement procedures.

Old timers such as myself find it heartening that the inward-looking Mexico that we have known over the past thirteen years is now prepared to talk to us about these matters. But President de la Madrid has gone further than mere words. He has said that, in addition to the signing of the bilateral subsidies agreement and the start of negotiations of a possible framework agreement with the United States, he is prepared to review Mexico's multilateral trade arrangements. His words have been given substance by Mexico's announced intention to enter the GATT.

Passage of natural resource legislation, therefore, could be a serious setback for this process of change. Such new evidence of U.S. protectionism would change overnight an atmosphere which, I think, has significantly improved in the last year.

Mexico is the third largest trading partner of the United States, and United States imports from Mexico totalled $13 billion in 1985. The United States is Mexico's leading supplier and principal customer. In 1985, 66% of Mexico's foreign purchases came from the United States. In 1985, major United States exports to Mexico included corn, sorghum, motor vehicle parts, soybeans, automatic data processing parts, paper and paperboard, and sunflower seeds. The demand in Mexico for United States grain, machinery and high tech products continues to grow. This demand may be expected to increase further as Mexico continues to seek economic expansion and development. Overall in 1985, United States exports to Mexico increased by 29.6% over the previous year.

Mexico's chief economic assets are its oil reserves and petroleum industry. The country is a leading exporter of oil and petroleum products. The operations of this industry are, however, deeply dependent on equipment imports, most of which come from the United States. This dependence is not likely to decrease in the future.

It is the view of AmCham that natural resource provisions represent an attempt to penalize foreign producers for availing themselves of "comparative advantages" stemming from the mere fact of location in a country with significant deposits of natural resources. If natural resource subsidy legislation, which is aimed at, and most certainly, will harm Mexican industry, is enacted into law, the negative impacts on United States consumers, United States agriculture and on United States/Mexico trade relations will be severe. The protection of a few isolated members of a select industry or two in the United States at the expense of other industries and of the American consumer is not justified. I ask your Subcommittee and Congress to consider the widespread and damaging effect natural resource legislation would have on complex and fast developing trading relations between Mexico and the United States.

If natural resources subsidy legislation is enacted, you will be slowing down, if not reversing a process of change which is now well underway. I urge you to give Mexico the opportunity to accomplish its new trade agenda.

Thank you.

STATEMENT OF WILLIAM C. FOSTER, MANAGER, SUPPLY AND DISTRIBUTION, CARBON BLACK DIVISION, CABOT CORP., ATLANTA, GA

Mr. FOSTER. Thank you, Senator Long. I have with me Terry Stewart, who is our special counsel on the so-called carbon black case. Cabot is the world's largest and most efficient producer of carbon black, an important petrochemical used in the production of automobile tires and other essential products. I appreciate having the opportunity to express our support for this natural resource legislation.

Worldwide, Cabot produces 2 billion pounds of carbon black annually, which represents nearly 25 percent of the free world capacity. We have four carbon black plants in the United States, one each in Texas, in West Virginia, and two in Louisiana.

Despite our superior production efficiencies, subsidized Mexican carbon black has had a significant impact on the United States market. In 1982, carbon black imports from Mexico totaled 6.7 million pounds. In 1983, Mexican exports to the United States tripled to nearly 19 million pounds. In 1984, almost 50 million pounds of carbon black were imported to the United States from Mexico. In 1985, the level of Mexican carbon black exports to the United States began to stabilize. This may have been due, in part, to Cabot's so far unsuccessful but ongoing efforts on behalf of the United States carbon black industry to have a countervailing duty imposed on Mexican carbon black.

We also believe, however, that the slowing of Mexico's rate of increased imports is only temporary. Mexico has announced plans to expand further its carbon black production capacity, which already substantially exceeds the Mexican market demand. This additional capacity would equal approximately 25 percent of the current total U.S. capacity.

The target for this additional Mexican carbon black is the United States market. This poses a devastating threat to U.S. carbon black producers and workers. Mexico's pricing policy with respect to carbon black feedstock is a subsidy which is significant and damaging, since hydrocarbon feedstock represents 70 percent of the total cost of production of carbon black in the United States. Mexico's pricing policy on carbon black feedstock, even after recent Mexican price increases, still provides Mexican carbon black producers with a major production cost advantage.

This cost advantage cannot be offset through technological advance or efficient operations. With such a disproportionate advantage, Mexican plants can easily operate at lower efficiencies and still underprice United States producers in the United States home market. In fact, if United States producers decided to write off all the costs of production and simply charge for carbon black what they pay for feedstock alone, they still could not compete with subsidized Mexican carbon black.

The natural resource legislation which you are now considering addresses the critical issue of Mexico's discriminatory feedstock and energy pricing policy. It is our fervent hope that this legislation will be given the support it deserves. Thank you.

Senator LONG. Thank you.

[The prepared written statement of Mr. Foster follows:]

STATEMENT OF

WILLIAM C. FOSTER

OF

CABOT CORPORATION

BEFORE

THE SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE

OF THE

U.S. SENATE

ON

NATURAL RESOURCE SUBSIDIES

JUNE 26, 1986

MY NAME IS WILLIAM C. FOSTER. I AM MANAGER OF SUPPLY AND DISTRIBUTION FOR THE CARBON BLACK DIVISION OF CABOT CORPORATION. CABOT IS THE WORLD'S LARGEST PRODUCER OF CARBON BLACK, AN IMPORTANT PETROCHEMICAL USED IN THE PRODUCTION OF AUTOMOBILE TIRES AND OTHER ESSENTIAL PRODUCTS.

I APPRECIATE HAVING THE OPPORTUNITY TO EXPRESS OUR SUPPORT FOR THE PENDING NATURAL RESOURCE LEGISLATION (S.1292), INTRODUCED BY SENATOR BAUCUS OF WYOMING AND SENATOR LONG OF LOUISIANA. THIS LEGISLATION WOULD CLARIFY U.S. COUNTERVAILING DUTY LAW TO EXPLICITLY COVER MEXICO'S METHOD OF SUBSIDIZING AND ENCOURAGING EXPORTS OF MEXICAN PRODUCTS SUCH AS CARBON BLACK, BY PROVIDING HYDROCARBON FEEDSTOCKS AND ENERGY TO MEXICAN PRODUCERS AT PRICES FAR BELOW THE WORLD MARKET PRICES AND MEXICO'S OWN EXPORT PRICES.

LET ME GIVE YOU SOME BACKGROUND ON OUR INDUSTRY AND WHY WE ARE CONCERNED WITH THE CURRENT SITUATION. CABOT IS A 100 YEAR OLD MANUFACTURING COMPANY WITH ANNUAL SALES OF ABOUT $1.6 BILLION. APPROXIMATELY ONE-THIRD OF THOSE SALES COME FROM OUR OLDEST BUSINESS, THE MANUFACTURE OF CARBON BLACK.

CARBON BLACK HAS BECOME AN INDISPENSABLE MATERIAL IN THE MODERN WORLD. THE LARGEST USE FOR CARBON BLACK IS AS A REINFORCING AGENT IN RUBBER WHERE IT IS A CRITICAL COMPONENT OF TIRES AND OTHER RUBBER GOODS. CARBON BLACK, HOWEVER, SERVES MANY OTHER IMPORTANT PURPOSES -- A PIGMENT, A REINFORCING AGENT, AN ELECTRICAL CONDUCTOR AND A MATERIAL RESISTANT TO ULTRAVIOLET LIGHT. CARBON BLACK IS ESSENTIAL IN THE MANUFACTURE OF AUTOMOTIVE PARTS, PRINTING INKS, AND COMPUTERS AND IS EVEN USED IN CERTAIN KINDS OF FARMING.

CARBON BLACK IS MADE THROUGH THE THERMAL DECOMPOSITION OF CARBON BLACK FEEDSTOCK, A HYDROCARBON-BASED RAW MATERIAL. THE COST OF HYDROCARBONS ACCOUNT FOR AT LEAST 70 PERCENT OF THE COST OF CARBON BLACK PRODUCTION IN THE UNITED STATES.

WORLDWIDE CABOT PRODUCES 2 BILLION POUNDS OF CARBON BLACK ANNUALLY, WHICH REPRESENTS NEARLY 25% OF THE FREE WORLD CAPACITY. WE HAVE FOUR CARBON BLACK PLANTS IN THE U.S.; ONE EACH IN TEXAS AND WEST VIRGINIA AND TWO IN LOUISIANA. OUR DOMESTIC CARBON BLACK OPERATIONS EMPLOY ABOUT 800 PEOPLE.

AS THE LARGEST PRODUCER OF CARBON BLACK, CABOT IS COMMITTED TO MANUFACTURING THE HIGHEST QUALITY OF CARBON BLACK FOR THE LOWEST COST. IN FACT, WE BELIEVE WE ARE THE MOST EFFICIENT PRODUCER OF CARBON BLACK IN THE WORLD. WE HAVE

INVESTED MILLIONS OF DOLLARS IN THE LAST DECADE TO MAKE OUR PLANTS EFFICIENT AND TO ADVANCE OUR PRODUCT DEVELOPMENT AND PROCESS TECHNOLOGY -- SO THAT WE CAN BE THE MOST EFFICIENT PRODUCER.

DESPITE THESE SUPERIOR PRODUCTION EFFICIENCIES, SUBSIDIZED MEXICAN CARBON BLACK HAS HAD A SIGNIFICANT IMPACT ON THE U.S. MARKET. IN 1982, CARBON BLACK IMPORTS FROM MEXICO TOTALED 6.7 MILLION POUNDS. IN 1983, MEXICAN EXPORTS TO THE U.S. TRIPLED, TO NEARLY 19 MILLION POUNDS. IN 1984, ALMOST 50 MILLION POUNDS OF CARBON BLACK WERE IMPORTED TO THE U.S. FROM MEXICO. IN 1985, THE LEVEL OF MEXICAN CARBON BLACK EXPORTS TO THE UNITED STATES BEGAN TO STABILIZE. THIS MAY HAVE BEEN DUE IN PART TO CABOT'S SO FAR UNSUCCESSFUL BUT ON-GOING EFFORTS ON BEHALF OF THE U.S. CARBON BLACK INDUSTRY TO HAVE A COUNTERVAILING DUTY IMPOSED ON MEXICAN CARBON BLACK. WE ALSO BELIEVE, HOWEVER, THAT THE SLOWING OF MEXICO'S RATE OF INCREASED IMPORTS IS ONLY TEMPORARY.

MEXICO HAS ANNOUNCED PLANS TO EXPAND FURTHER ITS CARBON BLACK PRODUCTION CAPACITY, WHICH ALREADY SUBSTANTIALLY EXCEEDS THE MEXICAN MARKET DEMAND. THIS ADDITIONAL CAPACITY WOULD EQUAL APPROXIMATELY 25 PERCENT OF CURRENT TOTAL U.S. CAPACITY. THE TARGET FOR THIS ADDITIONAL MEXICAN CARBON BLACK IS THE U.S. MARKET. THIS POSES A DEVASTATING THREAT TO U.S. CARBON BLACK PRODUCERS AND WORKERS.

IN NOVEMBER OF 1982, CABOT ASKED THE U.S. DEPARTMENT OF COMMERCE (DOC) TO IMPOSE A "COUNTERVAILING DUTY" ON CARBON BLACK IM

INVESTED MILLIONS OF DOLLARS IN THE LAST DECADE TO MAKE OUR PLANTS EFFICIENT AND TO ADVANCE OUR PRODUCT DEVELOPMENT AND PROCESS TECHNOLOGY -- SO THAT WE CAN BE THE MOST EFFICIENT PRODUCER.

DESPITE THESE SUPERIOR PRODUCTION EFFICIENCIES, SUBSIDIZED MEXICAN CARBON BLACK HAS HAD A SIGNIFICANT IMPACT ON THE U.S. MARKET. IN 1982, CARBON BLACK IMPORTS FROM MEXICO TOTALED 6.7 MILLION POUNDS. IN 1983, MEXICAN EXPORTS TO THE U.S. TRIPLED, TO NCAUSE CBFS WAS "GENERALLY AVAILABLE" TO ANY MEXICAN COMPANY WHICH COULD USE IT. THE FACTS THAT ONLY TWO MEXICAN COMPANIES COULD USE CBFS, THAT PEMEX INTENTIONALLY PRODUCED CARBON BLACK FEEDSTOCK IN LIMITED QUANTITIES AND ALLOCATED ALL OF IT TO THE TWO MEXICAN CARBON BLACK PRODUCERS, AND THAT PEMEX REFUSED TO SELL ANY CARBON BLACK FEEDSTOCK TO CABOT DESPITE REPEATED REQUESTS, DID NOT DETER COMMERCE FROM CONCLUDING THAT THE SUBSIDY WAS "GENERALLY AVAILABLE" AND NOT COUNTERVAILABLE UNDER THE DEPARTMENT'S INTERPRETATION OF PRESENT U.S. LAW.

IN A RECENT PRELIMINARY DETERMINATION OF THIS DECISION WHILE OUR APPEAL WAS PENDING, THE COMMERCE DEPARTMENT FINALLY AGREED WITH US THAT CARBON BLACK FEEDSTOCK IS NOT GENERALLY AVAILABLE. HOWEVER, DESPITE THIS FINDING, COMMERCE STILL DID NOT FIND MEXICO'S PRICING PRACTICES TO BE A COUNTERVAILABLE SUBSIDY.

IN ORDER TO DETERMINE WHETHER THE MEXICAN GOVERNMENT IS PROVIDING THE FEEDSTOCK AT A PREFERENTIAL PRICE, COMMERCE COMPARED THE PRICE OF CARBON BLACK FEEDSTOCK IN THE MEXICAN MARKET WITH THE DOMESTIC PRICE OF A SIMILARLY SUBSIDIZED PETROLEUM PRODUCT THAT IS WIDELY AVAILABLE IN THE MEXICAN MARKET. THE COMMERCE DEPARTMENT FOUND THAT THE PRICE RELATIONSHIP BETWEEN THESE TWO EQUALLY SUBSIDIZED PRODUCTS ROUGHLY PARALLELED THE RELATIONSHIP BETWEEN THE SAME TWO PRODUCTS IN THE FREE U.S. MARKET, ALTHOUGH AT AN ENTIRELY DIFFERENT ABSOLUTE LEVEL AND, THEREFORE, CONCLUDED THAT CARBON BLACK FEEDSTOCK WAS NOT PROVIDED AT A PREFERENTIAL PRICE WITHIN MEXICO. THIS, OF COURSE, IGNORES THE CRITICAL ISSUE OF WHETHER TWO-TIERED PRICING OF BOTH PRODUCTS ARE COUNTERVAILABLE SUBSIDIES.

IN FACT, THE MEXICAN PRICING POLICY WITH RESPECT TO CARBON BLACK FEEDSTOCK IS A SUBSIDY WHICH IS SIGNIFICANT AND DAMAGING. THE HYDROCARBON FEEDSTOCK REPRESENTS 70% OF THE TOTAL COST OF PRODUCTION OF CARBON BLACK IN THE U.S. MEXICO'S PRICING POLICY ON CARBON BLACK FEEDSTOCK EVEN AFTER RECENT MEXICAN PRICE INCREASES STILL PROVIDES MEXICAN CARBON BLACK PRODUCERS WITH A MAJOR PRODUCTION COST ADVANTAGE. THIS COST ADVANTAGE CANNOT BE OFFSET THROUGH TECHNOLOGICAL ADVANCE OR EFFICIENT OPERATIONS. WITH SUCH A DISPROPORTIONATE ADVANTAGE, MEXICAN PLANTS CAN EASILY OPERATE AT LOWER EFFICIENCIES AND STILL UNDERPPRICE U.S. PRODUCERS IN THE U.S. HOME MARKET. IN FACT, IF U.S. PRODUCERS DECIDED TO WRITE OFF ALL THE COSTS OF PRODUCTION AND SIMPLY CHARGE FOR CARBON BLACK WHAT THEY PAY FOR FEEDSTOCK ALONE, THEY STILL COULD NOT COMPETE WITH SUBSIDIZED MEXICAN CARBON BLACK.

THIS FEEDSTOCK PRICING ADVANTAGE HAS ALLOWED MEXICO TO ENTER THE U.S. MARKET AGGRESSIVELY. SALESMEN FOR MEXICAN CARBON BLACK QUOTE DELIVERED PRICES TO U.S. BUYERS' PLANTS WHICH ARE GUARANTEED TO BE 1 C U.S. (ONE CENT) PER POUND (ABOUT 3 TO 4% OF U.S. MARKET PRICE) LOWER THAN U.S. CARBON BLACK PRODUCERS' LOWEST <u>UNDELIVERED PRICE</u>, WITHOUT REGARD TO WHAT THE U.S. PRODUCERS' PRICE MAY BE. FOR A U.S. PRODUCER THIS IS LIKE TRYING TO STAND ON QUICKSAND AND IT EXPLAINS HOW THE MEXICAN CARBON BLACK PRODUCERS HAVE BEEN ABLE TO DOUBLE OR TRIPLE THEIR EXPORTS TO THE U.S. DURING THE LAST FEW YEARS. THIS PRICE UNDERCUTTING BY MEXICAN CARBON BLACK PRODUCERS HAS REVERBERATED THROUGH THE ENTIRE U.S. MARKET CAUSING A MAJOR CONCERN REGARDING THE LONG TERM VIABILITY OF MAJOR PARTS OF THIS IMPORTANT U.S. INDUSTRY.

YOU SHOULD ALSO BE AWARE THAT THE U.S. IS A MAJOR SUPPLIER OF CARBON BLACK FEEDSTOCK TO OTHER NATIONS WHILE THE MEXICAN GOVERNMENT STILL REFUSES TO EXPORT ITS CARBON BLACK FEEDSTOCK. NOR WILL MEXICO ALLOW FOREIGN COMPANIES TO HAVE MORE THAN 40 PERCENT OWNERSHIP IN ANY MEXICAN CARBON BLACK PLANT THAT COULD TAKE ADVANTAGE OF THIS LOWER FEEDSTOCK PRICE. THIS IS BLATANT DISCRIMINATION THROUGH GOVERNMENT INTERVENTION.

THE NATURAL RESOURCE LEGISLATION WHICH YOU ARE NOW CONSIDERING ADDRESSES THE CRITICAL ISSUE OF MEXICO'S DISCRIMINATORY FEEDSTOCK AND ENERGY PRICING POLICY. IT IS OUR FERVENT HOPE THAT THIS LEGISLATION WILL BE GIVEN THE SUPPORT IT DESERVES.

I WILL BE GLAD TO TAKE YOUR QUESTIONS.

SUPPLEMENTAL STATEMENT OF CABOT CORPORATION

REGARDING S.1292 AND S.1356

ON THE COUNTERVAILABILITY OF NATURAL RESOURCE SUBSIDIES BEFORE THE SENATE FINANCE COMMITTEE

JULY 10, 1986

Cabot Corp. is the leading producer of carbon black in the United States, and also produces specialty metallic alloys and other chemicals, and explores for petroleum and natural gas. Cabot has plants throughout the United States and around the world. As a major exporter, the interests of Cabot in free and fair international trade are great. In the past few years, however, Cabot has faced competition in the United States market from foreign producers who benefit from the availability of their natural resource inputs at prices set by their governments at levels far below those on the world market. This Committee is considering two bills, S.1292 and section 502 of S.1356, that would explicitly define such practices as subsidies if certain conditions are met. Cabot submitted testimony at the hearing held on June 26, 1986.

The Administration has raised two major objections to the natural resource provision. The first is the allegation that such legislation would violate the asserted "principle" that generally available benefits are not countervailable, a principle that is supposedly established by our subsidy code obligations to which the United States must adhere. The second is that the International Trade Administration's proposed preferentiality appendix removes the need for the bill by providing a method under which such practices can be countervailed if they are not generally available in fact. Cabot wishes to provide its comments upon these objections.

As a prelude to addressing these specific arguments, however, Cabot will review briefly the Congressional purpose and economic justification of the countervailing duty law. There is an international consensus that subsidization can cause real dislocations in the international economy, and that the use of subsidies by governments ought to be restrained. The arguments of the administration against the implementation of the natural resource legislation do not address how the administration of the countervailing duty law promotes the goals and purposes behind the legislation.

I. THE PURPOSE OF THE COUNTERVAILING DUTY LAW

The purpose of the countervailing duty law has been often articulated by the Congress and the courts. For example, this Committee indicated that purpose in its report upon the Trade Agreements Act of 1979, when it stated that "[s]ubsidies and dumping are two of the most pernicious practices that distort international trade to the disadvantage of the United States." S. Rep. No. 249, 96th Cong., 1st Sess. 37 (1979). The purpose of the countervailing duty law, then, is to remove the distortions subsidies produce in the international economy by offsetting them, and so to allow United States industries to compete on the basis of creativity, quality and efficiency, rather than relative subsidization.

The same purpose underlies the international obligations of the United States governing the use, and countervailing, of subsidies. In the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, the so-called "Subsidies Code," the parties agreed that domestic subsidies were a legitimate means of implementing domestic policies. The parties also agreed, however, that such subsidies could have a negative impact upon world trade by distorting normal trade flows. See Article 11(2). For this reason, domestic subsidies are countervailable under the Code if they result in the injury of an industry competing with a subsidized import. As in United States law, the focus of the Subsidies Code is upon the impact of subsidies on international trade. Indeed, the very reason that the Subsidies Code exists at all is to ameliorate the negative effect that subsidization has had upon world trade.

In interpreting the countervailing duty law, the courts have confirmed that the purpose of the countervailing duty law is to rectify the unfair advantages in international competition that subsidies provide. The Court of Customs Appeals enunciated this principle as early as 1919, when it held that:

> Its [the countervailing duty law's] plain, explicit and unequivocal purpose is: Whenever a foreign power . . . shall give any aid or advantage to exporters of goods imported into this country therefrom whereby they may be sold for less in competition with our domestic goods, to that extent by this paragraph the duties fixed in the schedule of the act are increased. It was a result Congress was seeking to equalize regardless of whatever name or in whatever manner or form or for whatever purpose it was done.

7 C.C.A. at 106 (emphasis in original). Although the court was talking about export subsidies in particular, the purpose of the countervailing duty law has remained the same regarding domestic subsidies as well. As the Court of International Trade has stated, "[t]he only purpose of the countervailing duty law is to extract the subsidies contained in the merchandise entering the commerce of the United States in order to protect domestic industry from their effect. In this domestic purpose, its effectiveness is clearly intended to be complete and without

exception." Continental Steel Corp. v. United States, 9 CIT ___, 614 F. Supp. 548, 553 (1985), appeal docketed, No. 85-2805 (CAFC September 24, 1985). That the countervailing duty law is intended to protect United States producers from subsidized competition was also stressed in ASG Industries, Inc. v. United States, 467 F. Supp. 1200 (Cust. Ct. 1979), in which the court explained that "the purpose of the statute [the countervailing duty law] is, indisputably, to protect domestic producers from import competition which has benefited from bounties or grants," 467 F. Supp. at 1224, and later, that "[t]he purpose of the law is to prevent unequal competition in our markets -- to prevent foreign goods from competing with domestic goods at a lower price than they would otherwise be sold." Id. at 1230. Similar statements appear in a number of other cases as well. See, e.g., Zenith Radio Corp. v. United States, 437 U.S. 443, 455 (1978); ASG Industries, Inc. v. United States, 610 F.2d 770, 776 (C.C.P.A. 1979); Bethlehem Steel Corp. v. United States, 7 CIT ___, 590 F. Supp. 1237, 1241 (1984).

The inevitable conclusion to be drawn from the statement of this Committee and of the decisions of the courts is that the purpose of the countervailing duty law is to protect United States producers from the ability of foreign producers to sell their products in the United States at prices that are lower than would have been possible without government subsidies. The existence of the countervailing duty law reflects this nation's commitment to the principle that international trade should be governed by market forces, rather than by the intervention of governments through the bestowal of subsidies. International trade is premised upon the law of comparative advantage, which states that for any given product, one country will have a comparative advantage in its production over another. If international trade is conducted on the basis of comparative advantage, total resources will be used on the most efficient basis possible, so that, at the international level, the most goods that can be produced using the available inputs will be produced. The free operation of comparative advantage thus benefits all members of the international trading system. See P. Samuelson, Economics 627-30 (11th ed. 1980); P. Lindert and C. Kindleberger, International Economics 18-25 (1982); Taxing Unfair International Trade Practices 273-75.

As noted above, subsidization of a product artificially alters the comparative advantage one country has in the production of a product over another. The provision of goods or services at preferential rates constitutes a subsidy because it relieves the recipient of some of the normal costs of producing an article, and thus bestows upon the producer an artificial competitive advantage. The recipient can then charge less for its products than would otherwise be possible, so enabling it to sell goods in which it does not have a comparative advantage. The amount of the artificial competitive advantage created by the provision of goods or services at controlled prices is therefore equal to the difference between what it would have cost the producer to produce the article under normal conditions of comparative advantage, i.e., where the free market, rather than a market affected by government or other third party intervention, determined the costs of the inputs used to make the product, and what it actually cost the producer. Unless the full amount of the artificial competitive advantage bestowed by the subsidy is offset, the subsidy will still result in a distortion of the comparative advantage, and so in potential injury to producers in the importing country's economy and in a diminution of total world prosperity. It is also clear that whether or not producers of other products in the exporting country have access to the input at the same price is irrelevant. The provision of inputs at preferential prices is countervailable, not because one company in a foreign country may be preferred over another, but because the sale of the input at a controlled price provides the purchaser an advantage over its <u>international</u> competitors.

Both Congress and the courts have described the subsidy inherent in the sale of inputs at controlled prices as arising from the difference the subsidy makes in the normal operation of market forces. The House Ways and Means Committee explicitly described the law of comparative advantage as constituting the underlying rationale for countervailing subsidies. In explaining the reason for defining explicitly as a subsidy the sale by foreign governments of natural resources at prices below their fair value, the committee noted first that the use of two-tier pricing policies and other below market pricing schemes by foreign governments "have the unwanted effect of subsidizing their domestic producers by affording them preferential or below market rates for resource products, and in so doing, skewing normal comparative advantage." H.R. Rep. No. 581, 99th Cong., 2d Sess. 97 (1986). The committee explained further that the bill would not require the imposition of countervailing duties where the lower price for an input in a foreign country was the result of comparative advantage. Id. at 98. In other words, the sale of inputs at a controlled price is a subsidy to the extent that the price diverges from the free market price because the sale of the input at the controlled price disrupts the natural operation of comparative advantage in the world economy.

The statement of the Ways and Means Committee echoes the conclusion reached by the Court of International Trade in Cabot Corp. v. United States, 9 CIT___, 620 F. Supp. 722, appeal dismissed, # 86-729 (Fed. Cir. April 9, 1986), in which Cabot had appealed the decision by the ITA that the sale of carbon black feedstock and natural gas by the Mexican government to the Mexican producers of carbon black at prices far below world market levels was not a subsidy. The court first held that the ITA had applied an improper test in making its decision. The court then indicated that the proper measure of subsidization was whether the price charged was lower than it would have been in a free market. In rejecting the plaintiff's argument that the sale of inputs at below world market prices constitutes a subsidy per se, the court noted that the low prices charged by the Mexican goverment could be the result "of various non-countervailable factors, such as comparative advantage." 620 F. Supp. at 733. On the other hand, the court continued, "'generally available' benefits are not necessarily the result of the exercise of comparative advantage." Id. The court so indicated that the countervailability of preferential prices arises from the distortion of comparative advantage that such prices cause.

Subsidies are countervailable because they disturb the normal operation of comparative advantage and expose United States industries to unfair competition--competition that is unfair because it is made possible by government intervention, rather than by the free operation of market forces. The purpose of the countervailing duty law is to offset the subsidies that provide foreign producers an advantage over their United States competitors. To be effective, the countervailing duty must offset the full amount of all benefits provided. In the case of goods or services, as was shown above, the competitive advantage provided by the subsidy is the ability of the foreign producer to purchase inputs at prices lower than those that would have been available absent goverment intervention. If a countervailing duty is to remove this unfair advantage completely, the subsidy offset must be the full difference between the price actually paid, and what the price of the input would have been in a free market. Moreover, the subsidy to be offset includes any benefit that provides an advantage, regardless of its nominal availability within the country of export. It is this international effect of subsidization, rather than any effect within the country doing the subsidizing, that constitutes the greatest negative aspect of subsidization, and that is the focus of the national and international rules governing the countervailing of subsidies.

II. THE GENERAL AVAILABILITY TEST IS NOT REQUIRED BY THE INTERNATIONAL OBLIGATIONS OF THE UNITED STATES, AND IS CONTRARY TO THE PURPOSE OF THE COUNTERVAILING DUTY LAW.

The first, and greatest, objection voiced by the Administration against the enactment of a provision making explicit the countervailability of natural resource inputs at prices below world market levels, when those prices are not available to producers outside the country in question, is that it violates the "general availability" test. See Statement of Michael B. Smith before the Senate Finance Committee, June 26 1986, at 1-2 ("Smith Statement"); Statement of Gilbert B. Kaplan before the Senate Finance Committee, June 26, 1986, at 3 ("Kaplan Statement"). It is the Administration's position that subsidies are defined as distortions within the economy of a foreign country. Under the general availability test, the ITA will not treat as subsidies benefits provided to more than a restricted number of enterprises or industries. Under this test, the sale of goods or services by a government to firms in a country at controlled prices is not a subsidy if the price is "generally available," regardless of how far below the free market price the controlled price is, and even though the input sold is used by some industries more than others and United States or other foreign purchasers are not allowed to purchase the input at the controlled price. See Carbon Black from Mexico, 51 Fed. Reg. 13,269, 13,272-73 (1986). It is claimed that the generally availability test is required by the international obligations of the United States and by United States law. See Smith Statement at 1-3; Kaplan Statement at 3.

Such a restriction upon the definition of "subsidy" does not appear in the Subsidies Code or in the countervailing duty statute, nor is it implied by the legislative history of the countervailing duty law. Decisions of the courts in interpreting the countervailing duty law have explicitly held that the general availability test is contrary to the basic purposes of the countervailing duty law. A review of each of these sources will establish this point.

A. The General Availability Test in International Law

Deputy U.S. Trade Representative Smith's prepared statement before this Committee alleges that there is a "broad international consensus" that the proper test of a domestic subsidy is whether it was granted to a specific industry or group of industries, so that generally available benefits are not countervailable. He claims that this "specificity test" is recognized in the GATT Subsidies Code, the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade. Smith Statement at 2. A review of the language of the Code and of other international authorities reveals that the Code does not embody any such test, and moreover, and that no such "broad international concensus" exists.

Mr. Smith cited as his authority for this proposition Article 11(3) of the Subsidies Code, which states that development goals may be met "inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises." The article then lists some examples of domestic subsidies, and notes that "the above forms of subsidies are normally granted either regionally or by sector." Nothing in this language supports the position that the Subsidies Code forbids the countervailing of generally available subsidies. In the first place, the article itself notes that the subsidies described are merely examples, and do not constitute a comprehensive list of subsidies. Likewise, the article only "notes" that domestic subsidies are normally granted on a sectoral or regional basis. This statement is far different from a requirement that only subsidies granted by region or by sector be countervailed. Indeed, the very use of the word "normally" indicates that the parties were not precluding the countervailing of subsidies that were "abnormal," i.e., given on a general basis.

Finally, the article notes that subsidies may be conferred to provide an advantage to certain enterprises. The ITA, and Mr. Smith, have apparently interpreted this to mean an advantage over other enterprises in the same country. Such an interpretation is inconsistent with the fundamental purpose of the Subsidies Code, which is to ameliorate the effect subsidies have upon international trade. It is for this reason that the entire orientation of the Code is towards the distortive effects domestic subsidies can have upon international trade and the injury subsidies can inflict upon industries in the importing country. See Article 11(2). In this context, the "advantage" conferred upon certain enterprises described in Article 11(3) can only mean an advantage over the international competitors of the recipients. Such an advantage is completely independent of whether or not the same benefit is available to other, non-competing firms in the same country. For international purposes, it is irrelevant whether a country sells natural gas to a producer of fertilizer at a lower price than to a toy maker. It

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is important if the price of the gas sold to the fertilizer maker is below the free market price, and is unavailable to fertilizer producers in other countries. That the toy maker can buy natural gas at the same artificially low price in no way lessens this international competitive advantage.

Far from requiring the use of a general availability test, the Subsidies Code appears to allow the countervailing of generally available subsidies. This is consistent with the focus of the Code upon the international effects of subsidies. Recent testimony before this Committee has emphasized this conclusion. See Testimony of Rep. Sam M. Gibbons before the Trade Subcommittee of the Senate Finance Committee 3 (June 26, 1986); Testimony of Prof. Gary C. Hufbauer before the Trade Subcommittee of the Senate Finance Committee 1 (June 26, 1986).

The Code plainly leaves individual nations the decision, on a case-by-case basis, of whether specific practices constitute subsidies. The illustrative list of domestic subsidies found in Article 11:3 represented only those types of programs as to which there could be no question that they were subsidies; the list was explicitly not exhaustive, and represented a floor on the definition of domestic subsidies, as it were, rather than a ceiling.

The position that the GATT Subsidies Code requires the application of the general availability test distorts the language of the Code, and ignores its fundamental purpose, which is to minimize the impact subsidies have upon international trade. Far from supplying a definition of "subsidy" that excludes generally available subsidies, the

Code left that definition open to interpretation by individual countries. Instead, under the Code, the key criterion for determining whether a program is a subsidy is whether it damages the economic interests of another country. If a domestic program causes "serious prejudice" to the economic interests of another country, it can be a domestic subsidy under the Subsidies Code, no matter how widely or narrowly it was made available.

B. The General Availability Test and United States Law

The second defense of the general availability test raised by the Administration is that it is required under United States law. See Smith Statement at 2; Kaplan Statement at 3. This defense is unsupported by the language of the law, its underlying purpose, or legislative history, and flies in the face of repeated judicial rejection of the test.

The ITA has based its use of the general availability test upon the language of 19 U.S.C. § 1677(5)(B), which describes as domestic subsidies those provided to a specific enterprise or industry, or a group of enterprises or industries. According to the ITA, the use of the word "specific" means "limited," so that if a benefit is generally available, it is not countervailable. See Certain Steel Products from Belgium, 47 Fed. Reg. 39,305, 39,328 (1982). The Court of International Trade has rejected this interpretation of the statutory langauge. In Bethlehem Steel Corp. v. United States, 590 F. Supp. 1237 (1984), the court reviewed the statutory language in detail, and held that, far from limiting the countervailability of subsidies to those that were not generally available, the statutory language was designed to define subsidy as broadly as possible. 590 F. Supp. at 1241-42. Similarly, the court held in Cabot Corp. v. United States, 9 CIT___, 620 F. Supp. 722, appeal dismissed, # 86-729 (Fed. Cir. April 9, 1986), that neither the language of 19 U.S.C. § 1677(5)(B) nor that of the other countervailing duty law statute, 19 U.S.C. § 1303(a), prevented the countervailing of generally available benefits. The court noted first that the language of § 1677(5) is explicitly not exclusive, and held that it is the effect of a benefit, rather than its nominal availability, that determines whether it is countervailable or not. 620 F. Supp. at 729-30. The court then examined whether non-application of the test would cause absurd results, such as the countervailing of bridges and highways. The court found that the ITA had overlooked a vital distinction, that between generally available goods that provided specific benefits and general benefits. The court explained this key distinction as follows:

> ... [N]ot all so-called generally available benefits are alike -- some are benefits accruing generally to all citizens, while others are benefits that when actually conferred accrue to specific individuals or classes. Thus, while it is true that a generalized benefit provided by a government, such as national defense, education or infrastructure, is not a countervailable bounty or grant, a generally available benefit -- one that may be obtained by any and all enterprises or industries -- may nevertheless accrue to specific recipients. General benefits are not conferred upon any specific individuals or classes, while generally available benefits, when actually bestowed, may constitute specific grants conferred upon specific identifiable entities, which would be subject to countervailing duties.

Id. at 731.

The court explained that this analysis of the countervailing duty law removed any fear that roads and bridges would be countervailable. At the same time, it also addressed the equally great absurdity inherent in the general availability test, namely, that the more widely a government bestowed a subsidy, the less likely it is that, under the general availability test, the subsidy would be found countervailable by the ITA. 620 F. Supp. at 731-32. The court concluded that "the generally available benefits rule as developed and applied by the ITA is not an acceptable legal standard for determining the countervailability of benefits . . . ." Id. at 732. Instead, the court held that the determination of whether a benefit constitutes a subsidy must be based upon whether the benefit is measurable, is supplied to an identifiable recipient, and bestows a competitive advantage upon that recipient. See id. at 732-33.

The decisions of the Court of International Trade in Bethlehem and Cabot directly rebut the claims that the general availability test is required by United States law. To the contrary, the courts have held that the test violates the fundamental purpose of the countervailing duty law. This conclusion is in full accord with that reached by Senator Baucus of this Committee, who has stated that "I have looked at the GATT, the subsidies code, and our own CVD law from every possible angle, and I cannot find this 'general availability' test anywhere." 132 Cong. Rec. S1621 (February 26, 1986). It is also in accord with the discussion above of the purpose of the United States countervailing duty law. The general availability test looks only for distortions within an economy, while ignoring the effect that even "generally available" subsidies can have upon international trade, and upon United States industries in particular. There is simply no support for the statement that United States law requires the use of the general availability test, while there is a great deal of support for the position that the test is contrary to both the language and the purpose of the countervailing duty law of this country.

III. THE ITA'S PROPOSED PREFERENTIALITY APPENDIX DOES NOT PROVIDE AN ADEQUATE ALTERNATIVE TO THE LEGISLATION PROPOSED.

Mr. Kaplan of the ITA stated to this Committee that these bills were unnecessary for a second reason. He explained that the ITA was reevaluating its application of the general availability test, and would henceforth focus on the actual use of a program, rather than its nominal availability. In the review of the countervailing duty order covering imports of carbon black from Mexico, for example, he stated that the ITA had preliminarily reversed its earlier position regarding the provision of carbon black feedstock to the Mexican carbon black producers by the government at very low prices. In the original investigation, the ITA had held that this program was generally available. During the review, the agency revised its position at the preliminary determination stage, and stated that a program used by only two companies, as was the case here, could not be considered generally available. Kaplan Statement at 5.

It was shown above that the general availability test is contrary to law. Therefore, even as "revised" by the ITA, the test still violates the purpose of the countervailing duty law. The agency has to date not accepted the reasoning set forth by the Court of International Trade in Cabot.

Mr. Kaplan also expressed the view that the ITA's development of a standard methodology for determining whether goods or services had been provided at preferential prices would solve most of the problems that are the subject of this bill. See Kaplan Statement at 6. A review of the agency's proposed methodology reveals severe deficincies in it. Cabot's critique of the proposed methodology, as submitted to the Department of Commerce, is attached for informational purposes of the Committee.

The agency's methodology is only proposed at this point and will, hopefully, be modified by the agency after full deliberation of all views submitted. Nonetheless, because the ITA has claimed that its methodology will address most of the issues sought to be resolved by this bill, Cabot wishes to emphasize that at least the preliminary methodology adopted by the agency -- the methodology that is supposed to cure all problems -- will leave domestic industries requesting relief from natural resource pricing practices with no relief at all. This is exactly Cabot's position after the preliminary determination by the agency.

IV. CONCLUSION.

Present U.S. law and present U.S. international commitments do not require the Commerce Department to refuse to countervail so-called "generally available" benefits. S. 1292 and section 502 of S. 1356 are two efforts to deal with one particularly acute problem area of existing agency administration -- failure to countervail two-tiered pricing systems of our trading partners for natural resources. Cabot strongly supports the statutory modifications proposed in these two bills. The administration's protests to the contrary attempt to prove too much and stray from the founding principles of the countervailing duty law.

Respectfully submitted,

Cabot Corporation

Stewart and Stewart
Special Counsel

BY: Eugene L. Stewart
Terence P. Stewart
D. Scott Nance

Senator LONG. I want to call Richard Rivers up for just a moment and maybe he could take a seat next to Mr. Foster, and Mr. Foster might let you use his microphone for a moment. I just want to ask Mr. Rivers a couple of questions.

Mr. Rivers, first, let us make this point: At one time you worked for this committee, did you not?

Mr. RIVERS. That is correct, sir.

Senator LONG. And then, you moved on to other areas. You became the General Counsel for the U.S. Trade Representative?

Mr. RIVERS. That is correct, 1977 through 1979.

Senator LONG. It is my understanding that you were one of those who negotiated the subsidies agreement during the time that you were with the Carter administration?

Mr. RIVERS. I was the principal U.S. negotiator of the subsidies code.

Senator LONG. Now, you have heard the testimony here, the differences of opinion, with witnesses contending that there is no subsidy if the Nation is doing the type thing Mexico is doing with their natural gas or the sort of thing that Canada is doing with their lumber and their timber, as long as an advantage is generally available to producers within that country. Did you also hear the testimony of the chairman of the House subcommittee?

Mr. RIVERS. Mr. Gibbons?

Senator LONG. Mr. Gibbons. Can you tell me about what your thoughts are on that subject from your experience?

Mr. RIVERS. Thank you, Senator. I will be happy to tell you what my thoughts are. There is nothing in the General Agreement on Tariffs and Trade which supports the position of the Commerce Department or the doctrine known as general availability. The term does not appear in the GATT. The GATT itself does not define or confine or constrain the definition of the term "subsidy." It says that a subsidy is countervailable if it is demonstrated that it causes material injury to an industry in the importing country.

When we negotiated the Code on Subsidies and Countervailing Measures, we were scrupulous in avoiding any kind of definition of what a subsidy—either an export subsidy, or a Government grants or bestows a benefit upon the condition of exporting a product—or a domestic or production subsidy because we were concerned that governments would find new ways that would be outside of any kind of definition that we could come up with. So, we did not confine or define the notion of what is a domestic subsidy in the Subsidies Code, nor is there any foundation for this notion or doctrine here known as general availability.

What has happened here is the Subsidies Code itself, for the first time, has induced or permitted the United States to begin countervailing against domestic subsidies. We didn't do that prior to 1979, with very few exceptions. So, this has brought into the rate of the countervailing duties statute a whole range of subsidy practices which the United States, or the Treasury Department in the old days, was very reluctant to countervail against because they were concerned about criticism from abroad.

But the international rules are absolutely clear: that the United States can impose countervailing duties on domestic subsidies as it sees fit, provided that it reaches a finding or determination that they cause injury. That is the criteria. If someone disagrees with us about whether a practice that we characterize as a subsidy or not, then they can bring us to the GATT or the Committee on Signatories to the Subsidies Code and talk to us about that. We might win or we might lose; but in the case of general availability, I must say I was somewhat astonished this morning to hear the testimony of the administration.

If I understand it correctly, the European Community 7 years ago—8 years ago—seriously considered countervailing against U.S. synthetic fibers on grounds that our gas prices constituted a countervailable subsidy, but the U.S. Government by the sheer force of legal argumentation convinced them that it was GATT illegal. I am going to tell you that that is just not what happened.

What we did—we didn't argue that it was not a violation of the GATT. What we argued was: we are deregulating our gas prices. So, with all due regard to my colleagues, and to my successors, it was not the force of their legal argumentation. Now, I am told that the Community has come around to the view that it is violation of the GATT; and to compound things, we were told that the GATT rules are really only what the contracting parties say they are, which is a very bizarre interpretation of an international contract.

This is a serious problem in international trade. It has to do with foreign government—and to some extent possibly U.S. Government—programs where governments take valuable resources and manipulate and control those resources and manipulate and control the prices of those resources in order to bestow benefits on people who make things and ship them for sale in the United States and compete with domestic producers. That is what is at issue here.

And to say that this is protectionist legislation, and the opponents of this legislation have wrapped themselves in the mantle of free trade, alleging that this is protectionist legislation and that they are the proponents of a free trade philosophy. In fact, Senator, I submit that the protectionism exists in these Government programs. That is where it starts in the first instance. It is these Government programs that are distorting the world trading system and, in fact, causing problems such as this.

The countervailing duty law, I mean what the House has passed by such an overwhelming margin, really would make it clear that an industry has a right to bring its case to the Commerce Department and allege that this is a domestic subsidy which is causing injury to a domestic industry.

The Commerce Department has adopted a series of really very artificial rules to greatly confine the class of domestic subsidies that they will countervail. For example, if the Government of Brazil has a soft loan program—which they do, I assure you—where they will say we will make loans available to anyone for 2 percent interest, which in anybody's mind outside of the Commerce Department, is a subsidy, well, that is generally available to borrowers in Brazil. Well, then, in the mind of the Commerce Department, it is not a subsidy; it is not a countervailable subsidy within the ambit of the countervailing duty law.

Well, I just don't believe that is what the Congress intended in 1979. I don't think it is what this committee contemplated.

Ms. BARSHEFSKY. Senator, may I make a comment?

Senator LONG. Let me just say this because I want to make a statement. Clinton Anderson was once a member of the President's Cabinet, and then he later on served as a member of this committee; and I was honored to serve with him. This was some of his philosophy and also some of his knowledge.

He said that if a Government department head or a Government bureaucrat wants to do something that is good for the country, they can usually find a way to do it; and if they don't want to do it, they can find a thousand excuses for not doing it. Now, that sounds like one of those thousand excuses to me. Here are American people who have a right to call upon their Government and such a countervailing duty, which they have a right to do.

Now, I would be glad to hear from you; what is your name?

Ms. BARSHEFSKY. My name is Charlene Barshefsky, and I am counsel to the Coalition to Promote America's Trade.

Senator LONG. You were with the last panel, were you not?

Ms. BARSHEFSKY. Yes, sir; and I am also counsel for Cargill as a coalition member.

Senator LONG. All right.

Ms. BARSHEFSKY. I would, if I may, like to respond to something that Mr. Rivers said.

Senator LONG. Go ahead.

Ms. BARSHEFSKY. I think if you lined up three international trade lawyers and asked them if this legislation was consistent or inconsistent with GATT and the Subsidies Code, you would get four different opinions. Quite apart from GATT, the real issue is the effect of the legislation. To my mind, in the first instance, one ought to analyze whether a legislative proposal is one that is a positive proposal or one that is perhaps a less than positive proposal. And when I look at this legislation, what I see is a bill that makes a natural cost advantage a subsidy. To say that a natural cost advantage is a subsidy turns the countervailing duty law on its head. Our unfair trade laws are aimed at producers without natural cost advantages who, by means of Government subsidies, are able to lower their costs of production below what they would otherwise be.

But as Mr. Jacquier was pointing out, that really isn't the case here in terms of, for example, Mexico's policy in connection with energy and ammonia. Natural resource legislation is the antithesis of our countervailing duty law, because under this bill it is the operation of a natural cost advantage that gives rise to a subsidy. That a cost advantage can be equated with a subsidy is not only internally inconsistent to my mind, but it expands the meaning of the term "subsidy" well beyond any internationally accepted understanding of that term.

Senator LONG. I have heard enough. I would appreciate it if you would give us a written statement to tell us what else you think about the matter, if you would, please.

Ms. BARSHEFSKY. Thank you, sir.

[The prepared information from Ms. Barshefsky follows:]

STATEMENT OF THE COALITION
TO PROMOTE AMERICA'S TRADE

The Coalition to Promote America's Trade is an _ad hoc_ organization of American petrochemical, agricultural and other companies that was formed in early 1984 to support fair and free trade and to oppose passage of so-called "natural resource subsidy" trade legislation. In the present hearing, the Coalition wishes to emphasize two major points.1/ First, in attempting to cast the natural resource issue as one involving unfair pricing and subsidies, the natural resource proposals (S. 1292 and section 502 of S. 1356) incorporate serious conceptual flaws, so that their implementation would give rise to grave economic and trade-related repercussions.

- The proposals would treat as countervailable subsidies the utilization by foreign countries of their natural cost advantages. In so doing, the arguments justifying the proposals are based on a model of private business behavior that is unrealistic, and on a view of the legitimate scope of government activity that is contrary to the United States' own regulatory conduct.

- Enactment of such a proposal would have serious anticompetitive implications and serious trade repercussions.

- The proposals would be unadministrable and foreign compliance virtually impossible.

1/ For a fuller review of the arguments against such legislation, see Barshefsky, Diamond & Ellis, "Foreign Government Regulation of Natural Resources: Problems and Remedies Under United States International Trade Laws," 21 _Stanford J. Int'l L._ 29 (1985).

Second, the concerns that underlie the "natural resource subsidy" proposals, when properly viewed, are not problems of unfair pricing practices by foreign governments. They are, therefore, not properly addressed through the countervailing duty law. Rather, the question of U.S. producer access to low-cost foreign natural resources and the underlying issue of reciprocity, which are at the heart of the natural resource debate, can be effectively addressed in the short term under section 301 of the Trade Act of 1974. In the longer term, the proper approach to natural resource issues is through multilateral trade negotiations, as proposed in S. 1860.

I. AMENDMENT OF THE COUNTERVAILING DUTY LAW TO ADDRESS THE NATURAL RESOURCE QUESTION IS ILL-ADVISED

The thrust of the natural resource proposals is to declare as countervailable the sale of foreign government-regulated natural resources to local purchasers at prices below what is termed a "fair market price" and below the price at which the resource is sold to United States purchasers for export to the United States. The amount of the countervailable subsidy would be the difference between the foreign country's domestic price and the "fair market price" of the resource. The subsidy would be applied against a product made from the resource in the foreign country and exported to the United States. In determining fair market value, the bills authorize consideration of various factors. Such factors include the natural resource's export price, the prices at which it is generally available in world markets, whether foreign markets are available to the exporting nation to sell the natural resource, and the competitive market-clearing price at which the resource can be sold in those foreign markets.

It is clear from the description of the proposals that they are not intended to attack the provision by governments of natural resources at prices below the fully allocated cost of production. Sales below cost can be effectively addressed under the current U.S. antidumping law. Nor are the proposals meant to attack the establishment of uneconomic plants or other commercially unreasonable investments by foreign governments. Those may already be challenged as domestic subsidies under the present countervailing duty law. Rather, the proposals would radically expand the countervailing duty law to treat as countervailable subsidies a country's natural cost advantages.

The concept of a cost advantage recognizes that different nations are more efficient at producing different types of goods, because they are endowed with different types of resources. Under the bills, however, a country with a cost advantage in the production of a natural resource cannot provide that resource to its domestic downstream users at a price less than so-called world market or U.S. prices for the same resource. Reduced to its most essential element, this legislation says that no country can utilize a natural cost advantage in the development of natural resource-based industries without running afoul of the U.S. countervailing duty law.

The notion that a natural cost advantage constitutes a countervailable subsidy turns the countervailing duty law upside down. Our unfair trade laws are aimed at producers without natural cost advantages -- inherently high-cost non-competitive producers -- who, by means of government subsidies, are able to produce and sell their products at low prices. Natural resource legislation is the antithesis of this framework. The goal of this legislation is to strike at countries that have a genuine cost advantage in the production and development of particular natural resources. Under the bill, it is the exercise of that cost advantage that gives rise to a countervailable subsidy.

This radical and extraordinary expansion of the countervailing duty law cannot be justified on economic or policy grounds. The countervailing duty approach suffers from the following defects:

- The legislation expects governments to behave in a manner different from many private enterprises in making pricing decisions.
- The proposals conflict with the internationally accepted view of the scope of legitimate government activity.
- The proposals condemn government activities in the regulation of a nation's natural resources similar to those that have routinely been undertaken by the United States.

- The proposals have serious anticompetitive consequences in that they act to reinforce and strengthen the market power of cartels.

- The proposals would invite retaliation against United States exports by our trading partners, or the enactment of "mirror" legislation.

- The proposals are impossible to embody in predictable, enforceable legislation.

Allow us briefly to elaborate on these points.

A. The Proposals Expect Governments to Behave in a Manner Different From Many Private Enterprises in Making Pricing Decisions

As described above, the proposed legislation attacks sales of a natural resource at below world market or U.S. prices, i.e., at levels lower than the immediate short-term profit maximizing price. The trade laws, however, have never been interpreted to compel enterprises -- private or government-regulated -- to operate at a specified level of profit, let alone engage in short-term rather than long-term profit maximization.

This ill-advised expansion of the countervailing duty law is justified by proponents of natural resource legislation as a way to restrain the behavior of foreign governments by limiting them to actions taken by private businesses. The assumption made is that only one market strategy is available to a private company -- that of maximizing short-term profits. In fact, this assumption is often wrong. In forcing governments to pursue short-term profit maximizing strategies as the only way in which downstream products can "fairly" be sold on world markets, the proposals expect governments to behave in a manner that private enterprises often do not satisfy.

In contrast to the simplistic view of private business behavior embodied by the natural resource proposals -- quick sales at the highest price -- diverse market conditions and different attitudes toward risk and long-term growth may lead companies to pursue radically different marketing strategies. Companies may choose to undersell the market in order to trigger an immediate growth in sales. They may lower prices to selected buyers, or seek long-term supply commitments, all in furtherance of longer-term growth. Or a company that sees a potentially lucrative new market for its products may lower its prices to the infant companies that are creating that market to help improve their chances of success. These varied strategies are often adopted by U.S. companies; indeed, they are required by the diversity of the market place. To penalize foreign governments for pursuing similar long-term strategies simply imposes limits on them which U.S. companies have never had to meet. Similarly, to define as an "unfair practice" the failure to reap maximum short-term profits on sales made abroad sets an extremely dangerous precedent which could be used to attack as "unfair" our own U.S. exports.

B. The Proposals Are Contrary to the International Consensus as to What Constitutes a Subsidy and Conflict with U.S. Development of its Own Natural Resources

Not only are the natural resource proposals based on an unrealistic view of private business conduct, but they also ignore the internationally accepted nature of the government activities involved here. Governments are quite properly motivated by broad general welfare considerations that may result in behavior different from that of a private company. One means by which governments have attempted to improve their nations' general welfare is by developing their natural resources. The impact of such development on their societies may be dramatic.

The fact that a government acts to promote the general welfare of its citizens does not necessarily immunize it from the imposition of countervailing duties under current U.S. law and GATT principles. But the international community has agreed -- and the United States has firmly supported the proposition -- that such actions are exempt if the benefit provided is generally available to all citizens. Both the GATT Subsidies Code and U.S. law recognize that to be countervailable government benefits must be sector specific in nature. Generally available benefits -- such as U.S. control of oil prices in the 1970's --[1] have been staunchly defended by the U.S. as non-countervailable. Indeed, the European Community has accepted this argument, and in 1980, it agreed not to initiate a countervailing duty investigation of U.S. petroleum-based products such as synthetic fibers, because the low U.S. regulated price of the natural resource was made generally available throughout the U.S. economy.

Generally available benefits may take myriad forms. For example, a government may distribute part of the income generated from sales of a natural resource directly to its citizens, or use such funds to provide roads, schools, hospitals or food. Alternatively, the government may provide a resource which it owns directly to its citizens at low prices or, by regulation, require that the resource be sold at low prices. The United States has frequently engaged in this type of resource distribution, for example, in selling power generated by federal dams at very low rates, in selling cheap water from government river control projects in the West, or in regulating the prices at which oil and natural gas may be sold. Few examples of greater magnitude exist than the land grant programs sponsored by the U.S. government during the nineteenth century.

Moreover, the Congressional Research Service recently completed a study, "The Subsidization of Natural Resources in the United States" (Feb. 5, 1986), demonstrating the U.S. government's substantial and pervasive subsidization of the development of our resources. These programs have cost the government billions of dollars in outlays and foregone revenues in a diverse range of industries, such as:

- Federal irrigation water. Water offered by the government to users at prices below cost provided a potential subsidy value in 1982 (the most recent year for which data were available) of $1 to $1.6 billion, or 14 to 22 percent of the value of the crops irrigated in that year alone.

- Livestock grazing fees on federal lands. The low fees charged by the government provided an estimated 77.5 percent subsidy when compared to private grazing fees.

- Hydroelectricity generated at federal dams. Prices for power sold at Bonneville alone were calculated to be as much as 33 percent below the prices charged by private utilities.

- Hard rock minerals. Depletion allowances for copper alone range from $0.3 to $1.5 billion, exclusive of the value of the federal land sold at below market prices to the mining industry.

- Uranium and coal. $5 to $7 billion in government funds were provided to construct and operate enrichment plants, and tax breaks for the coal industry have totaled an estimated $1 billion over a five-year period.

- Oil and natural gas. As of January 1985 an estimated 40 percent of domestic natural gas reserves remained controlled at below market rates. Tax and other benefits to the oil industry have been enormous.

These programs are similar to those of foreign governments that would be subject to attack under the natural resource proposals before this Committee. And these programs, among others, would be natural targets for foreign "mirror" legislation.

The view that such government programs have never been considered countervailable subsidies is made explicit by the 1984 Congressional debates on the extension of the contracts to provide power generated at the Hoover Dam at prices far below market rates. Numerous defenders of the proposal -- of both parties and in both Houses of Congress -- argued that the contracts would allow the government to charge enough to recover costs and perhaps earn some profit (though certainly not the highest possible profit). More fundamentally, they noted that throughout United States history the role of government in the development of this nation's resources has never been that of a profit-maximizing entity.

The bill reauthorizing below-market pricing of hydroelectric power from the Hoover Dam passed both Houses of Congress by substantial margins. The numerous statements made in support of that legislation apply with equal force to the provision of natural resources by foreign governments to their people:

- "There is no subsidy inherent in the concept of tying the price of power to its cost of production. This is the way 98 percent of all power in America is priced." (Sen. Chic Hecht, R-Nev.)

- "[W]e ought to be pricing the power on the basis of what it costs to produce it." (Sen. James McClure, R-Idaho)

- "The Federal Government is not in the business to make a profit. . . . [I]n each of [its] investments we have done it at the lowest possible price in order to give to the people of this country . . . an opportunity to better themselves. . . .

  [The] policy which has been held in this country, in my view, for virtually all of its 200-year history . . . [is] to build this infrastructure for what it costs and to regain those costs, but not to make a profit beyond that . . . . I think it has been a good policy, it is a good policy, and will continue to be a good policy." (Sen. Daniel Evans, R-Wash.)

- "There is no need for the United States to make a profit from federal hydropower resources. . . .
  Clearly the arguments for market pricing are specious. It is against the public interest." (Sen. Barry Goldwater, R-Ariz.)

- "While some will argue that we should not be selling Federal power at below-market rates, the primary purpose of the Federal power program is not to maximize the Government's revenues but to sell power from public projects at the lowest possible rates to consumers that will recover the Government's investment and pay the operating expenses." (Sen. Dennis DeConcini, D-Ariz.)2/

In short, the regulation and development of a nation's natural resources have long been recognized by the United States as falling within the legitimate scope of government activities, as to which countervailing duties do not apply. No compelling argument has been advanced to alter this view.

2/ Similar arguments were made by various Representatives during the course of the House debate on the Hoover Dam bill. For example, Rep. Howard Berman (D-Calif.) noted:

> The purpose of the Federal power program has never been to maximize revenue but to sell power from public projects at the lowest possible rates that will recover the Government's investment and pay all operating expenses. The projects should pay their own way -- and Hoover does.

C. <u>The Proposals Have Serious Anticompetitive Consequences and Will Strengthen the Market Power of Cartels</u>

The proposals provide an exception to countervailability in the event the foreign nation permits U.S. producer access to the low-priced resource (again revealing the importance of the access issue to the natural resource proposals). But where such access is denied -- whether for political or other reasons -- that nation can comply with the proposal only if it raises its internal price of the resource to so-called "world market" levels. In already cartelized markets for certain natural resources, serious economic repercussions would arise from such a pricing measure.

As a matter of economic policy, the lowering of world prices of natural resources more accurately to reflect costs of production should be sought. Instead, however, the natural resource proposals would directly counter this type of positive economic activity. In utilizing "fair market value" to determine the extent to which the internal price of the resource is subsidized, these proposals essentially mandate the use of cartel prices, whenever a cartel exists, as the benchmark against which the subsidy is to be calculated. Undercutting the cartel price is penalized; reinforcing the cartel is accomplished. This latter point is particularly disturbing when one considers that U.S. law would effectively extend a cartel's price discipline to countries <u>not</u> currently a member of the cartel. A more irrational result -- the legitimizing of inflated world market prices for natural resources -- could hardly be imagined.

The natural resource proposals would not merely lead to a lessening of competition in the natural resource itself, but also would have an obvious and direct adverse impact on U.S. businesses and consumers. Using natural gas as an example, compliance with the proposals would force the prices of imported energy-intensive products -- such as ammonia -- to rise. The result could well be higher food prices for U.S. consumers. So, too, the prices of imported cement to U.S. industries would rise, further escalating already high costs of construction. While these are but two of innumerable examples, it is clear that the natural resource subsidy proposals have serious commercial implications both at the level of the natural resource and at the level of the downstream product.

D. <u>The Proposals Will Adversely Affect Foreign and Domestic Trade</u>

Enactment of the natural resource proposals could significantly impede or disrupt U.S. trade. Disruption would occur not only because of the potential retaliatory actions that other countries might take in response to such legislation, but also because of the effect that these proposals would have on existing purchaser/seller relationships.

<u>Retaliation against U.S. exports would be likely.</u> As noted earlier, the U.S. countervailing duty law provides for a sector specificity test in determining whether a particular

domestic subsidy is countervailable. Article 11(3) of the GATT Subsidies Code, enumerating specific examples of possible "domestic subsidies," specifies that such subsidies are those "granted with the aim of giving an advantage to certain enterprises," and are "normally granted either regionally or by sector." These references form the basis for the explicit requirement in U.S. law that only domestic benefits "provided to a specific enterprise or industry, or group of enterprises or industries" are countervailable.

In 1984, the Administration, after close study, concluded that in light of the sector specificity rule the natural resource proposals considered in the 98th Congress constituted "a drastic and unilateral departure from the internationally accepted definition of a countervailable subsidy," in violation of the GATT, and that enactment of such a provision "would subject the United States to a GATT challenge, which we would almost certainly lose. The result could be GATT authorization to retaliate against U.S. exports." The Administration reiterated its position in 1985 in hearings before the Trade Subcommittee of the House Committee on Ways and Means on the natural resource subsidy proposal now in H.R. 4800 -- a proposal identical to S. 1292 and section 502 of S. 1356.

Likely targets for retaliation would be our own major exports, such as agricultural and textile products. Indeed, the Congressional Research Service, as noted above, described numerous U.S. government programs involving billions of dollars of benefits to producers using our natural resources. Exports benefiting from these programs would be clear targets for retaliation if a natural resource proposal were to be enacted. And even if the natural resource proposals were to survive a GATT challenge, it would be a pyrrhic victory, for foreign governments would then have every encouragement to enact their own "mirror" legislation.

Key U.S. exports would become less competitive on the world market. The adverse impact of the natural resource proposals on U.S. exports extends far beyond GATT retaliation or the enactment of mirror legislation. Many U.S. industries use basic petrochemical and other natural resource-derived products imported from other nations to make more advanced products, which are then exported from the United States. American agricultural interests, petrochemical industries, and the forest products industry, to name just a few, all utilize natural resource-based products to produce downstream goods for export. If the prices of the basic products are driven up by substantial duties, the prices of the exports of the finished products will also rise, severely undermining or destroying their competitiveness in world markets. The marketplace would thus "retaliate" against U.S. exports, even if our trading partners did not.

The proposals would seriously jeopardize U.S. relations with developing countries. Finally, the natural resource proposals would hit hardest at trading partners of the United States in the developing world, where regulation of natural resources is frequently an essential part of long-term economic and social development. Indeed, the GATT recognizes the difficult economic situation of the developing nations, by allowing them greater commercial latitude without the threat of retaliation. And the United States for decades has repeatedly urged those nations to rely on the development of their natural resources to diversify their productive capacity, improve their financial position, and enhance the welfare of their people. Enactment of the proposed legislation would clearly undermine the substantial progress made by these countries.

United States exporting industries would also be substantial losers if duties were imposed on products from the developing world. These countries are major purchasers of United States exports: for example, some forty percent of total U.S. agricultural sales now go to developing countries, and these countries are the key growth market for future U.S. agricultural sales. It is simply not in the interest of the United States to jeopardize substantial long-term trading relationships with these countries, as would be the case were this legislation enacted.

E. The Proposals Are Virtually Unadministrable and Compliance Impossible

In addition to the anticompetitive and adverse trade-related consequences of the natural resource subsidy legislation, compliance with and predictable administration of the proposals are virtually impossible.

<u>The proposals send a "damned if you do, damned if you don't" signal to foreign governments and producers</u>. Under present U.S. law, the foreign exporting industry would run afoul of the antidumping statute if the natural resource in question was exported at a price <u>lower</u> than the domestic price of that resource. At the same time, however, under the natural resource proposals, such producers would also be committing an "unfair" practice if the export price of the resource were <u>greater</u> than the price charged in the domestic market. Indeed, such a result would obtain even if there were no exports of the resource in question; under such circumstances, a "fair market value" analysis would govern. Compliance with U.S. trade laws would thus be virtually impossible for affected foreign exporters, however the natural resource was priced.

<u>The proposals are virtually impossible to embody in predictable, enforceable legislation</u>. The proposals employ terms which are impermissibly vague or impossible to quantify. For example, they specify certain factors to be used in determining "fair market value," including "market clearing price," and "generally available" prices in "world markets." Although understandable concepts, such terms are not amenable to precise calculation. Moreover, no guidance is provided as to their relative weight, or the manner in which they are to be balanced against the domestic price of the resource. Indeed, as the International Trade Commission stated in its section 332(b) investigation of natural resource pricing, "[f]or a

nation that has no current viable natural gas export market, the domestic price cannot be compared to the world natural gas price.[3/] The very vagueness inherent in the concepts employed in these proposals underscores the fact that no foreign country, however it priced its resources, could be assured that its practices would comply with U.S. law. This unpredictability is itself a barrier to trade.

The same indefiniteness also renders unworkable reliance on the "export price," which is one factor that the proposals would consider in determining fair market value. Just as myriad internal prices may exist for a resource, so too, a broad spectrum of export prices may be available for comparison purposes. No guidance is provided, however, for adjusting those prices to reflect vastly different terms and conditions of sale.

F. An Injury Test Does Not Mitigate the Proposals' Serious Flaws

The proposals provide an injury test, according to which injury must be demonstrated by the petitioning U.S. industry before countervailing duties may be imposed, even though for all other purposes under the countervailing duty law the foreign nation may not be entitled to an injury test.

3/ U.S. International Trade Commission, Potential Effects of Foreign Governments' Policies of Pricing Natural Resources (Final Report on Investigation No. 332-202 Under Section 332(b) of the Tariff Act of 1930) at xv (May 1985).

While the provision of an injury test may mitigate a proposal's impact in specific cases, it does not address and thus cannot mitigate the underlying conceptual problems that plague the proposals. Nor can the presence of an injury test resolve the practical problems with the proposals, such as their anti-competitive effects, their negative market impact on U.S. consumers and export business, and their impossibility of administration and compliance.

II. THE PROPOSALS ARE UNNECESSARY, BECAUSE PRESENT U.S. TRADE LAW PROVIDES A REMEDY FOR THE PRACTICES ALLEGED

Because the proposals would effect so significant a change in the United States' and the international community's understanding of proper government regulation of natural resources, resolution of the issues involved, at least in the long term, must be through multilateral trade negotiations. This is precisely the approach adopted in the Senate's omnibus trade proposal, S. 1860. In the shorter term, present U.S. trade law -- specifically section 301 of the Trade Act of 1974 -- already provides a remedy for the practices complained of by proponents of the legislation. Thus, enactment of a natural resource proposal is unnecessary.

As is evident from the natural resource debate, the proposals are intended not merely to remedy alleged foreign pricing improprieties, but also to gain access for U.S. producers to foreign natural resources at low internal prices. The proposals demonstrate the importance of access by defining a "natural resource subsidy" to exist only where the price of the resource "is not freely available to United States producers for purchase of the input product for export to the United States." An effective natural resource remedy is thus one through which access may be achieved while, at the same time, providing for the imposition of duties or other forms of trade relief in the event access is denied.

The access and pricing issues involved in the natural resource debate are concerns that can be specifically addressed under section 301 of the Trade Act of 1974. That a remedy is available under section 301 is especially clear when one examines the amendments to that law that were enacted in October 1984 -- amendments that make explicit the ability of the United States to attack the type of practices at issue here. For example, the law now defines the term "commerce" to include "foreign direct investment by United States persons with implication for trade in goods and services." And the definition of the term "unreasonable" has been expanded to include acts or practices that deny "market opportunities" or "opportunities for the establishment of an enterprise" by United States parties in the foreign nation. These provisions of section 301 thus have as their aim an opening of foreign investment and access opportunities for U.S. producers -- precisely the concerns addressed by the natural resource proposals. In addition, S. 1860 proposes further strengthening of section 301. Given the obvious applicability of section 301 to the pricing and access issues raised by proponents of the legislation, the proposed change in the countervailing duty law, which would have such dramatic negative effects, is simply unjustifiable.

Senator LONG. Now, let me ask this question of Mr. Foster. The Commerce Department's witness, Mr. Kaplan, indicated that the Commerce Department has significantly modified its interpretation of the U.S.-countervailing duty law. How has this change modified the results in the carbon black import cases?

Mr. FOSTER. I would like to ask Mr. Stewart to answer because he has handled that case for us and is much more familiar with the legal aspects.

Senator LONG. All right.

Mr. STEWART. Mr. Chairman, the Commerce Department has issued a preliminary determination in what is called a 751 Review in which they have identified a new policy called A Preferntiality Appendix, and in which for the first time they have said that a product given to two companies in one industry is not generally available on a preliminary basis.

It has proven to date to be what you might call an elusive victory. The margin on carbon black feedstock in the *Origino* case was found to be zero, despite the fact that the cost was roughly 10 percent of the world market price or the price that a United States or a Mexican company could obtain it anywhere besides Mexico. In the review, the price of the carbon black feedstock was somewhere around 15 or 20 percent and, despite that, under the Preferentiality Appendix, the Commerce Department found a vehicle for purposes of the preliminary determination to say that constituted no preference, even though it was no longer generally available.

Now, as Mr. Kaplan said, that case is presently pending, and it could well be that the light will yet shine on the Commerce Department in the context of the review.

[The prepared written statement of State Representative Brewster follows:]

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Statement of Oklahoma State Representative Bill K. Brewster
on behalf of the Southwest Regional Energy Council
before the
Subcommittee on International Trade, Committee on Finance
U. S. Senate
June 26, 1986

I am Bill Brewster, State Representative from Oklahoma. I am testifying on behalf of the Southwest Regional Energy Council which is an organization composed of state senators and representatives from Arkansas, Louisiana, New Mexico, Oklahoma, and Texas. The Council was organized in 1975 to aid these states in developing a regional consensus on energy and environmental issues impacting them.

Following extensive debate, our organization has concluded that foreign government subsidization of energy inputs used in the production of ammonia and other petrochemicals poses a severe threat to the economic health of the Southwest. Therefore, we support S. 1292, the natural resource bill introduced by Senators Long and Baucus.

Today I will focus my comments on the impact the petrochemical industry has on the nation as a whole and the Southwest in particular. Due to its heavy concentration of energy-intensive producers, the Southwest is particularly vulnerable to this type of unfair foreign competition.

In general, the U.S. petrochemical industry has several strong long-lasting advantages over many of its foreign competitors including its:

- low capitalization, efficient operations, and access to excellent support facilities;
- up-to-date "state of the art" manufacturing facilities for chemical production; and
- locations convenient to a very close and large market area.

I would like to draw attention to four primary petrochemicals produced from energy feedstocks that would be directly impacted by the legislation before us today. If we look at the production of ammonia, carbon black, polyethylene, ethylene and methanol, their contribution to a sound and stable regional economy is clear. Not only are there direct contributions such as employment, payroll and sales, but there are a number of indirect benefits as well. These include such things as spending for goods and services by petrochemical and support services employees and tax revenues to local, state and Federal governments. Finally, it is critical to take into account the infrastructure that has been established to support these petrochemical facilities. Many local business were established for the sole purpose of keeping the petrochemical facilities operative. Many people, therefore, are totally dependent on the petrochemical industry for their economic well-being.

o EMPLOYMENT

While the petrochemical industry contributes to U.S. employment to a lesser degree than other industries due to its being a capital rather than labor-intensive industry, its regional impact on jobs is highly significant. For example in 1983 11.6% of Louisiana's manufacturing employment was in the petrochemical industry; the comparable figure for Texas was 4.4% The four primary petrochemicals mentioned above provided 93% of that segment of employment in Louisiana and 91% in Texas.

o INCOME EFFECTS

The effect of the petrochemical industry on income is also significant and can be gauged by examining sales and payroll data. In 1977 sales of the U.S. petrochemical industry were $53 billion; by 1983, they had increased by 45 percent to $76.6 billion. Petrochemical sales increased by 53 percent in Louisiana and 58 percent in Texas to $9.3 and $21.8 billion, respectively.

In 1983, the petrochemical industry was responsible for $28.1 billion of the total income generated in the United States, and for $3.6 billion and $9.1 billion of the income earned in Louisiana and Texas, respectively.

Payrolls are another indication of the industry's importance. Direct wage and salary outlays were over $7.5 billion in the U.S. petrochemical industry in 1983. The industry paid over $600 million in wages in Louisiana and $1.3 billion in Texas in 1983.

The majority of sales and payroll in the petrochemical industry is generated by the four primary petrochemicals. In 1983, for example, sales in these four sectors were 75.1 percent of the total petrochemical sales for the United States. In Louisiana, sales in the four sectors dominated the industry with 93.5 percent of the total. In Texas, the comparable figure was 86.6 percent.

o **TAXES**

At the Federal level, the petrochemical industry paid approximately $1.4 billion, or 2 percent of the total corporate tax payment in 1980. State and local tax payments by the petrochemical industry are not readily available. However, an idea of the importance of this industry to major petrochemical producing states can be gleaned from examining data from CF Industries' Louisiana petrochemical plants. These data indicate that each plant operating in Ascension Parish paid $79,000 in property taxes in 1983. Each plant also paid about $100,000 in state and local taxes, for a total of $179,000 per plant. Assuming that millage rates and local sales taxes in Ascension Parish are typical of other parishes, each plant closing costs the state and parish $179,000 in lost property and sales taxes. This estimate of tax revenue losses from a plant's closing is understated because of accompanying decreases in corporate income tax payments to the State of Louisiana. The revenue loss estimate is further understated because it measures only the direct effect and ignores the indirect effects caused by decreased sales and tax payments by the plants' suppliers.

o **NON-ECONOMIC FACTORS**

The advantages associated with the petrochemical industry are rarely only economic. Aside from the financial benefits, many social, educational and other values tend to be strengthened by the petrochemical industry. Almost all industry today is affected by petrochemical manufacturing - from packaging to fertilizing farmland to improve yield quality to improving certain qualities of textile materials. Therefore, any change in the economic well-being of the petrochemical industry will have ripple effects on the employment, income and tax payments of industries and individuals in many other sectors of the economy.

When economic conditions cause a job to be either created or destroyed in the petrochemical sector, a chain reaction is set in motion throughout the state and the country. This chain reaction causes the creation or loss of additional jobs in states and regions.

It is also important to note that an entire infrastructure is developed to support the petrochemical facility. Transportation of feedstocks, however short the distance between the fields and the petrochemical plant, involves very complex equipment such as pipelines, meters and gauges. To reach domestic markets or industrial consumers the products must be transported by rail, truck, or barge and thus, a complex, modern transportation system is a necessity. And of course a reliable energy supply is a very important part of this intricate support system. In Louisiana alone, the petrochemical industry directly and indirectly uses 60% of its natural gas.

FUTURE OPTIONS

It is wise then to consider carefully what many believe is an option for the petrochemical industry. Part of this theory states that if the commodity chemical business is moved offshore, those displaced domestically can import commodity chemicals to manufacture specialty chemicals in the U.S. I would point out that in reality this is not as easy as it sounds.

The U.S. chemical industry would have to invest large sums of money in capital facilities to upgrade to specialty chemicals based on the purchase of commodity chemicals from foreign sources. A change to the manufacture of value-added chemicals produced from imported commodity chemicals seems unlikely due to its high investment risk and concerns about the reliability of supply. Where there are segments of the chemical industry that can convert to specialty chemicals, those facilities will still need a source of competitively-priced reliable commodity chemicals. This would be particularly true with any major supply displacement or shortage. In addition , if a foreign country is investing capital in commodity chemicals wouldn't it be logical for them to look into producing value-added chemicals themselves?

The point is, any change to value-added speciality chemicals should complement, or be a natural extension of, the existent commodity chemical industry. The U.S. chemical industry must still be able to compete with other products in the world market if it is to integrate and expand vertically into specialty chemicals. The U.S. industry must also have a period of relative prosperity and stability so that it can make this transition and modernize its facilities as necessary.

CONCLUSION

There is a real need for those making national policy decisions to take the time to understand what the petrochemical industry is up against today and provide measures to insure that the industry is not victimized by some very real threats. The commodity chemical industry is essential to the well-being of our nation.

It is imperative then that there be a realisitic recognition of the value of this industry to the United States and to local communities. It is time for all of us to understand the true contributions of this industry and the consequences should it disappear.

The legislation before us today attempts to correct a very real threat to the continued viability of this industry. At present there are serious problems within the commodity chemical industry created by the pricing policies of foreign nations which subsidize energy inputs used to manufacture energy-intensive petrochemical products. Using subsidized energy, these government-controlled competitors are able to lower their prices as far as necessary to sell their products in the U.S. market. This action can easily force the higher-cost U.S. producer out of the market.

There are those who are willing to give up on the commodity chemical industry. I find it quite alarming that the U.S. may be willing to gamble its future on the possibility that Mexico, Russia, Saudi Arabia, Nigeria and others are going to be fair, reasonable, and reliable suppliers of commodity chemicals including agricultural chemicals such as ammonia and urea. If we continue our present policy of allowing these government-controlled countries to enter the U.S. market with subsidized energy pricing policies that are seriously damaging our domestic industries we could find ourselves relying upon foreign suppliers for our basic building block chemicals. Are we willing to take this gamble?

Senator LONG. As Senator Heinz is not returning, I will conclude this hearing for the day. If anyone wishes to submit additional statements, I will urge that they be included in the record.

[Whereupon, at 5:27 p.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF KENNETH G. ARNE
VICE PRESIDENT AND GENERAL MANAGER,
CAN-AM CORPORATION
BEFORE THE INTERNATIONAL TRADE SUBCOMMITTEE
OF THE SENATE COMMITTEE ON FINANCE
JUNE 26, 1986

I am Kenneth G. Arne, Vice President and General Manager of Can-Am Corporation. Can-Am is a producer of quicklime located in Douglas, Arizona, near the international border with Mexico. In addition to my own company, I am speaking on behalf of Chemical Lime, Inc.; Dixie Lime and Stone Company; and Genstar Lime Company. Chemical Lime is the largest lime producer in the five-state region composed of Texas and the adjoining states. Dixie Lime is a Florida lime manufacturer. Genstar Lime is the major lime producer in the western United States, with plants in California, Arizona, Nevada, and Utah.

Can-Am, Chemical Lime, and Genstar have production facilities or markets that have felt the impact of sharply increased imports of subsidized lime from Mexico, and Dixie Lime is threatened with a similar import surge into Florida.[1]

1/ Exports of lime from Mexico increased from an estimated 19,000 short tons in 1980 to about 73,000 short tons in 1984. Almost all of exports were shipped to the United States. Over the same period, imports of lime into Mexico declined from an estimated 24,000 short tons (in 1980) to 1,000 short tons (in 1984) "due to Mexican restrictions imposed on lime imports." U.S. International Trade Commission, Potential Effects of Foreign Governments' Policies of Pricing Natural Resources, USITC Pub. 1696 (May 1985) at 52-53.

Quicklime, or simply "lime," is a strongly alkaline material which easily reacts with water and thus has wide application in chemical processing. Major uses of lime include steelmaking, copper ore processing, potable and waste water treatment, papermaking, and the production of refined chemicals.

As I will explain more fully, the process of manufacturing lime is highly energy intensive. In the United States, kiln fuel and electrical costs account for approximately 40 percent of the cost of producing lime. The Government of Mexico, through its wholly-owned oil and gas monopoly PEMEX, provides fuel oil to the Mexican lime industry at a government-determined price that represents only a fraction of the market value of the fuel. This important, government-conferred benefit enables Mexican lime producers to enter U.S. markets in which they otherwise could not compete and to undersell domestic producers that have high quality raw materials and equally efficient production facilities.[2]

The artificial competitive advantage conferred by the fuel subsidy is exactly the kind of unfair trade practice that our countervailing duty laws are intended to redress. The Commerce Department, however, takes the position that it cannot countervail against this damaging subsidy under current law. For that reason, it is imperative that Congress amend the law to give domestic industries a means of obtaining such relief.

2/ See USITC Pub. 1696, supra, at 54-55.

To appreciate the impact of this subsidy on United States lime producers, it is necessary to know something about how lime is manufactured. Quicklime is produced by heating limestone pebbles to a temperature of 1600-2100°F. Heating the limestone, which is calcium carbonate ($CaCO_3$), drives off the carbon dioxide gas (CO_2), leaving quicklime, which is calcium oxide (CaO).

The heating process takes place in large, refractory-brick-lined vessels called "kilns." There are a number of different types of kilns in use. The most common in the United States are rotaries, which are long, slightly inclined steel tubes which turn on special wheels called "trunnions." Raw stone is placed in the upper end of the kiln, and a burner is ignited at the lower end. As the stone slowly moves down the length of the kiln, it is heated and transformed from calcium carbonate to calcium oxide. Vertical kilns, as the name implies, are refractory-brick-lined shafts set on-end. The shaft is completely filled with raw stone and burners ignited through special ports at the bottom. As the stone is heated by the combustion gases as they travel up the shaft, the limestone is converted to quicklime just as in a rotary kiln. Exhibit 1 is a diagrammatic flow chart of the lime manufacturing process.

Regardless of the type of kiln employed, lime manufacturing is an energy-intensive process. Shown below are examples of the heat required to produce a ton of lime in the various types of kilns:

Kiln	Millions of Btu's per ton
Rotary without preheater	5.6 - 7.5
Rotary with preheater	4.5 - 5.3
Vertical	3.4 - 5.2
Schmid-Hofer design	3.4 - 3.8

It is important to note that the heat rates shown here are a marked improvement over the kilns commonly operated a generation ago. By and large, the lime industry has modernized its plants in the face of higher energy costs and has added heat capturing equipment to its kiln systems in order to minimize energy consumption.

Nevertheless, energy remains the single largest cost of manufacturing lime. To explain the significance of the fuel subsidy, in May 1985 we prepared a cost comparison using our internal cost account records and estimates made by Mr. Vernon Moore, President of Moore Engineers, Inc., a consulting engineering firm that specializes in lime and cement plant operation.[3] See Exhibits 2 and 3.

With so great a portion of our production cost in fuel, it should be obvious that a key to success in the lime business is access to low cost fuel supplies and high thermal efficiency in the operation of the kilns. The fact of the matter is that an

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3/ The world market price of fuel oil has declined since May 1985, with the result that the artificial cost advantage now enjoyed by the Mexican producers is not as great as it was 14 months ago. Nevertheless, it remains substantial, and the principles illustrated by these data remain valid.

operator with access to substantially lower cost fuel, gained either as a result of market forces or by government fiat, has an insurmountable advantage in competing with other producers. Thus, for energy intensive industries such as lime manufacturing, the Mexican fuel subsidy provides a critical government-conferred advantage with, if unchecked, can destroy American competitors.

Exhibit 3 compares plant costs for American and Mexican lime facilities. This cost comparison demonstrates that faced with world market prices for fuel oil, the Mexican lime producers would not be competitive. Indeed, under world market circumstances, their best alternative would be to convert their kilns to coal and import lower-cost U.S. coal as their fuel source. Conversely, Exhibit 3 also shows why the Mexican lime exporters have been able to expand their shipments into the U.S. The massive subsidy received as a result of the Mexican Government's gerrymandering of fuel prices has enabled these producers to obtain the most important cost element of their operation at a price resulting in a total production cost amounting to less than one-half that of a typical American producer. U.S. producers simply cannot compete with this kind of artificial advantage, no matter how modern or efficient our plants are.

Defenders of the Mexican Government fuel subsidy claim that the low cost of the fuel oil provided to Mexican industries is an example of comparative advantage. Comparative advantage exists when a nation specializes in the production of goods that it can produce most efficiently and engages in trade to obtain other items of consumption. Under these circumstances, the greatest amount of goods is available for consumption. The problem with arguments claiming that this principle justifies United States inaction here is that the cost advantage enjoyed by the Mexican producers comes not from any greater efficiency, but rather from a government agency supplying fuel at an artificially low price (while selling the same fuel for export at the international market price level). No increased efficiency or greater production of goods arises from a direct government subsidy of this kind. To the contrary, resource misallocations, inefficiencies, and trade distortions are the result.[4]

The theory of comparative advantage, and the reasons why the arguments advanced by the Administration citing that theory are invalid, are explained in Exhibit 4, a statement prepared by Richard Newcomb, an economist at the University of Arizona.

The Department of Commerce takes the position that current countervailing duty law provides relief when an individual company or industry receives special consideration, but not when a number of industries or all domestic producers

---

4/ The U.S. International Trade Commission has determined that in the absence of the fuel subsidy, "the delivered cost advantage of Mexican producers would not exist. The resources directed toward the Mexican lime industry, therefore, may have been allocated elsewhere . . . ." USITC Pub. 1696, _supra_, at 55.

receive a massive government benefit that substantially reduces their direct production costs. Under this policy, the more widespread the damage to U.S. industries, the less likely the Commerce Department is to act against the unfair practice. The purpose of the countervailing duty law is to insure that all competitors, domestic and foreign, face equal conditions of competition in United States markets. The Commerce Department's policy of acting only in the case of single industry subsidies, but not more pervasive unfair practices, turns the intent of our countervailing duty law upside down.

The Department's attitude on this issue is precisely why S. 1292 is so important. The officials administering our trade laws need to see the clear intent of Congress regarding foreign-government pricing of natural resources.

We support S. 1292 and Section 502 of S. 1356, which expressly provide for the imposition of countervailing duties to offset natural resource subsidies like the Mexican Government's fuel subsidy. We believe that in the case of transportable natural resource products for which there is a world market, like fuel oil, the proper measure of the countervailable benefit conferred by such subsidies is the difference between (1) the subsidized price at which the resource product is provided or sold by the government of the exporting country to its domestic producers and (2) the market value of that fuel, as determined by examining representative market prices.

Thank you, Mr. Chairman, for this opportunity to express our views.

EXHIBIT 1

PRODUCTION OF LIME

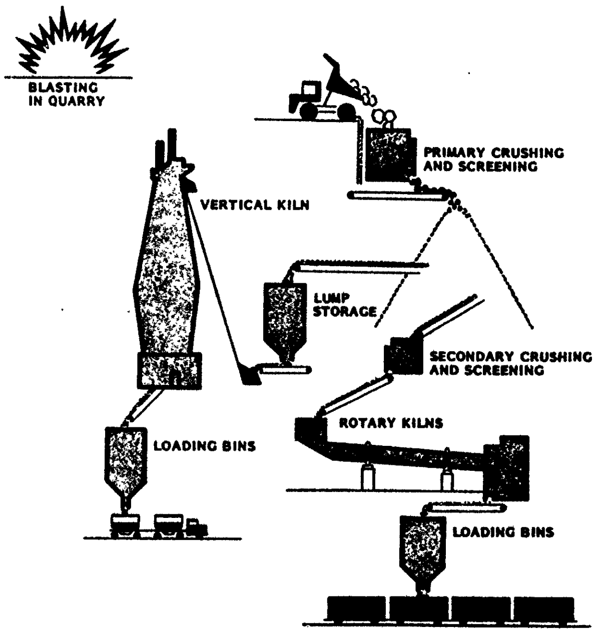


EXHIBIT 2

U.S. PLANT PRODUCTION COSTS

U.S. DOLLARS PER TON OF LIME

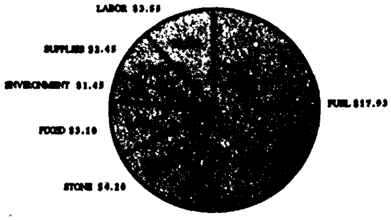
TOTAL $32.68

EXHIBIT 3

COMPARISON OF PLANT COSTS

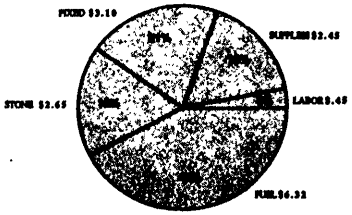
U.S. DOLLARS PER TON OF LIME

U.S. PLANT



$32.68

MEXICAN PLANT SUBSIDIZED FUEL



$14.97

MEXICAN PLANT WORLD PRICE FUEL

$41.44

[redacted]

EXHIBIT 4

COMPARATIVE ADVANTAGE, RESOURCE SUBSIDIES AND TRADE DISTORTION

by

Richard Newcomb[1]

The theory of comparative advantage describes how specialization and free exchange optimize and balance world trade. Textbooks demonstrate the optimality of specialization by measuring the increased benefits from the removal of trade barriers, including subsidies, nontariff barriers and other distortions of the free exchange of goods between a country and its trading partners. The advocates of S. 1292 employ the concept to urge the removal of foreign resource subsidies, currently doing extensive damage to U.S. mineral and energy industries. Curiously, the Administration[2] and others opposing the bill, have appealed to the same doctrine in defense of such subsidies. Their appeal violates both the assumptions and the meaning of comparative advantage theory (gains from trade).

1/ Professor of Mineral Resource Economics, University of Arizona, College of Engineering and Mines; former chairman, Department of Mineral Economics, College of Mineral and Energy Resources, West Virginia University, and Professor, College of Earth and Mineral Sciences, The Pennsylvania State University; University of Minnesota (Ph.D., 1965), Stanford University (M.B.A., 1953), St. John's College (B.A., 1949).

2/ See the testimony of Michael B. Smith, Deputy United States Trade Representative (USTR) on H.R. 2451 before the House Trade Subcommittee, June 6, 1985, and article by Alan F. Holmer, USTR General Counsel, "Subsidies and Natural Resources," Journal of International Law and Economics, George Washington University, vol. 18, 1985 (with J. Bellow).

Comparative advantage theory describes the conditions for the optimal international exchange of goods. These are the same conditions for efficient production and consumption that operate within a country in competitive markets to insure efficient balance of supply and demand. The difference internationally lies only in the inability of some factors, principally labor, to move across borders. Two assertions are proved for the simple case of world balance with two agents or countries and two traded goods:

(1) The gain from trade (efficiency) peaks when trade balances (supplies equal demands). Each country supplies the things it produces best relative to other things it does and symmetrically demands from others via exchange those things it produces relatively less well. Absolutely more skilled or scarce labor or absolutely cheaper natural resources are not the bases required for comparative advantages, as implied by the opponents of S. 1292. A lawyer who is a brilliant legal researcher, but can also type better than any secretary, distorts efficiency by taking time to do his own typing. The theory proves the law firm benefits therefore when he exchanges the typing task with his secretary despite the latter's absolute disadvantage in both typing and legal research.

(2) Reciprocity is required to achieve the optimal gains from free specialization and the terms of trade change until balanced trade occurs. If the secretary is not permitted

to specialize and to exchange activities symmetrically with the lawyer according to the new allocation of work and relative terms of trade, then the work accomplished clearly diminishes, and/or unemployment results (viz., labor supply exceeds labor demands among the secretaries, and the services market will not clear). This demonstrates the sub-optimal implications of asymmetric trade (the "unlevel trading field").

So demonstrated, the theory of relative comparative advantage is simply an application of competitive market pricing for goods and services, the laws balancing supply and demand, and the concept of the mutual gains from exchange. For optimality, the same rules which insure efficiency within a country's internal markets, therefore, apply to both countries and to their free international trade exercise in both goods. Specialization occurs through the reallocation of efforts within each country and its exchange of goods with the other country. It is determined not by the absolute costs of the goods in each country, but by the relative prices or "opportunity costs" in each, i.e., the "trade-off" or ratio for which one good trades in terms of the other in each country. This trade-off differs before trade in each country, and as reciprocal exchange is extended, the better terms of trade present a ratio which falls between the individual country opportunity costs. Gains occur, therefore, even when the absolute prices of both goods remain higher (and absolute wages remain lower) in one of the countries.

Subsidies distort balanced trade efficiencies. Suppose within one country the efficient trade-off or opportunity cost is changed by forces outside the free market determining supplies and demands within that country (e.g., by government incentives to producers or government control of the country's natural resources). The theory of exchange readily shows that this subsidy distorts efficiency in production and in consumption within the country, so that consumers receive less benefit from the mix of goods than before the subsidy.

This distortion is not removed when that country opens exchange with another country. Suppose opening the foreign country to international exchange has demonstrated a comparative advantage in a natural resource product (e.g., natural gas or fuel oil) used also as a factor or input in the manufacture of another good (e.g., lime or cement). That government's subsidy permits the gas or oil to sell domestically at a price that is less than the input's free market value at the same time as the input is sold at a higher price as an export good, while the final product, cement, is sold in U.S. markets at a significantly lower price than U.S. manufacturers' costs. Clearly, trade does not remove the pre-trade subsidy's distortion of opportunity cost.

Clearly, also, the distortion introduced by the subsidy does not become a "comparative advantage" by the fact of its being the basis for increased exports. Indeed, the subsidy wastes the favored resource by making inefficient use of it within the country before and after trade. This is easily demonstrated by the removal of one unit of gas or oil from its subsidized domestic market and its sale in the free export market. This leaves the foreign country richer by the difference between the domestic and export market price, measuring the distortion of the subsidy. The incremental benefit can be measured also by the added consumption afforded after the subsidy's removal which results in greater total consumption in both countries than the sum of the subsidized consumptions in both countries under the distorted trade assumptions.

The theory assumes zero transportation costs. In actual markets, however, the inefficiencies of the subsidized export trade can be much greater. For example, a subsidy of $20 per barrel of oil permits a cement producer to ship a ton of product as far as 700 miles by absorbing transportation costs to penetrate a U.S. market. Clearly, the energy and hopper cars to ship cement so far could be employed elsewhere if not so wasted, adding to the gains in the producing country from the removal of the subsidy. Suppose the subsidy is not removed domestically, but has to be offset by a countervailing duty? Then the cessation of wasteful export shipments offsets some but not all distortion. Thus, the competitive edge granted to subsidized industries is an added cost to taxpayers, not in any sense a part of free market comparative advantage, and comparative advantage is distinguished from artificial advantages created by government intervention in the free market.[3] While countervailing duties will not remedy all the inefficiencies caused by resource subsidies, they do act in the direction of restored competitive conditions in the U.S. domestic markets, where new investment, added output and employment will result. To the extent a duty diminishes the waste of the exporting firms' over-extended transportation, it will also improve efficiencies in the exporting country.

Mexico does not, in fact, have absolute advantages in energy resources over the U.S. Competent studies will show that Mexican gas sold domestically at free market prices cannot profitably be transported to many U.S. locations to compete with U.S. gas. U.S. coal can also be profitably substituted for Mexican oil in potential locations for power generation, thus releasing Mexican oil for far more profitable export elsewhere with net gains to all trading countries. Restoring free trade based on comparative advantage would result in fossil fuels being exchanged by both countries as a function of regional factors.

3/ The dialogue on this issue is especially confused by the attempt of Administration representatives to ignore the distortions if subsidies are "generally available" or without the intention to increase export markets. Neither condition changes the waste of natural resources, and only removal of the subsidy and a return to competitive market exchange can restore the gains from trade. Failing the willingness of the offending country to drop the domestic subsidy, a countervailing duty can restore efficiency within the receiving country by removing the distortion partially.

While it is clear that Mexico has comparative advantage in the primary oil products, this disappears for many higher valued energy intensive products when high transportation costs are incurred. Thus, in the cement case, the U.S. has comparative advantages from the use of coal-based kilns over the oil-fired Mexican kilns in addition to locational advantages. Where these occur, the full restoration of free trade by the elimination of the domestic subsidy would bring added benefits to both countries from U.S. exports to neighboring Mexican states. Current distortion from the subsidy prevents this U.S. investment from occurring. Countervailing duties, therefore, at a minimum can offset both export market distortions and some of the distortions in the domestic markets. Finally, the duty provides an incentive to eliminate additional inefficiencies if free trade based on comparative advantage, i.e., competitive market theory, is fully restored.

C/S/E

Written Testimony for the Record
On Natural Resource Subsidies
(S. 1292 and Section 502 of S. 1356)
Citizens for a Sound Economy
To the Subcommittee on International Trade
June 26, 1986

Citizens for a Sound Economy (CSE) is a 250,000 member nonprofit grassroots organization dedicated to expanding consumer opportunity and economic choice. One way in which CSE seeks to advance consumer interests is by fighting protectionist legislation. As a devoted advocate of open trade, CSE therefore opposes S. 1292, the natural resource subsidy bill, and Section 502 of S. 1356. CSE bases its opposition to this legislation on the premise that it is detrimental to U.S. consumers as well as the U.S. economy. Furthermore, if passed, the natural resource subsidy bill will exist as a violation of the General Agreement on Tariffs and Trade (GATT), and, therefore, will invite other countries to enact "mirror legislation." Finally, this bill attempts to destroy a natural advantage in competition and stands as an impediment to free trade, an impediment that ultimately harms the consumer.

Passage of natural resource subsidy legislation would ensure harsh economic consequences for consumers. According to a study conducted by Wharton Econometric Forecasting Associates, consumer prices will rise by approximately one-half a percent due to the levying of duties on such imports as petrochemicals, fertilizers and lumber entering the United States. Not only will consumers be forced to contend with higher prices, but they will also experience a loss in personal income. The Wharton study projected this loss in income to be (in 1985 dollars) $28 billion from 1986 to 1994. This figure does not reflect additional losses that will occur if other countries retaliate--a consequence that seems certain because of the dependence of many countries on exports of natural resource products. Loss in personal income with retaliation may approach $41 billion.

Beyond the suffering of individual consumers, the entire U.S. economy will be significantly harmed by input subsidy legislation. Wharton Econometrics estimates that U.S. GNP will be decreased by about $80 billion dollars from 1986 to 1994 should this legislation become law. Again, this figure does not reflect the impact of retaliation by other countries; the loss in GNP will be significantly greater with the inevitable consequence of retaliation. In addition to its negative impact on GNP, the natural resources subsidy bill may raise federal outlays (i.e., unemployment compensation) by as much as $11 billion over the 1986-1994 period. The Wharton study also estimates that the federal debt will increase by approximately $5 billion.

A specific area in which consumers can expect to pay more is in housing. The National Association of Home Builders (NAHB) says that the increase in the price of lumber due to the impact of duties will

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be transferred to the consumer. According to the NAHB, the recent imposition of a 35% tariff on Canadian cedar shakes and shingles has already caused an increase in the building of homes; the standard 1700 square foot home has increased in price, on the average, by $800 throughout the country. Some home builders have reported an increase in cost of $1000 per home. The NAHB estimates that every $1000 increase in home prices guarantees an additional 300,000 families priced out of the market and, therefore, denied the ability to build a home.

An additional negative consequence of this legislation is the certainty that it will be found to violate our GATT obligations. The United States now adheres to the "specificity" principle in the GATT Subsidies Code which says that government actions must benefit a particular industrial sector in order to be defined as a domestic subsidy. If the specificity test is discarded, and the United States departs from the international consensus regarding the definition of a domestic subsidy, then the United States itself will be exposed to countervailing duties imposed on U.S. industries that other countries deem subsidized.

Such "mirror legislation" enacted by other countries is perfectly legal under the GATT. In making itself susceptible to retaliation by other countries, the United States invites countervailing duties to be inflicted upon such industries as petrochemicals and man-made fibers. Industries which are aided by federal irrigation and rural electrification programs could also be perceived as receiving subsidies. Indeed, U.S. corn producers are currently facing an investigation of 77 U.S. government subsidy programs petitioned by the Ontario Corn Producers' Association. Such retaliation proves that legislation enacted with the intent to "protect" a few industries ultimately guarantees harm to many industries.

Finally, the natural resource subsidy bill attempts to negate the usefulness of comparative advantage. The bill would cause a country, that now benefits from its inherent ability to extract a natural resource more economically than another country, to lose that benefit. By denying a country its comparative advantage this bill would ensure that the United States would lose its own comparative advantage when other countries inevitably impose countervailing duties upon those natural resources in which the United States has an inherent advantage. Countervailing duties imposed by one country invite reciprocity by the country faced with the original duty. Conceivably, such duties could make some imports so costly that they cease to enter the United States.

The natural resource subsidy bill is a direct attack on consumers and the economic welfare of the United States. The bill forces consumers to pay higher prices and to face a loss in personal income as well as reduce their choice of purchases. This legislation encourages retaliation from other countries; retaliation that will impede free trade. Ultimately, we can expect such legislation to reduce the standard of living for all of us.

Post-hearing Statement of the
Coalition for Fair Lumber Imports
to the Trade Subcommittee of the
Senate Finance Committee
Concerning Natural Resource Legislation
July 10, 1986

It is becoming generally recognized that foreign governments subsidize their natural resources to the detriment of U.S. industries and U.S. jobs. It has become apparent that something must be done to redress the deleterious effects of natural resource pricing subsidies. A number of objections have, nevertheless, been expressed to the pending natural resource legislation in H.R. 4800, S.1292 and § 502 of S.1356. These objections, upon examination, appear to be without merit. The Coalition for Fair Lumber Imports files this statement in response to these arguments and in response to questions which were asked at the Trade Subcommittee hearing on June 26, 1986.

I. Natural Resource Legislation Would Not Violate the GATT

The GATT Subsidies Code is not all that we would have it be. The United States had sought a direct discipline on the granting of domestic subsidies as they affect trade in addition to the rules governing export subsidies which have long been a part of the GATT. In this objective, the United States negotiators did not succeed. A rough balance was struck: while the Code recognized the legitimacy of resort to domestic subsidies as instruments of national policy, it also recognized that these subsidies could cause serious prejudice to the interests of others or injury to their industries, and offered a right of response through the imposition of countervailing duties and dispute settlement procedures.

Thus the Code did not offer much of a direct curb on the use of domestic subsidies. Its principal obligation reads --

> "Signatories further agree that they shall seek to avoid causing, through the use of any subsidy:
>
> (a) injury to the domestic industry of another signatory:
>
> (b) nullification or impairment of the benefits accruing directly or indirectly to another signa-

tory under the General Agreement; or

(c) serious prejudice to the interests of another signatory."

Nor, however, did it offer much of a curb on the use of countervailing duties, other than through reiteration of the need to demonstrate the existence of, or threat of, material injury. This was clearly the most significant point for the other signatories to the Code. In return for a recognition of the legitimacy of a nation responding to harmful foreign subsidies (and some greater definition of export subsidies), the United States agreed to apply the injury test in all cases, something which it had previously not done because its statute predated the GATT and benefited from a grandfather clause.

While the GATT Subsidy Code is disappointing because of its lack of stringent rules governing either the use ofdomestic subsidies or countervailing duties, what had been gained in the Code should not be underestimated -- the United States could no longer countervail unless the injury test was met, but, if that requirement was met, it now was absolutely free to do so. This was the bargain that had been struck. From the other signatories' point of view, they had gained an acknowledgment that the United States would not act unilaterally unless injury were present or clearly threatened. No longer would hostility be engendered by the world's largest trading nation not being subject to the same requirements to which all others adhered. For domestic U.S. industries who might feel that trade had not been a good one, the realization slowly sank in that while the United States had long possessed a right to countervail unfettered by the injury test, it had also demonstrated an extreme reluctance to countervail at all, such was the hostility which its acting caused.

Perhaps no bargain in the Tokyo Round of Trade Negotiations received greater scrutiny from the Congress. The drafting of the injury test itself occupied numerous mark-up sessions of the Senate Finance Committee. Much testimony was received on the commitments which had been received in return for the injury test being applied. In the end, the balance which the Congress found was more one based in domestic law than in additional foreign commitments. This is summed up in the President's Statement of Administrative Action which was submitted with the proposed legislation implementing the agreement:

"While including an injury test, the proposed legislation also contains a number of provisions designed to ensure that where subsidized imports are caus-

> ing material injury to a domestic industry producing a like product, effective relief is available." H.R. Doc. 96-153, 96th Cong., 1st. Sess., Part II, 393 (1979).

The Congress was particularly cautious about what had been negotiated. To be sure that no agreement had direct domestic effect, it provided in the first operative section of the Trade Agreements Act of 1979 that the President was authorized to accept for the United States the final legal instruments or texts embodying each of the trade agreements only as approved by the Congress in the Act (Pub. L. 96-39, sec. 2), and further required that "[n]o provision of any trade agreement [so] approved by the Congress . . . nor the application of any such provision to any person or circumstance, which is in conflict with any statute of the United States, shall be given effect under the laws of the United States."

It is in this context of the closest possible Congressional examination of an international trade agreement -- an agreement that has no relevant limitations on the use of the U.S. countervailing duty law -- that the Administration advances the theory that the Subsidies Code actually proscribes the use of countervailing duties against natural resource input subsidies which it or others might find to be "generally available." When pressed as to whether countervailing in these circumstances would be a violation of the Code, Administration witnesses admit that this would not be the case but say that such action would not be "in conformity with" the Code. This they explain as follows: They admit that there is no explicit language in the Code itself which contains a prohibition of this kind. Instead they point to some descriptive language in an explicitly non-exhaustive list of subsidies which <u>are recognized as those which may be used</u> by countries in the pursuit of social and economic policy objectives which these countries consider to be important and desirable. Based on this language, which addresses a different subject in the Code and on their experience in Experts Meetings, these Administration witnesses then state that it is clear to them that even if the Code does not explicitly prohibit the United States from countervailing against these subsidies, to do so (despite the presence of injury) would clearly be contrary to a widely recognized international consensus that "generally available" subsidies be immune from the imposition of countervailing duties.

This statement concludes that, contrary to Administration protestations, neither the Subsidies Code nor the GATT itself contains any obligation that would restrain a Signatory or Contracting Party from utilizing countervailing duties against injurious natural resource input subsidies of any kind.

A. Interpretation of the Subsidies Code

The General Agreement on Tariffs and Trade and the Subsidies Codes[1] are contracts. They are not to be expanded to include additional obligations without the consent of the parties. If they were, then a majority vote would suffice to add agreements to the GATT. But this is not the case. Even interpretations of existing obligations, if sufficiently significant, such as comprise the bulk of the Subsidies Code, must be accepted by each Contracting Party by a separate formal act.

Contracts are to be strictly construed. See, e.g., Calderon v. Atlas S.S. Co., 170 U.S. 272, 280 (1898); S.S. Kresge Co. v. Sears, 87 F.2d 135 (1st Cir. 1936); Restatement (Second) of Contracts, § 203 (1981). Clear evidence must be adduced of an implied obligation before it may be considered to exist. To find a specific obligation, one must first look to the agreement. Section 147 of the Restatement (Second) of the Foreign Relations Law of the United States, (1965) (Restatement), without giving a particular hierarchy to interpretive aids, directs the reader first to "(a) the ordinary meaning of the words of the agreement in the context in which they are used." No examination of the words of this particular agreement reveals any relevant obligation which would limit the right of the United States to counter injurious natural resource input subsidies. On the contrary, Article 4(1) states that "[t]he decision whether or not to impose a countervailing duty in cases where all requirements for the imposition have been fulfilled and the . . . amount [of the duty] . . . are decisions to be made by the authorities of the importing country."

Failing to find an obligation that curbs the use of countervailing duties, the Administration's representatives point to another section of the agreement which deals only with some illustrations of subsidies that are used by Signatories. The text to which they refer in Code Article 11(1) begins --

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[1] General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 194 (1948), as amended; Agreement on Interpretation and Application of Articles VI, XVI and XXII of the General Agreement on Tariffs and Trade, Geneva, April 12, 1979, T.I.A.S. No. 9619.

> "Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable."

In the next paragraphs the Code signatories recognize that these measures may cause injury and that those employing these measures should seek to avoid "adversely affect[ing] the conditions of normal competition." It is after the Code sets forth these principles sanctioning the use of subsidies and asking that they not prejudice others, that it proceeds to review some forms of subsidy that are often used as instruments of national policy "granted with the aim of giving an advantage to certain enterprises." Art. II(3) (emphasis supplied). It notes that these "forms of subsidy are normally granted either regionally or by sector", but even qualifies this statement by saying that "the enumeration of forms of subsidy set out above is illustrative and non-exhaustive." Lastly, the article (11(4)) states that "nothing in . . . the enumeration of forms of subsidy creates, in itself, any basis for action under the General Agreement, as interpreted by this Agreement."

It is this discussion in the Code which recognizes the legitimate use of certain subsidies to which Administration representatives point when they seek a basis in the Code for differentiating between specific and generally available subsidies. However, no useful distinction is in fact drawn by the Code that would lend itself to being cited to support the proposition that specific subsidies are countervailable and generally available subsidies are not.

The text cited above was not haphazardly drafted. It might have given rise to a safe-harbor for specific subsidies (as opposed to those which are generally available), but for the recognition in the second paragraph that such subsidies might cause adverse effects. Were that safe-harbor to have been created, paradoxically enough it would have been for the opposite kinds of subsidies from the ones that the Administration says are impliedly immune from countervailing duties. The Code discusses approvingly as instruments of national policy, as long as they are not harmful to the interests of others, subsidies which are often specifically "granted with the aim of giving an advantage to certain enterprises" and which are "normally granted either regionally or by sector". The Code, even when recognizing the validity of certain subsidies, does not single out or even mention "generally available" subsidies as being appropriate for usage. Its limited blessing is available only for those subsidies which the Administration feels are countervailable -- namely, specific subsidies.

Thus the ordinary meaning of the words can give no comfort to those who wish to find an obligation limiting the use of countervailing duties. The Code neither states explicitly nor implies that "generally available" subsidies are not countervailable.

If the language of the Agreement were ambiguous, it would be appropriate to review the drafting history and the intent of the negotiators. But, here again, one cannot find evidence on the basis of which to conclude that injurious natural resource input subsidies, if generally available, must be tolerated. Each and every one of the U.S. negotiators has attested to the fact that the Commerce Department's doctrine of general availability is self-imposed and is not to be found in the Subsidies Code or in the General Agreement. This has been stated by Richard Rivers, the lead U.S. negotiator of the Code (Letter from Richard Rivers to Chairman Sam Gibbons (June 21, 1985)), John Greenwald, his deputy who subsequently became the chief administrator of the U.S. countervailing duty law and was the U.S. representative to the Subsidies Code Committee in the initial years of operation of the Code (Greenwald and Rivers, The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Polity Differences, 11 Law & Policy in Int'l Bus. 1447 (1979)), Professor Gary Hufbauer, the chief Treasury representative to the negotiations and former Deputy Assistant Secretary of the Treasury for International Trade, who is also the co-author of the most recent and definitive text on subsidies, entitled Subsidies in International Trade, Institute for International Economics, Washington, D.C. 1984, and Alan Wolff, the U.S. Deputy Special Trade Representative who was responsible for coordinating the instructions to the U.S. negotiators of the Code. Testimony of Alan Wolff, before the Trade Subcommittee of the Senate Finance Committee, June 26, 1986.

One can next turn, as an interpretative aid, to "subsequent practice of the parties in the performance of the agreement" (Restatement, § 147(1)(f)). As Professor Hufbauer noted in his testimony before the Senate Finance Committee on June 26, 1986, the U.S. law implementing the Subsidies Code defined the word "subsidy" as having the same meaning as the term "bounty or grant" in the pre-existing statute, dating back to 1897. This statute was intended to implement the Subsidies Code. It was scrutinized by our major trading partners, particularly with respect to the faithful carrying out of U.S. Subsidies Code obligations. No complaint was made that the United States was clearly preserving existing law completely unfettered in adopting a definition of subsidy that had no limits. Had there been any obligations as to how subsidies were to be defined, this gap in performance would have been far too large to have been overlooked.

Another interpretative aid is the travaux preparetoires of the negotiations, the official record of the deliberations during the course of the negotiation, and drafts and other documents submitted for consideration, together with the actions taken on them. Professor Hufbauer in his testimony outlines the negotiating history of the relevant Subsidies Code provisions. The United States sought a definition of domestic subsidies. See Greenwald and Rivers, The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Polity Differences, 11 Law & Policy in Int'l Bus. 1447 (1979). This was rejected by the Europeans and Canadians, and the open-ended freedom of action which characterizes the current text, drafted by the Canadians, was adopted. As Hufbauer states, had the other parties agreed to guidelines for the use of domestic subsidies, the U.S. negotiators might have entertained a hypothetical demand for a parallel use of these guidelines for the application of its national countervailing duty laws. But this exchange never took place.

As Hufbauer notes, the absence of these disciplines was not due to the absence of their consideration by the negotiators. "In fact, the United States and Europe could never agree whether off-budget subsidies (for example, the assignment of valuable mineral rights free of charge) can be a subsidy. . . . The consensus held that we could not reach agreement on a 'negative list' of subsidies; moreover it was believed that the injury test would eliminate nuisance suits." In conclusion, he wrote "Any subsidy that causes economic injury to another signatory's industry can properly be the object of national countervailing duty proceedings, whether or not the subsidy appears on the illustrative list."

B. The Absence of an International Consensus

The Administration has taken the position that if the Subsidies Code itself does not proscribe countervailing against injurious natural resource input subsidies which are generally available, then the Committee of Code Signatories certainly would do so were the issue laid before it.

This is an interesting proposition. The Congress has gone to some lengths to prevent the United States from entering into obligations that are not explicitly approved by it pursuant to specific notice requirements. It has explicitly stated that agreements are not to have the force of domestic law absent such approval. It is now put forward that delegates who have no authority to bind the United States (there being no delegation from the Congress or President for this purpose), attending meetings of committees of experts can informally evolve a significant obligation where none is contained in the text of the approved agreement. On the basis of this, it is submitted by Administration representatives that a panel, were one constituted under the Code procedures, would quickly find against the United States. This is far from clear, however, given the text and drafting history of the agreement set forth above.

Putting aside the practical problem of assembling a neutral panel in the GATT when one country's interests are at variance with many others, it is valid, as an interpretative aid, to look to "the subsequent practice of the parties in performance of the agreement, or the subsequent practice of one party, if the other party or parties knew or had reason to know of it; . . . ." Restatement, § 147(1)(f). Looking for common practice is not fruitful, however. The United States is one of the only countries to employ a countervailing duty law. Its own practice is not clearly established, with one major case in the process of judicial review and another in the process of the investigation. Japan, the second largest trading nation, has a countervailing duty law on its books, but has never used it. It has found other means of dealing with import problems. It has had two antidumping cases, but neither of these went through to conclusion. The EEC only rarely employs countervailing duties. Canada's countervailing duty law has been, until recently, a dead letter. A case was initiated on July 3, 1986, against U.S. corn exports, which includes allegations of the granting of many natural resource input subsidies which are "generally available" as the U.S. Commerce Department has employed that term. The Canadian Government has not yet made findings. As of June 1984, according to International Monetary Fund data, the United States had 56 countervailing duty cases, the rest of the world had five. It is thus clear that there is no settled body of national practice on this subject, there being so little use of this form of trade measure.

Whether an impartial panel could be constituted on this issue from a world that utilizes trade restrictions other than countervailing duties is unclear. However, this is irrelevant to a consideration of the GATT legality of taking action against "generally available" injurious natural resource input subsidies. A search of public materials fails to reveal any views on this subject. In a world of subsidization it would not be surprising, however, to find a consensus abroad on the notion that such subsidies ought not to be countervailed. The issue is then one of policy not legal obligation.

C. Conclusion -- The Optimal Policy Choice

Whatever the status of any international consensus of experts, and none has been demonstrated by the Administration to exist, in advancing its argument that the United States cannot countervail against certain injurious subsidies, the Administration is not describing a process of interpretation of an existing obligation, but the creation of a new obligation. That no obligation currently exists is clear from the language of the Code and from its negotiating history. As noted above, however, groups of experts cannot create obligations at all, not in the GATT, and not as a matter of international or domestic law. Not even the President himself could do so. This is a matter that must be done pursuant to international agreement in accordance with constitutional and statutory procedures. If the rules are to be changed, the United States must agree to it, statutory procedures must be followed, and the formal approval of Congress obtained.

The Administration would be better advised to address the injurious natural resource subsidy issue on grounds of policy. Does it make sense to exempt all injurious natural resource input subsidies ab initio from countervailing duties? This is a point never raised in the GATT or in the Subsidies Code negotiations, so no guidance can be found by consulting these sources. Nor can much be said about an argument that if the United States pursued these injurious practices with offsetting duties, that other countries would then act against our exports. In the first place, a good argument can be made that if we by subsidy injure another country's industries than that country should be free to countervail. But in fact almost no other country employs countervailing duties at all (the EEC blocks our exports of agricultural commodities, for example with variable levies of highly questionable legality, Japan with nontariff barriers, developing countries with GATT-sanctioned and other restrictions), and the one other country that does countervail is considering acting against these "generally available" subsidies even though the United States has never done so previously.

Thus, our abstinence from acting against these subsidies should be debated entirely on the merits, putting aside arguments about the GATT and the Subsidies Code (two documents that are clearly inapplicable).

Professor Hufbauer was asked at the Natural Resource Subsidy Hearing of the Senate Finance Trade Subcommittee his reasons as an economist why the United States should not just sit back and enjoy the subsidies of others. He answered that first this resulted in a misallocation of the world's resources, and had to be inefficient and wasteful. Natural resource subsidies, like other subsidies, undermine the benefits of natural comparative advantage that can be achieved through free market forces. Secondly, he stated, the United States would never as a political matter be willing to stand by and see its industries and agriculture eroded by foreign subsidies. If it felt constrained to avoid the use of countervailing duties, he said, the response would not be to do nothing but to employ countervailing subsidies. This he concluded would be tragic because it would consist of meeting waste with waste.

Clearly, the best policy for the United States, and other signatories to the GATT and the Subsidies Code, is to apply countervailing duties against the injurious subsidies of others, even when they are natural resource input subsidies, and even if they are within the scope of what the Commerce Department has considered to be "generally available" in the past.

II. Mirror Legislation Should Not be Viewed as a Substantial Problem

Natural resource legislation has been criticized because it would, it is alleged, lead to other countries offsetting any U.S. natural resource subsidies which injure their industries. As a preliminary matter, as Representative Gibbons noted at the Senate Finance, Trade Subcommittee hearing on June 26, one must ask whether or not the United States should subsidize natural resources to the detriment of our trading partners and our budget. If we do so, arguably offsetting duties should be employed by our trading partners to protect their industries against injury. As Senator Baucus noted, however, most countries have subsidies which are many times the level of U.S. subsidies, and the ratio between foreign countries subsidies and our gross domestic product is rising. In 1980, the most recent year for which data is available, Canada, for example, subsidized its economy at a rate which was 5 1/2 times greater than the United States. See G. Hufbauer and S. Erb, Subsidies in International Trade, 3 (1984). Thus, their interest in creating precedent in countering those kinds of subsidies would be limited. Finally, and perhaps most importantly, the proposed natural resource legislation, were it to be used as a model by other nations, includes a number of limitations which would prevent its use by other countries in a manner harmful to U.S. industries.

The three primary limitations in the proposed bill which would make its use as foreign mirror legislation unlikely to harm U.S. industries, are: (1) the requirement that a domestic industry must be injured before a duty can be imposed, (2) the requirement that a resource must be a significant portion of the cost of a good before a subsidy can be found, and (3) the qualification that a subsidy only exists if a government sale is below fair market value (not below the U.S. price or some other arbitrary standard).[2] In fact, it is difficult to imagine what U.S. program would be subject to duties if foreign governments adopted mirror legislation.

It has been alleged that various U.S. programs which currently are not open to allegations of subsidization would be subject to countervailing duties under legislation which mirrored proposed natural resource legislation. This is simply not the case. For example, it has been argued that allegedly subsidized U.S. grazing rights might be subject to countervailing duties under mirror legislation. In fact, those grazing rights account for only about 2% of U.S. grazing, and do not injure an industry in a foreign country. Further, were there injury and if subsidies exist, they would be subject to duties under any current countervailing law which resembled that of the United States (e.g., Canada's) as they are provided to a specific group of industries.

Similarly, the Administration has argued that the Ontario countervailing duty case against U.S. corn growers demonstrates the potential problems implicit in natural resource legislation. In fact, as the petition in the Ontario case explains, it is filed under current legal standards, not under any new natural resource standard. Ontario corn growers argue that the programs which they allege as subsidies are provided to a specific group of industries under current law. Further, most of the programs alleged against, e.g., land-grant colleges, do not contribute a significant portion of the cost of production of the product, nor do they constitute resource subsidies. Clearly, so-called mirror legislation would not substantially affect the Ontario corn growers case.

It has also been argued that the European Community did not file a countervailing duty case against alleged U.S. natural gas subsidies to textile manufacturers because the United States convinced the EC that such subsidies were generally available. Even assuming that such natural gas subsidies are a significant portion of the cost of production of textiles, and thus potentially subject to mirror legislation, it appears that the real reason that the EC did not file a case against U.S. natural gas was because of the pending substantial deregulation of U.S. natural gas prices, i.e. any subsidy which existed is being eliminated, and because of appreciation of the dollar, which eliminated the trade problem.

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[2] Further, this fair market value standard will allow foreign nations to capture all of their natural comparative advantage, but will prevent them from distorting the market with government interference.

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U.S. industries suffering from foreign natural resource pricing subsidies need relief from such practices. It is unlikely that such relief could be turned effectively against U.S. industries as opponents of S.1292 and S.1356 have alleged.

III. Natural Resource Legislation Would Not Substantially Increase Housing Costs

The imposition of countervailing duties on Canadian softwood lumber imports into the United States will not substantially increase the cost of housing in the United States. Currently, subsidized Canadian lumber is flooding across the border and injuring U.S. lumber producers and lumber producing regions. Off-setting that subsidy will have some effect on lumber prices, but calculations created by opponents of natural resource legislation have incorrectly calculated the potential costs to consumers.

It is interesting to note that the alleged housing cost increase resulting from a countervailing duty on subsidized lumber has consistently been revised downward by opponents of the legislation. When natural resource legislation was before the House, opponents argued that a duty on subsidized lumber would result in an increase of $2,500 per new home. The number alleged by the opponents of this legislation has since dropped to $1,000 per new home.

The actual increase in costs will be very small. The average new home contains about 10 thousand board feet of lumber. A duty on the one-third of U.S. lumber consumption imported from Canada will not result in a price increase for lumber produced in the United States equal to the duty. Thus, a duty off-setting Canadian lumber subsidies, about $54 per thousand board feet would probably only increase the cost of a new home by a few hundred dollars.

Given that the average mortgage for a new home is $80,000, the minimal increase in the cost of a new home resulting from a duty on subsidized lumber will amount to only $2-$3 per month on a monthly payment of over $700. This could hardly price any households out of the market for the average new home. Statistics advanced by opponents of this legislation, that as many as 376,000 families would be made homeless, are ludicrous.

The estimation that 376,000 households will be priced out of the new home market is based on faulty reasoning. That number was calculated by using Bureau of Census data showing the number of households in the income range that would qualify for a mortgage at $81,000, as opposed to $80,000. The difference is 376,000 households. The problems with this analysis are several. First, as shown above, the $1,000 difference is drastically inflated. Second, the numbers used from the Bureau of Census indicate the total number of households who qualify for any $80,000 mortgage, not those who will purchase an $80,000 new home. Since the price of used homes will not be affected and the number of persons who purchase new homes is much smaller than those who purchase existing homes, the effect on new housing purchases would be de minimis. Further, about 64% of those capable of purchasing new homes at any particular price, i.e., 64% of those included in the estimate, already own their own homes, and some of those capable of purchasing a new home have absolutely no interest in actually purchasing a home. Certainly no one looking for a new home will turn away from an increase in cost of $2-3 per month. Meanwhile, the effect a countervailing duty will have on unfair Canadian lumber imports will substantially aid the nation's economy, providing jobs for unemployed lumber workers and the communities that depend upon lumber production, and assure reasonably priced supplies of lumber for years to come.

IV. The U.S. Lumber Industry has been Seriously and Consistently Injured by Subsidized Canadian Lumber

During the Senate Trade Subcommittee hearings on natural resource legislation, the National Association of Homebuilders argued that in determining the deleterious effects of subsidized Canadian lumber imports, one should consider changes in the marketplace from two periods of peak demand for softwood lumber, rather than comparing a period of peak demand with a recession year. While there was some confusion at the hearings as to the appropriate base-year to be used, the National Association of Homebuilders is correct in theory. For the purpose of determining whether the U.S. Lumber market has been injured by softwood lumber imports from Canada, the current softwood market more closely resembles the market situation in 1978, a year of peak demand, than the 1982 market, a recessionary year.[3] Comparing Canadian market penetration and the condition of the U.S. industry between 1978 and 1985 clearly shows the injury subsidized Canadian lumber imports have inflicted on the U.S. industry.

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[3] While, as the Coalition for Fair Lumber Imports stated at the hearing, 1979 was a very good year for U.S. softwood lumber consumption, 1978 remains the best year for comparison with the current market situation because it was the peak of softwood lumber consumption in that market cycle.

In 1978, the United States imported 11.8 billion board feet of Canadian softwood lumber with domestic consumption of 42.6 billion board feet. By 1985, subsidized Canadian imports had risen to 14.5 billion board feet, almost one-third of U.S. consumption of 43.7 billion board feet. Canadian imports increased by almost 23% while U.S. consumption increased by less than 3%. U.S. production fell.

Though the volume of Canadian imports decreased during the recession of the early 1980's, U.S. consumption also fell substantially. In fact, throughout the recession the market share of Canadian imports did not decrease, but stayed well ahead of consumption such that the Canadian's percentage of the U.S. market grew from 27.6 percent in 1978 to 29.2 percent in 1982. That percentage has continued to grow and in 1985 reached 33.2 percent of the U.S. market. See attached table. The increased penetration of Canadian lumber, only made possible by Canadian lumber subsidies, has had serious detrimental effects on the U.S. industry. Between 1978 and 1985, the United States lost a net of over 650 softwood lumber mills while Canada was opening new mills.

Further, it is important to remember that even in 1978, as today, subsidized Canadian imports were injuring the U.S. lumber industry industry. Even Canada's 1978 market penetration does not show properly what the U.S. softwood market would be absent the heavily subsidized imports. Subsidized Canadian imports injured the U.S. industry then as they do now.

Whether one compares periods of peak U.S. lumber demand or the period since the last recession, Canadian lumber imports have seriously injured the U.S. industry. Subsidized Canadian softwood dimensional lumber will continue to injure the U.S. market until the government imposes a countervailing duty, allowing U.S. mills to compete against Canadian mills Canadian mills rather than competing against the Canadian provincial governments.

REGIONAL MARKET SHARE OF U.S. LUMBER CONSUMPTION
(Million Board Feet)

Year	South	% of U.S. Consumption	West	% of U.S. Consumption	North	% of U.S. Consumption	Canadian Imports	% of U.S. Consumption	Total U.S. Lumber Consumption
1970	6,441	20.2%	18,318	57.5%	1,407	4.4%	5,716	17.9%	31,881
1971	7,428	20.5%	20,308	53.9%	1,396	3.8%	7,186	19.8%	36,318
1972	7,690	19.5%	21,298	54.1%	1,497	3.8%	8,869	22.5%	39,354
1973	6,880	18.1%	20,781	54.6%	1,598	4.2%	8,831	23.2%	38,090
1974	6,003	18.7%	17,727	55.3%	1,627	5.1%	6,724	21.0%	32,081
1975	6,432	21.2%	16,734	55.2%	1,475	4.9%	5,667	18.7%	30,309
1976	7,137	19.8%	19,336	53.6%	1,688	4.7%	7,904	21.9%	36,085
1977	8,246	20.2%	20,472	50.2%	1,753	4.3%	10,345	25.3%	40,816
1978	8,617	20.2%	20,166	47.3%	2,046	4.8%	11,760	27.6%	42,589
1979	8,337	20.5%	19,079	47.0%	2,124	5.2%	11,065	27.3%	40,605
1980	7,252	21.4%	15,052	44.3%	2,012	5.9%	9,514	28.1%	33,831
1981	7,517	23.4%	13,971	43.6%	1,392	4.3%	9,182	28.6%	32,063
1982	7,902	25.3%	12,872	41.3%	1,309	4.2%	9,091	29.2%	31,174
1983	9,215	23.2%	17,036	42.9%	1,543	3.9%	11,947	30.1%	39,742
1984	9,985	23.2%	18,296	42.5%	1,515	3.5%	13,221	30.7%	43,017
1985	9,903	22.7%	17,799	40.7%	1,492	3.4%	14,510	33.2%	43,704

Source: NFPA

WRITTEN STATEMENT OF CONTINENTAL GRAIN COMPANY

TO THE INTERNATIONAL TRADE SUBCOMMITTEE OF THE SENATE COMMITTEE ON FINANCES IN REGARD TO U.S. TRADE LEGISLATION

July 8, 1986

Continental Grain Company is a major exporter of U.S. grains, oilseeds and products as well as an importer of fertilizer and hydrocarbon products. The Company employs approximately 12,000 workers worldwide, the majority of whom are employed in the United States.

Because of the substantial impact which proposed trade legislation will have on U.S. agriculture and world trade, we wish to make the following observations and to express some of our concerns regarding the legislation now under consideration by the U.S. Senate, specifically S. 1860, S. 1292 and S. 1346.

Continental Grain particularly is opposed to the proposals contained in the current Senate legislation aimed at imposing countervailing duties on imported products where those products benefit from low-cost natural resource inputs in the country of origin. First, the existing trade laws of the United States already provide relief from access and pricing disparities, and these issues can be further resolved through multilateral trade negotiations. Second, the imposition of the natural resource proposals as contained in the Senate bills violate U.S. international obligations and invite retaliation by other countries. Third, the natural resource proposals will have adverse effects on the farm and general economies of the United States.

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Continental Grain feels strongly that natural resource proposals, if enacted, will cause retaliation from this country's export customers. This would come at a time when U.S. exports are at an extremely low level and, in fact, when the U.S. recorded its first farm trade deficit in 15 years. American farmers also stand to lose the availability of economically-priced fertilizer products imported from abroad.

Additionally, the Senate legislative proposals raise the question of whether such proposals will violate the General Agreement on Tariffs and Trade, as the Administration has consistently argued in Congressional testimony. Continental Grain believes that the issue of natural resource subsidies should be left to multilateral negotiations under the GATT.

Many Developing Countries depend upon exports of natural resources to pay for their food imports -- much of which comes from the United States. If the Developing Countries cannot earn foreign exchange through exports, they will be adversely affected, losing their ability to import as well as their ability to increase their peoples' standard of living.

Insofar as S. 1860 intends to reform Section 301, Continental Grain supports mandatory and expedited action but we do not favor the transfer of authority in these cases from the President to the United States Trade Representative. Such transfer will dilute the President's power to act forcefully in trade disputes.

S. 1860 also would establish specific objectives for a new round of trade negotiations, including the redressing of upstream subsidies. While Continental Grain supports a new round of multilateral trade negotiations, we believe those negotiations should be free of any preconditions set by Congress. Specifically, a new round should be allowed to (1) achieve a stronger dispute settlement process, (2) eliminate agricultural export subsidies, and (3) remove all barriers to agricultural trade, including tariffs and import quotas.

Page 3.

New trade legislation, if it is to succeed, must be designed to expand U.S. exports, not diminish them, as is the case with many of the proposals contained in the Senate initiatives. This country learned well in the 1930s that restrictive trade laws will lead to less trade, not more. We should not repeat the errors made a half century ago; but we should understand that our ability to expand trade requires rational negotiation with our trading partners, not unilateral actions that destroy the foundations of a free and fair marketplace.

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October 9, 1985

Comments on a Wharton Econometric Forecasting Associates Report, "The Macroeconomic Impacts of Implementing Natural Resource Subsidy Legislation," June 6, 1985

Summary

- o The Wharton study of proposed natural resource subsidy legislation appears to greatly overstate the likely economic impacts. The study's overestimates come from assumptions, not analyses, and while the assumptions employed are not impossible, they do not appear to be the most likely. The Wharton study assumed that:

  —legislation would require large duties on imports, even though real economic conditions may have brought external market prices down to levels being charged producers in several important exporting countries. EPI and others including the Congressional Budget Office (CBO) estimate that duties would likely be much smaller than those assumed by Wharton.

  —very large increases in U.S. commodity prices would result from the duties, even for products where imports are a small share of total use, and excess domestic production capacity is large.

  —important customers would retaliate and those actions would directly reduce farm sales and income. However, both the likelihood of retaliation and the probable impact of such actions appear to be overstated.

  These assumptions of large price and cost increases very much influence the large economy-wide losses in incomes and jobs reported in the Wharton results.

- o EPI believes, and other studies agree, that under current conditions of excess supply in the natural gas and fertilizer industries, the impact of the proposed legislation likely would be small. CBO, in its September 1985 report, indicates that the only area in which it foresees substantial price increases on a national scale is the lumber industry, and those increases likely would not result in income losses big enough to have substantial economic effects. With regard to the impacts of the legislation on fertilizer prices, Blue, Johnson & Associates, an independent consulting firm specializing in the economics of energy, fertilizers, chemicals, and minerals, reached similar conclusions.

- o The Wharton study examined the impacts of the proposed legislation on farm income under two scenarios, with and without retaliation from U.S. trading partners. In the case suggested as most likely, they appear to significantly overestimate the effectiveness of trade retaliation. In both cases, because of the assumption of large and persistent increases in farm production costs, income effects appear to be overestimated.

- The Wharton study appears to overstate the likely impacts of the legislative proposal for another reason. Overall, its projections depend on the occurrence of each of the assumptions in succession, and the persistence of each through 1994. If any one does not occur or does not persist, the total impact is greatly changed. The duties must be as large as assumed; domestic price increases must directly reflect the increases in duties; the impacts of retaliation must be as large and direct as assumed; and all these must persist through 1994 in order for the Wharton estimates to be realized. The likelihood of all those events happening in that order and continuing that long appears quite small. Thus, it is probable that the Wharton study very sharply overestimates the impacts of the proposed legislation.

Comments on the Study

The Wharton study proceeds by comparing prices for ammonia, petrochemicals, carbon black, and softwood lumber for Canada, Mexico, the USSR, Saudi Arabia and other Middle Eastern countries, and Trinidad-Tobago to a legislatively indicated "fair market value." Based on these comparisons, compensating duties were estimated which were projected to increase domestic nitrogen fertilizer prices by 27.1 percent, petrochemical and carbon black prices 14.5 percent, and softwood lumber prices 14.4 percent. The study then analyzed the impacts of the higher prices on the U.S. economy. Our examination primarily concerned the portion of the study related to the agricultural economy.

In each of the three analytical steps (estimates of duties, domestic price impacts, and the macroeconomic effect), the Wharton study relied heavily upon assumptions rather than employ a more sensitive analysis of the world and domestic economic situation. Each of these is discussed below.

Countervailing Duties

The proposed legislation provides that countervailing duties be based on a comparison between a "fair market value" for natural resources such as petroleum, natural gas, and timber and the prices at which those resources are sold by foreign government agencies to their domestic manufacturers. In each case, the Wharton study estimates the fair market value in terms of either calculated or published "external prices" compared with internal product prices, whether or not the external prices are realistic. As a result, it appears to have substantially overestimated the duties that would be applied on most products.

In a detailed study of the proposed law, the Congressional Budget Office (CBO) examined alternative ways fair market prices could be estimated for the subject commodities in each major market. 1/ The use of actual market prices or those that reasonably might be assumed resulted in generally lower countervailing duties than those assumed in the Wharton study. Mexican

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1/ Congressional Budget Office, Effects of Countervailing Duties on Natural Resource Input Subsidies, Staff Working Paper, September 1985.

natural gas is a case in point. The Wharton estimate of the countervailing duty is based on the external Mexican "official" price which is not now an active market price and is far higher than actual U.S. prices at the Mexican border. By using a spot price at which Mexico could export natural gas, CBO estimates the price subsidy to be $0.76 per MCF, much lower than the $2.96 per MCF subsidy estimated by Wharton.

Throughout the Wharton study, broad interpretations of the law are used to estimate natural resource subsidies. Such interpretations have a significant impact on the resulting countervailing duty estimates.

Fertilizer. Fertilizer duties would depend crucially on how the fair market value was estimated in the case of the Soviet Union. If fair market value was interpreted to mean opportunity cost, Soviet fertilizers could be held to be nondutiable according to CBO. As a result, the only major exporter of fertilizer to the United States against which a duty could be applied would be Mexico, which represents only a small percentage of imports. However, if the duty were based on a decision that Soviet domestic natural gas prices must equal their negotiated export price (net of transportation) regardless of whether or not additional sales could be made at that price, then a duty would be required. Wharton assumed the latter case.

The two principal natural gas-derived fertilizers imported into the United States are anhydrous ammonia and urea. 2/ For the former, Canada, the USSR, Trinidad-Tobago, and Mexico are the major exporters to the United States. Mexican imports likely would be subject to duty, while Canadian anhydrous ammonia probably would not because its natural gas prices are being made market sensitive. Imports from Trinidad-Tobago also likely would not be subject to duty.

The possible range of countervailing duties could be large. Using the $0.76 per MCF subsidy on Mexican natural gas calculated by CBO, the duty on Mexican anhydrous ammonia would be $25.93 per ton, or 18 percent of the 1984 import price. Under the narrowest interpretation of the legislation, CBO calculates that the duty could reach almost 50 percent of the 1984 average import price.

U.S. imports of urea are dominated by Canada, the USSR, and Romania. Last year less than five percent came from Mexico. Under the broader interpretation of the bill, CBO estimates that Soviet urea imports might prove dutiable with a duty as high as $38.80 per ton, or 25 percent of the 1984 import price.

Clearly, the Wharton projection that the proposed legislation would require a 27.1 percent duty on fertilizer imports is based on a series of assumptions regarding internal and external resource cost and additional assumptions regarding the interpretation of the law. In our opinion, these have led to overestimates of the duties that likely would be applied.

2/ Anhydrous ammonia is an industrial product that is the base for nitrogenous fertilizers. In the United States, 80 percent of ammonia is used for this purpose. Urea is produced from anhydrous ammonia.

Petrochemicals. Total imports of ethylene, the building block for most petrochemicals, account for less than two percent of domestic consumption, while net exports of ethylene-derived products amount to close to ten percent. Important individual products include polyethylene resins, ethylene glycol, and methanol. CBO estimates that two-thirds of U.S. polyethylene resin imports are from Canada, largely derived from natural gas. The decontrol of Canadian natural gas prices should exempt these imports from duties under this legislation. With regard to ethylene glycol, U.S. exports are over five times greater than imports, which come from a wide variety of sources. As a result, duties on imports from any one source would likely lead to shifts among suppliers with little impact on U.S. prices.

U.S. imports of methanol were 12 percent of domestic consumption in 1984, up significantly from eight percent in 1983. About 90 percent of the imports are from Canada, and likely would not be subject to duty. The U.S. methanol industry is contracting, with production below 1981 levels and facilities closing. Also, there is significant excess capacity worldwide.

Lumber. Based on 1983 price comparisons, CBO estimates a countervailing duty of 303 percent of 1983 stumpage prices would be required. That would translate into a countervailing duty on imported Canadian softwood lumber of 13.5 percent of the average unit value of such imports. In 1984, Canadian imports accounted for approximately 95 percent of total U.S. softwood lumber imports.

Impacts of Countervailing Duties on U.S. Prices

Based on the assumptions of countervailing duties that would be required under the proposal, the Wharton study assumes that the following commodity price increases would occur:

Product Group	Resulting Increase in Price
Nitrogenous Fertilizers	27.1 percent
Petrochemicals and Carbon Black	14.5 percent
Softwood Lumber	14.4 percent

The Wharton study did not analyze the impact of duties on domestic prices, but rather assumed that each increase in duties would cause an identical increase in product prices. This assumption is described and explained by Wharton Vice President George Schink in his September 13, 1985 letter to Mr. George Weise of the Subcommittee on Trade of the House Ways and Means Committee:

> We have assumed that U.S. producers would increase product prices by the amount of the product-specific tariff. One could argue that the percentage rise in U.S. prices might be less than the tariff as a percentage of import prices, if the markets considered were perfectly competitive. The markets considered in our analysis, however, tend to be dominated by a dozen or fewer major companies. As a result, we believe that oligopolistic pricing models are appropriate.

The CBO, however, takes a much different approach and argues that the Wharton assumptions both about countervailing duties and about the impact of these duties on commodity prices are much too pessimistic. In their September 1985 analysis, CBO comments on the Wharton assumptions of large duty and price increases as follows:

> A separate question from that of whether Canadian fertilizer would be dutiable is the question of pass-through. Wharton assumes that the duties would increase domestic prices proportionately. This is a strong assumption. If demand and supply were to show much responsiveness, then the level of pass-through might be substantially reduced. In addition, the existence and large size of spare capacity in the U.S. petrochemical industry is beyond dispute. Hence, the large petrochemical price increases Wharton envisions are an unlikely response to this legislation.
>
> The only area in which CBO foresees substantial price increases on a national scale is the lumber industry. In this case, the 13.5 percent tariffs would result in a consumer income loss of at most $1 billion. If demand showed any responsiveness, this amount could be substantially less. Such an income loss is not large enough to have substantial macroeconomic effects.

Blue, Johnson & Associates, a firm specializing in the economics of energy, fertilizers, chemicals, and minerals, has appraised the price impacts of the proposal and the Wharton study. They comment that if the industry were able to pass through cost increases, as Wharton assumes, one would not expect to have seen either the wholesale or farmgate price behavior that actually has occurred, nor the rather dismal financial performance exhibited by the industry at large since 1980. 3/ For example, the ratio of net income before interest and taxes to total assets for basic integrated producers (Fertilizer Institute data adjusted to exclude the bias of ammonia producers still on old, low-cost gas contracts) was 4.9 percent in 1981, -4.5 percent in 1982, -3.9 percent in 1983, 1.2 percent in 1984, and an estimated -2.5 percent in 1985. Instead, the characteristics of the industry and the commodities make the Wharton projections highly unlikely.

The Blue, Johnson & Associates' comments include two other major points:

1. Industry Structure

 o The nitrogen industry in this hemisphere must be viewed as a "North American" entity (including Canada, Mexico, Trinidad, and the United States) because of trade and supply patterns and the interregional ownership relationships, particularly between Canada, the United States, and Trinidad. In this region, there are 48 "corporate" entities that currently operate ammonia plants, and at least 20 other firms of traders and/or brokers. Many of these handle North American products but many also handle products from external sources (e.g.,

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3/ Letter from Thomas A. Blue to Philip Potter, September 24, 1985.

Cargill, Kaiser, Occidental, Thyssen, Transammonia, Transnitro, Wilson & Geo. Meyers, etc.). Several of these redistributors also have made downstream investments in intermediate storage systems and retail operations (e.g., Cargill and ConAgra).

These two groups supply more than 68 firms that market major nitrogen products (e.g., ammonia and urea) at the bulk commodity wholesale level. These suppliers can be either price setters or price takers, depending on market conditions. More often than not they are price takers.

- The industry also consists of large "industrial" customers, i.e., large buyers who purchase nitrogen products (principally ammonia) at bulk wholesale prices. In the United States, there are over 125 of these accounts representing over 30 percent of the total U.S. trade in ammonia, largely in the Southeast. Most have access to the 68 firms that are wholesale suppliers.

- A related but separate link in the distribution chain consists of fertilizer dealers and retailers, which number more than 20,000 in Canada and the United States. Outside the farm supply co-op systems, most are independent of the basic nitrogen producers, although there has been some increased ownership of dealer networks by major commodity distributors.

- The last link is the agricultural customers—farmers. In the United States and Canada, there are over 2.5 million farms although less than 30 percent of the U.S. farms incur at least 80 percent of total farm production expenses.

2. Commodity Nature

- Nitrogen fertilizers, particularly ammonia and urea, are basically fungible commodities with large international as well as domestic markets, and most buyers are relatively indifferent to the product sources. Thus, nitrogen product prices are primarily sensitive to international product supplies in relationship to demand. In principle, producers/suppliers are unable to affect price other than by altering the amount of product they supply. Even so, no single producer can be certain of achieving any effect on price because of the large total volume of the industry and the large variety of individual firms' objectives, opportunities, and constraints.

These characteristics of the industry and the product thus make an assumption that U.S. nitrogen fertilizer prices would increase by the full amount of any duty appear largely if not totally implausible. Both CBO and Blue, Johnson & Associates agree.

Imported ammonia accounts for less than 15 percent of the total U.S. nitrogen supply. Any levy on ammonia imports would be applied essentially to the bulk commodity at the wholesale level, and on a country-specific basis. Based on the stratified structure of the U.S. fertilizer market described above, Blue, Johnson & Associates observe that:

- In such an environment, suppliers have not been able to demonstrate any consistent ability to "control" wholesale prices or margins (except in a few regionally isolated situations), much less retail prices. Buyers simply have too many options. Suppliers often attempt to pass through cost changes, but experience shows that they frequently cannot do so. Table 1 provides an illustration. From spring 1978 through spring 1981, both the Gulf Coast wholesale price for ammonia and the U.S. average farmgate price increased generally in tandem, with the margin for distributors and dealers fluctuating between $81 and $92 per ton. During most of this time, fertilizer purchases as a percent of total U.S. farm production expenses (excluding feed and other livestock costs and depreciation) generally remained at or below 12 percent.

Table 1. U.S. Fertilizer Prices

Year	1st Qtr. Gulf Coast NH3 Wholesale Price		U.S. Average Spring Farmgate NH3 Price		Price Difference, Farm Gate Over Gulf Coast
	$/ton	net change	$/ton	net change	$/ton
1978	86		177		91
1979	90	+4	171	-6	81
1980	148	+58	229	+58	81
1981	151	+3	243	+14	92
1982	140	-11	255	+12	115
1983	124	-16	237	-18	113
1984	184	+60	280	+43	96
1985	145	-39	na	na	

Source: Blue, Johnson & Associates.

- During the early years of this period, sales of Mexican and Soviet ammonia in the United States placed pressure on ammonia prices. Much of this was sold on two to three year contracts at prices below actual market conditions. Thus, had a levy been assessed after 1978, it could have been readily absorbed by the market without noticeable effect on either wholesale or retail prices.

- From spring 1981 through spring 1983, the wholesale ammonia price dropped 18 percent while the farmgate price fell 2.5 percent since prices for major crop commodities were also falling. Thus, the costs and margins for distributors and dealers increased to over $110 per ton. During this period, U.S. ammonia producers encountered a $13 per ton increase in their average cost of production due to rising gas prices. However, the producers were not able to pass this increase through to retail levels, and both wholesale and retail prices declined.

During these years, ammonia imports generally were priced "with the market." Had a 27.1 percent levy been assessed, some imports might have been replaced by production from idle capacity. Wholesale ammonia prices might have increased up to $10 per ton. In all likelihood, however, wholesale margins would have declined rather than pushed prices higher at the farm level.

- In the spring of 1984, the wholesale price jumped 48 percent, and the farmgate price rose 18 percent. These increases shrank the intermediate margin to $96 per ton, closer to levels prevailing before 1982. These price increases occurred in a post-PIK environment where both crop prices and fertilizer volumes were increasing. A 27.1 percent levy on certain ammonia imports, again, might have had an effect on wholesale ammonia prices in some markets, but the farmgate effect likely would have been negligible.

- With regard to sales of Soviet ammonia, Occidental is the only buyer from the Soviet Union. It then resells to customers in the United States. Thus, any levy on Soviet material first will be absorbed by Occidental who would attempt to pass the increase on to the market. However, increases in 1985 could not always be passed through (Table 2). Occidental and the Soviets appear to negotiate ammonia volumes and prices once a year; once these are set for a given year, they are not subject to further adjustment. Comparing average CIF import values with spot prices thus far through 1985, it appears that Occidental has been forced to reduce its margins this year on contracted ammonia imports. Thus, an assumption that price increases would be passed on to final customers seems questionable.

Table 2. Gulf Coast Louisiana Ammonia Values

Month	USSR Imports Average CIF Unit Value	Low Spot Price FOB Plant or Terminal
	- - current U.S. dollars per short ton - -	
January	168.65	145
February	164.11	145
March	---	145
April	164.11	145
May	164.11	145
June	---	138
July	na	135
August	na	135

Source: Blue, Johnson & Associates.

Historical price behavior clearly indicates there is no constant correlation between changes in costs of imports and farmgate fertilizer prices. The extent to which such cost changes eventually are passed through depends upon economic conditions both in the industry and in the farm sector. In a situation in which nitrogen is in short supply and the outlook is for strong farm commodity prices, cost increases in the industry (from whatever source) could be expected to be reflected in higher farmgate fertilizer prices (and to lead to increases in fertilizer supplies). But, when fertilizer supplies are ample with excess capacity in the industry, crop prices are declining, and competition is stiff for the world grain trade--a situation that prevails today--there may be little or no pass through.

There are other reasons as well that would suggest this assumption to be unrealistic, including:

- o most imported ammonia from Mexico, the USSR, and Trinidad may not directly enter the domestic fertilizer market. It is quite likely that a substantial share of the imported material is processed and reexported in other fertilizer products.
- o substantial excess production capacity exists in the U.S. industry while selling prices have been flat to declining, not an environment conducive to cost pass throughs to consumers. Blue, Johnson & Associates state in this regard that even "If import ammonia prices had been 27.1 percent higher due to the proposed levy, and if buyers had been willing to pay the higher prices, in all likelihood they would not have passed any of it through to the market."
- o while some of the imported ammonia is purchased directly by the user/consumer from the exporting country, some is imported by firms who use part of the material captively and resell the rest to others. These latter purchasers would first have to absorb the 27.1 percent levy themselves, and then try to pass it on to the market. If the market would not accept the pass through, the purchaser might take the material out of the U.S. market and try to place it elsewhere, or seek other types of price adjustment arrangements. Again, Blue, Johnson & Associates comment: "In a competitive market, however, it is fallacious to assume that a 27.1 percent levy against import value would automatically be passed through to (i.e., accepted by) the market, or that it would affect the total nitrogen market on a one-to-one basis."

<u>Macroeconomic Impacts on the U.S. Economy</u>

The Wharton study also examines the economic impact of the imposed duties and higher prices for two scenarios: no retaliation by the affected countries exporting to the United States (Canada, Mexico, the USSR, and Saudi Arabia); and, the one they suggest to be more likely, that these countries would retaliate with U.S. agricultural exports as the obvious target. The adverse results to the farm sector shown by the study, especially the large reductions in farm income, depend both on assumptions about retaliation by trading partners and on the assumption of higher fertilizer prices, reduced usage, and lower crop yields, combined with loss of export sales and lower commodity prices. The negative impacts on the U.S. economy and the farm sector are shown to be even more adverse when retaliation is assumed. However, this assumption also is one which deserves very careful scrutiny.

Impacts of Retaliation

To an important degree, the likelihood of retaliation depends on the duties applied under the proposal. Because the Wharton study appears to have overstated the duties that would be imposed, the likelihood of retaliation perhaps is overstated. However, the most serious shortcoming of the study in this regard is the failure to use realistic estimates of the impacts of retaliation if it occurred. Instead, the study merely assumes very large levels of retaliation, and that these retaliatory steps directly reduce U.S. farm product sales. On the basis of historical experience, such an assumption appears to be totally unwarranted.

Agricultural commodities in the world market are fungible, and only a few suppliers can provide the quantities and qualities required to satisfy large importers. For example, the USSR reluctantly buys grains from the United States, and would buy more from Argentina and other sources if it could do so with confidence. Purchasers choose markets because of favorable prices and necessity. Such patterns are not altered lightly, or in the absence of changes in economic fundamentals.

An assumption that the retaliating countries that curtail purchases of U.S. commodities would cause a loss of total export sales and a commensurate reduction in price is not borne out by experience. It is almost certain that substitution among suppliers would occur. As the affected countries switched their purchases to other sources, it is likely that the traditional buyers displaced from those sources would turn to the U.S. for supplies. While there would be some realignment of the trade patterns, it is highly unlikely that U.S. export sales or commodity prices would be affected to the extent assumed in the study.

There is recent evidence of such a shift in trade patterns. When the United States partially embargoed sales to the USSR in January 1980, the Soviets switched to other suppliers. But, U.S. total sales were little affected in that year. In fact, the volume of U.S. exports for the calendar year actually were 10.6 percent above the previous year and reached the highest point ever in that year.

Even when grain supplies are plentiful, shifts among suppliers can have only small impacts on major exporters as long as world trade totals are not materially changed. Russian or Mexican purchases shifted from the United States to competing producers could even result in higher U.S. prices with little net loss in sales if former customers of Argentina and other suppliers, for example, could not be served and the U.S. commodities not sold to these two were sold to the displaced customers.

Farm Income Responses

Even if fertilizer prices did increase by the amount assumed, the projections of farm income impacts seem unreasonably great because the Wharton study appears to underestimate other supply and demand responses that would be expected.

A large increase in fertilizer prices could be expected to reduce usage and production. USDA analysts suggest the reduction in usage to average about four percent for each ten percent increase in the price. Based on historical patterns, an increase in nitrogen fertilizer prices as great as 27.1 percent thus could reduce usage and consequently national average corn yields by 2.6 bushels per acre. Under 1985/86 conditions, this would reduce total production by 194 million bushels. However, the smaller production and lower carryover stocks would strengthen prices and increase revenue, even after the adjustment of total use to slightly higher prices. This is illustrated by considering some plausible changes in the corn sector that might be associated with a 27.1 percent increase in nitrogen fertilizer prices assuming 1985/86 conditions (below):

Yield	-2.59 bushels
Production	- 194 million bushels
Total Supply	- 194 million bushels
Domestic Use	- 21 million bushels
Exports	- 9 million bushels
Total Use	- 30 million bushels
Ending Stocks	- 164 million bushels
Season Average Price	+ 5 to 8 cents per bushel

If this situation should result, the revenues from corn sales at the higher prices would more than offset the higher fertilizer costs, leaving farmers' net revenues higher. Such a positive short-run revenue response to a cost change, of course, would be expected to diminish over time as farmers resume normal fertilizer usage in spite of higher costs and production resumes former trends.

Nevertheless, because of the short-term price and revenue responses likely to follow a cut in fertilizer use and corn production, the very large annual loss shown in the Wharton study appears to depend on the assumption regarding reductions in export sales. It would appear that the study assumes export market reductions much larger than those anticipated by normal price responses, even under the non-retaliation scenario.

The projections regarding losses in the livestock sector appear to depend on the same crucial assumptions, i.e., that crop price increases from the lower yields and production would increase livestock sector costs, that price responses would not be sufficient to maintain revenues, and that these conditions would persist through 1994. In fact, the agricultural sector and the livestock sector in particular do respond to changes in production incentives. The persistence of such a supply/demand imbalance for the 1986 through 1994 period appears highly unlikely.

Conclusions

It is important to emphasize that the extremely negative conclusions of the Wharton study depend crucially on a very few assumptions, each of which has only an unknown probability of occurring. In such a setting, it also would be fair to raise serious questions regarding the probability that each crucial condition will not only develop as assumed, but persist throughout the period between 1986 and 1994.

Our assessment, together with that of CBO and others, is that the crucial assumptions employed are unrealistic and contradictory to observed past behavior and economic responses. The use of more realistic assumptions would produce different economic impacts, quite likely showing the adverse effects on the farm sector to be much less severe than those suggested by the present study.

CBO summarizes its comments on the Wharton study as follows:

> The Wharton analysis appears to overstate the likely price and income effects of the bill. Unlike the CBO analysis, the Wharton report assumes that this proposal would have substantial effects on the prices of several industrial commodities, notably nitrogenous fertilizer. (For instance, it sees prices of nitrogenous fertilizer rising by 27 percent, and of petrochemicals by an average of 14 percent.) Since macroeconomic models are largely driven by income flows, these large price increases translate into more income for producers of fertilizer and other industrial commodities and less for farmers and other consumers. Thus, the Wharton results depend on the assumption of large price increases.

And, based on their analysis of individual commodities under current conditions of capacity utilization, CBO does not foresee large price increases outside the lumber industry. Those that do occur are likely to be local or regional in nature. In addition, outside the lumber and possibly fertilizer industry, CBO sees little likelihood of increases in domestic output or employment in affected industries, or changes of more than one or two percent at the national level.

In addition, the Wharton study appears to overstate the likely impacts of the legislative proposal for another reason. Overall, the Wharton projections depend on the occurrence of each of the assumptions in succession, and the persistence of each through 1994. If any one does not occur or does not persist, the overall projections are greatly changed. The duties must be as large as assumed; domestic price increases must directly reflect the increases in duties; and the impacts of retaliation must be as large and direct as assumed, in order for the Wharton estimates to be realized. The likelihood of all those events happening in that order appears quite small. Thus, it is probable that the Wharton study very sharply overestimates the impacts of the proposed legislation.

Independent Refiners Coalition

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INDEPENDENT REFINERS SUPPORT
LEGISLATION TO REMEDY EFFECTS OF CRUDE OIL SUBSIDIZATION
BY FOREIGN STATE-OWNED OIL COMPANIES

Washington (June 26, 1986) -- "U.S. Refiners are competing directly against foreign governments," a U.S. refining industry representative told the Senate Finance International Trade Subcommittee in testimony today. "These governments can subsidize the cost of crude oil to their export refineries. In many instances, they subsidize the capital cost of refinery construction as well. In 1973, governments controlled about 15 percent of free world refining. Today, governments control about 50 percent of free world refining. Adding the non-market economy nations, governments have dominate control of world refining."

George Jandacek, Chairman of the Independent Refiners Coalition (IRC), endorsed Senate Bill 1292, and Section 502 of Senate Bill 1356.

"U.S. refiners face many trade problems, one of which is the discriminatory pricing of crude oil by state oil companies to state-owned or supported refineries," said Jandacek. "These anti-subsidy bills would give U.S. refiners a remedy. Independent refiners are particularly vulnerable to these subsidy practices."

"OPEC and other energy rich governments 'discount' the price of oil to their state-owned refineries. Even if these refineries sell products at less than the cost of crude oil and refinery operations, the state oil company can absorb the loss in its crude oil profits. Even U.S. integrated oil companies cannot sustain refining losses today for an extended period. Losses lower their stock value and leave them vulnerable to mergers," said Jandacek.

(OVER)

1730 Pennsylvania Avenue N.W. · Suite 200 Washington, D.C. 20006

"OPEC governments also provide crude oil to many refineries in Europe and elsewhere on 'processing deals'." In these deals, the refiner accepts a consignment of crude oil, then refines it and sells the products on the market. The refiner deducts his expenses and a fee from the revenues received for the refined products, then pays the remainder to the oil supplier. The net return on crude oil to the state oil company is often less than the return for selling crude directly in the market."

"Over the last three years, virtually all refiners have lost money on their refining operations because refined product prices have fallen below their production costs. Netback analysis shows that foreign government refineries have also lost money on their exports to the U.S. market. To the extent that the net return on refined crude oil is less than the market value of the crude oil, it is a subsidy by the state oil company on the refined products," said Jandacek.

"The U.S. refinery industry is further threatened by the addition of new export capacity in the OPEC countries. These new refineries will add more supply to an already glutted world product market," said Jandacek. "Imports of gasoline and blendstocks have increased from 200,000 barrels per day in 1983 to about 500,000 barrels a day. Every barrel of imported gasoline replaces the need for two barrels of domestic oil refining capacity."

"European countries are the major exporters of gasoline to the U.S. market, followed by Venezuela, Canada and Saudi Arabia. Europe has a huge surplus of refining capacity and many refineries may be exporting only because they have processing deals with OPEC governments. Although the U.S. bans the importation of Libyan crude oil and products, Libya is a major supplier of crude oil to European refineries which may be exporting to the United States," said Jandecek. Tariff and non-tariff barriers in Europe and Japan serve to direct gasoline exports to the U.S. market, according to Jandacek.

"Environmental costs, lead phasedown costs and Superfund taxes on U.S. refiners currently give European and other refiners a cost advantage of 6 cents to 10 cents per gallon of gasoline. The current U.S. tariff added to ocean freight costs does not offset this advantage. S. 1292 or S. 1356 would help U.S. refiners defend themselves against unfair subsidy practices over the long term. These trade bills do not address immediate problems -- diversion of gasoline to the U.S. market and higher environmental costs on U.S. refiners which draw more gasoline imports to this market," said Jandacek.

# # #

Occidental Chemical Corporation

July 8, 1986

Senate Committee on Finance
Subcommittee on International Trade
Attn: Betty Scott-Boon, Hearing Coordinator
Senate Dirksen Office Building
Washington, D.C. 20510

Re: Dual Pricing of Natural Resource Legislation - Public Hearing - Thursday, June 26, 1986

Gentlemen:

The Subcommittee on International Trade of the Senate Committee on Finance held hearings on June 26, 1986, concerning the subject of "Dual Pricing of Natural Resource Legislation". As part of the record for that investigation, I am writing to express Occidental's opposition to the natural resource legislation (the "Proposed Natural Resource Legislation") included in H.R. 4800, S. 1292 and Section 501 of S. 1356 because the proposed legislation is both unnecessary and ill advised. It is unnecessary because present United States trade law (particularly Section 301 of the Trade Act of 1974) already provides a remedy for the complaints that are at the heart of the Proposed Natural Resource Legislation. Enactment is ill advised because the proposal suffers from serious conceptual flaws and would give rise to various trade related repercussions.

The Proposed Natural Resource Legislation is conceptually flawed because it violates GATT by abandoning the "sector specificity" requirement for domestic subsidies. This would, in turn, leave the United States exposed to GATT authorized retaliation or, at the very least, retaliation by mirror legislation. This retaliation is not illusory. As the Congressional Research Service pointed out earlier this year, the United States has many domestic subsidy programs that might be the object of such retaliation. Those subsidy programs include oil depletion allowances, special tax breaks for the timber industry, price controls on natural gas, Tennessee Valley electricity, western dams and irrigation projects, mineral depletion allowances and grazing subsidies for livestock on federal lands. As we have seen during this year, other governments (such as the European Community and Canada) are willing to retaliate when the United States raises barriers to the importation of their products into our country.

Continued .../...

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Occidental Chemical Corporation

Senate Committee on Finance
Subcommittee on International Trade
July 8, 1986
Page Two

Enactment of the Proposed Natural Resource Legislation would result in grave economic and trade related repercussions with or without retaliation. For example, Wharton Econometrics completed a study that showed the Proposed Natural Resource Legislation has the following disastrous results:

- Economy-wide job losses would reach 275,000 while net job gains in the protected domestic industries would be at most 9,000. This net job loss would affect every state and with retaliation would rise to 385,000 lost jobs.

- Net U.S. farm income would be reduced on average by $889 million per year ($2.6 billion per year with retaliation) over the 1986-1994 period for a total loss of about $8 billion ($23.8 billion with retaliation).

- The total real U.S. output (GNP) would be reduced by $79.7 billion (1985 dollars) over the 1986-1994 period ($113 billion with retaliation).

- Federal debt would be increased by $10.5 billion by 1994 ($33.3 billion with retaliation) due to reduced receipts from other taxes and higher outlays.

Moreover, imposing countervailing duties on natural resource products will have a devastating effect on United States trade with less developed countries. Many of these countries have a comparable advantage in natural resources and effectively disallowing them to export to the United States deprives them of dollars to purchase American products. Thus, not only are United States exports lowered, but reduction and payment of foreign debts are jeopardized.

The Proposed Natural Resource Legislation threatens Occidental's 1973, 20 year, $20 billion, bilateral trade

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Occidental Chemical Corporation

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agreement with the Soviet Union and the United States' favorable balance of trade with that country. That agreement (which was endorsed by both governments) provides for annual exports of superphosphoric acid from the Occidental Chemical Agricultural Products facility in White Springs, Florida, and imports of ammonia, potash and urea from the Soviet Union. It is the major trade agreement between the two countries and contributes vastly to the favorable United States trade balance with the Soviets. Although these imports are sold consistently at or above United States market prices, under the Proposed Natural Resource Legislation, assuming injury could be shown, the trade agreement with the Soviets is in jeopardy of being revoked. If imported ammonia is countervailed because of alleged two-tier pricing, duties amounting to 30-40% of the market price might be instituted. Because Occidental can not pay these tariffs and neither the market nor the Soviets will absorb these costs, the bilateral contract would likely be abrogated.

This would have a crippling effect on Occidental's $1 billion investment in assets predominantly dedicated to producing superphosphoric acid for sale to the U.S.S.R. Some 5,000 direct and indirect workers associated with the Florida facility would become unemployed. $70 million paid in salaries that contribute to the Florida economy would be lost and Florida would lose $20 million in taxes. The Port of Jacksonville would lose some 2 million tons of exports annually.

These ill effects would spread beyond Florida because the Soviets would probably retaliate through reduced grain and fertilizer purchases. As we saw during the 1980 grain embargo, the Soviet Union can easily purchase those products elsewhere with the attendant negative effect on one of America's few, favorable trade balances.

The problems that are at the heart of the Proposed Natural Resource Legislation can be resolved by the approach contained in the Senate's bipartisan trade bill, S. 1860,

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which includes natural resource subsidies as one of the issues to be resolved through multilateral trade negotiations. Moreover, the present United States trade laws, particularly Section 301 of the Trade Act of 1974, already provide the means to address natural resource issues. The efficacy of these remedies is manifested by recent experiences in markets for leather, insurance and canned fruit.

In conclusion, the Proposed Natural Resource Legislation reminds me of a time, fifty-six years ago, when there was a cry in the United States for Congress to protect our domestic industries. That protectionism cry resulted in the Smoot-Holly Tariff which was supposedly designed to cure all kinds of economic problems. Instead, it triggered a trade war. America does not want or need another trade war.

Sincerely,

A. W. Lopez

A. W. Lopez
Executive Vice President

AWL/cdl

MJK5:059

Policy Statement of the Southwest Regional Energy Council

Regarding Unfairly Subsidized Petrochemical Imports

Background.

The United States petrochemical industry is facing declining production, fewer jobs for American workers, declining capital investment, and the loss of market share both in America and abroad. The root of the problems is a new and specific kind of unfair trade practice. The governments of Mexico and the Soviet Union are manipulating the cost of energy in order to subsidize the production of petrochemicals for export.

Existing United States' trade law has proven insufficient to deal with this subtle but potentially devastating unfair subsidy. United States trade laws need to be modernized to effectively prohibit such practices.

The 1984 omnibus trade bill contained a provision to deal with this problem. The Natural Resource Subsidies Provision of the trade bill identified as an illegal subsidy, the practice whereby governments set a low price on energy sold to their own producers, but export energy only at a much higher price to other users. This practice was labelled "two-tier pricing."

The Natural Resources Subsidies Provision would have imposed a countervailing duty on subsidized imports entering the Unites States' market, equal to the difference between the low domestic price and the higher export price. Due to Administration opposition, this provision was dropped from the omnibus trade bill by the conference committee.

The United States ammonia industry has been particularly hard hit by the two-tier pricing. The penetration of subsidized imports from Mexico and the Soviet Union, the major users of the two-tier pricing scheme, caused an oversupply in the United States' market during a period of reduced demand. This depressed the price of ammonia below what it cost most American producers to make ammonia, driving many American producers out of business.

Unlike American producers, subsidized ammonia producers can create and withstand low prices because their governments subsidize the cost of natural gas, which is seventy percent of ammonia's production input and cost. Between 1981 and 1983, United States' ammonia production plummeted thirty percent. Thirteen percent of overall production capacity was permanently closed down. Exports of ammonia and its derivatives fell by thirty-three percent, while imports increased by ten percent.

Government subsidation of energy inputs in petrochemical products poses a severe threat to the economic health of the states of the Gulf Coast and Southwest. The majority of the American petrochemical industry is located in the Southwest. Almost all of the natural gas utilized by the ammonia industry is produced in the Southwest. In addition to supplying labor and resources for the production of ammonia, the many States are dependent on a strong domestic ammonia industry for fertilizer for farming and ammonia nitrate explosive used in coal mining.

Action.

Petrochemical production, like energy production, is rapidly shifting from private to state ownership in many countries. The damage to the American ammonia industry illustrates the potentially devastating effects of unfair government subsidies of energy resources in petrochemical manufacturing. The decline of the United States ammonia industry demonstrates that our trade laws are inadequate to cope with state ownership and trade practices.

Therefore the Southwest Regional Energy Council urges the Congress to amend the trade laws to recognize two-tier energy pricing as an illegal trade subsidy, thereby providing a legal mechanism for relief.

This recommendation has been adopted by:

The Western Legislative Conference on October 2, 1985;
The Southern Legislative Conference on July 24, 1985; and
The Southwest Regional Energy Council on December 6, 1984.

Statement of Jon P. McCoy
President, Valley Builders Supply Co., Inc.
Before the
Subcommittee on International Trade
of the Senate Committee on Finance
June 26, 1986

My name is Jon McCoy. I am president of Valley Builders Supply Co. of Pharr and San Benito, Texas. We manufacture and market concrete block, brick, and related masonry products. Our manufacturing plants are located in south Texas about 10 to 15 miles north of the U.S.-Mexican border.

My company has been in business since 1940. For decades, it has been a highly successful business enterprise and an important contributor to the economy of a depressed region. The company has had a record of growth even during periods of economic recession. Our facilities are among the most modern and efficient in the United States. One plant was built in 1973. Another -- a high technology, state-of-the-art, automated plant -- began operation in 1982.

Beginning in 1981, Mexican concrete block and brick imports began to enter United States border markets in increasing volumes. In 1983 and 1984, the flow of Mexican imports radically increased, reaching levels five times as high as that of 1980. These unfairly traded imports threaten the viability of Valley Builders Supply and the jobs of our employees.

The single most important reason why Mexican concrete block has penetrated United States markets is the preferential industrial fuel pricing policy of the Mexican Government. The Mexican Government protects its domestic industries from import competition and promotes exports of Mexican manufactured products by providing fuel oil and natural gas, through its state-owned oil and gas monopoly, PEMEX, to domestic industrial users for only a fraction of the fuel's market value. PEMEX sells the same fuel oil for export to the United States at international market price levels, and did the same with respect to natural gas until sales to the U.S. were suspended on November 1, 1984.

Plainly this pricing practice constitutes a subsidy. It is directly equivalent to payment by the Mexican Government of a substantial portion of the energy costs of the Mexican companies eligible to purchase the cheap fuel.

This unfair practice affects a number of United States industries with manufacturing processes that are resource-intensive. However, it has a double-barreled impact in the case of concrete block, because not only is the manufacture of block itself energy intensive, but so also are the processes of producing the two primary raw materials used in making block -- cement and lightweight aggregate. Because of this subsidy, in many instances the Mexican block imports with which U.S. producers must compete are being sold for less than the energy portion alone of our cost of manufacturing block and our suppliers' cost of producing the raw materials we use in making block.

The artificial cost advantage enjoyed by the Mexican block producers enables them to penetrate markets far from the Mexican border in which they otherwise could not compete. My company is limited to no more than a 120 mile market area because of transportation costs. Most producers market within a 40 mile radius of their plants. Because of the energy subsidy, the Mexican producers are able to haul from Monterrey, Mexico, to San Antonio and Houston -- a distance of nearly 500 miles -- and still undercut the competing prices of local producers in those areas.

The fuel prices paid by the Mexican producers are not the product of market forces, nor are they an example of comparative advantage. In the absence of government intervention, fuel would sell in Mexico for a local equivalent of the international market price. The Mexican producers' competitive edge is the result of government manipulation of their most important production cost, not any greater efficiency or any natural advantage that they enjoy.

When a foreign government's policy distorts the competitive balance in United States markets and injures U.S. companies and U.S. workers -- as is true here -- then in my view our government must act to restore equitable conditions in our markets.

We support S. 1292 and Section 502 of S. 1356. They are fair and moderate legislation that would restore equal competitive conditions in U.S. markets. Enactment of such a bill is vital to the survival of border region producers in our industry.

From the standpoint of concrete block producers, one other related change in law also would be of great importance. When Congress enacted upstream subsidy legislation in 1984, it specified the particular categories of subsidies that could be countervailed when they were received upstream. For obvious reasons, this listing does not now include natural resource subsidies.

As I have explained, upstream natural resource subsidies are an important element of this problem for concrete block producers. The same would be true of other industries that use resource-intensive input products. When you mark up trade legislation, we urge you to include an amendment specifying that upstream natural resource subsidies are among the upstream subsidies that may be countervailed under the provision adopted last session (section 613 of the Trade and Tariff Act of 1984).

Thank you for this opportunity to testify in support of S. 1292 and Section 502 of S. 1356.

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