VIEWS OF THE COMMISSION ON INJURY

Introduction

Pursuant to section 202(b) of the Trade Act of 1974 ("Trade Act") (19 U.S.C. 2252(b)), we determine that wheat gluten is being imported into the United States in such increased quantities as to be a substantial cause of serious injury to the domestic wheat gluten industry. Pursuant to section 311(a) of the North American Free Trade Agreement ("NAFTA") Implementation Act (19 U.S.C. 3371(a)), we have made negative findings with respect to imports of wheat gluten from Mexico and Canada.

In making determinations under section 202, the Commission analyzes the three criteria set forth in the statutory standard. Specifically, the Commission must find that--

(1) imports of the subject article are in *increased quantities* (either actual or relative to production);

(2) the domestic industry producing an article that is like or directly competitive with the imported article is *seriously injured or threatened with serious injury*; and

(3) the article is being imported in such increased quantities as to be a *substantial cause* of serious injury or threat of serious injury to the domestic industry.

Thus, the Commission must find that all three criteria are satisfied to make an affirmative injury determination.

When the Commission makes an affirmative injury determination under section 202, it must also consider, pursuant to section 311 of the NAFTA Implementation Act, whether imports from Mexico or Canada account for a "substantial share" of total imports and whether imports from those countries individually or collectively "contribute importantly" to the serious injury or threat of serious injury.

The basis for our affirmative injury determination and our negative findings with respect to imports from Mexico and Canada are set out below. Our findings and recommendations on remedy are set forth in the "Views on Remedy" that follow these views on injury.

Background

The Commission instituted this investigation effective September 19, 1997, following receipt of a petition filed by the Wheat Gluten Industry Council ("petitioner"). The petition alleged that wheat gluten is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat of serious injury, to the domestic wheat gluten industry. The Wheat Gluten Industry Council consists of two U.S. producers of wheat gluten: Midwest Grain Products, Inc. ("Midwest"), and Manildra Milling Corporation ("Manildra").[1] Midwest operates two wheat gluten facilities, and accounted for *** of U.S. production in 1997.[2] Manildra also operates two wheat gluten facilities, and accounted for *** of U.S. production in 1997.[3] Manildra is affiliated, through common ownership, with the largest Australian producer of wheat gluten.[4] The other two U.S. producers of wheat gluten are Archer Daniels Midland ("ADM") and Heartland Wheat Growers ("Heartland"), accounting for *** percent and ***

[1] Petition at 7.

[2] Report at II-6. Unless otherwise indicated, references in these views to yearly data are to crop year data, for the period July 1-June 30.

[3] Report at II-6.

[4] Report at II-8

percent, respectively, of domestic production in 1997.[5] ADM *** the petition and Heartland *** the petition.[6]

Wheat gluten is imported from many countries. However, the primary sources are the European Union ("EU"), Australia, and Canada, accounting for 51.5, 35.3, and 8.9 percent of imports (by quantity) in 1997, respectively.[7]

Wheat gluten is produced from wheat flour. The process of manufacturing wheat gluten always results in two products: one part of gluten and approximately five parts of starch.[8] Viewed alone, the gluten is a tough, elastic grayish protein substance.[9] About 80 percent of the wheat gluten consumed in the United States serves as an input to the baking industry to supplement the gluten in the flours used to make baked goods; wheat gluten must be used in the production of high-fiber and multi-grain breads.[10] The pet food industry accounts for the remaining 15-20 percent of consumption.[11]

Domestic Industry

Statutory Framework and Commission Practice. Before considering whether the statutory criteria are satisfied, it is first necessary to define the domestic industry. Under section 202(b)(1)(A), the Commission is required to determine whether increased imports of an article are a substantial cause of serious injury or the threat thereof "to the domestic industry producing an article that is like or directly competitive with the imported article." The term "domestic industry" is defined in section 202(c)(6)(A)(i), and additional instruction is provided in section 202(c)(4) of the Trade Act.

Section 202(c)(6)(A)(i) defines the term domestic industry to mean:

> with respect to an article, the domestic producers as a whole of the like or directly competitive article or those producers whose collective production of the like or directly competitive article constitutes a major proportion of the total domestic production of such article.[12]

This definition was added by the Uruguay Round Agreements Act ("URAA") and is based on the definition in paragraph 1(c) of Article 4 of the World Trade Organization Agreement on Safeguards ("Safeguards Agreement"). The Statement of Administrative Action to the URAA notes that this definition "codifies existing ITC practice, which is consistent with the meaning given to the term in the safeguards agreement."[13]

Section 202(c)(4) provides that the Commission (1) shall, in the case of a domestic producer that also imports, treat as part of the domestic industry only its domestic production, to the extent that information is available; (2) may, in the case of a domestic producer that produces more than one article, treat as part of such domestic industry only that portion or subdivision of the producer which produces the

---

[5] Report at II-8.
[6] Id.
[7] Report at II-12.
[8] Report at II-5.
[9] Report at II-4.
[10] Report at II-5.
[11] Id.
[12] Section 202(c)(6)(A)(i). The language "or those producers whose collective production of the like or directly competitive article constitutes *a major proportion* of the total. . ." (emphasis added) codifies the expectation that the Commission, as a practical matter, will not always obtain 100 percent participation in its fact gathering process.
[13] Statement of Administrative Action ("SAA"), submitted with the implementing bill on Sept. 27, 1994, published in H. Doc. 103-316, vol. I (103d Cong. 2d Sess.) at 961.

like or directly competitive article; and (3) may also find there to be a “geographic" industry when certain conditions are present.[14]

The term "like or directly competitive" is defined in the legislative history of the Trade Act. Therein, Congress stated:

> The words "like" and "directly competitive," as used previously and in this bill are not to be regarded as synonymous or explanatory of each other, but rather to distinguish between "like" articles and articles which, although not "like," are nevertheless "directly competitive." In such context, "like" articles are those which are substantially identical in inherent or intrinsic characteristics (i.e., materials from which made, appearance, quality, texture, etc.), and "directly competitive" articles are those which, although not substantially identical in their inherent or intrinsic characteristics, are substantially equivalent for commercial purposes, that is, are adapted to the same uses and are essentially interchangeable therefor.[15]

As this language indicates, "like" means substantially identical, and "directly competitive" means commercially competitive.[16] [17] The different meaning given to these terms suggests that “like”

---

[14] Sections 202(c)(4)(A)-(C).

[15] H.R. Rep. No. 571, 93d Cong., 1st Sess. at 45 (1973); S. Rep. No. 1298, 93d Cong., 2d Sess., at 121-122 (1974).

[16] Commissioner Crawford does not join the remainder of this paragraph or the following paragraph. Although she agrees that “like” and “directly competitive” clearly have distinct meanings, she does not concur with the domestic industry approach adopted by Chairman Miller and Vice Chairman Bragg in which they conclude that if there are identifiable domestic producers of a product that is “like” the imported product, they are not required to look further for an industry producing products that are “directly competitive.” Rather, she follows the plain language of the statute that the domestic industry is defined as the domestic producers of the “like or directly competitive article.” A consideration of both producers of “like” products as well as producers of “directly competitive” products is logical since both are commercially competitive with the imported article, in addition to competing with each other. She notes that under the approach adopted by Chairman Miller and Vice Chairman Bragg, if there are producers of a like product, no matter how small or disinterested, then producers of a directly competitive product face hurdles outside their control. They are either excluded from the domestic industry or, at a minimum, face the uncertainty of not knowing whether their petition will even be accepted by the Commission or, if it is, whether the Commission will consider them to be an industry for the purpose of making an injury determination. Therefore, producers of a directly competitive product are effectively foreclosed from ever bringing an escape clause action against imports that, by definition, are commercially competitive with its product unless the Commission, using unstated criteria, decides to consider them. Such an exclusion is inconsistent with the views of the Commission in *Fresh Winter Tomatoes* (Inv. No. TA-201-64 (Provisional Relief Phase), USITC Pub. 2881, April 1995, Views of Chairman Watson and Commissioners Crawford and Bragg). There, the Commission states that “[i]n our view, the concept of ‘directly competitive’ in the statute serves to expand the class of producers of products who may seek and obtain relief...” *Winter Tomatoes* at I-11, n. 26. An analysis of the domestic industry question is found in the reports of the WTO panel and WTO Appellate Body reviewing similar language in Article III:2 of GATT 1994 in *Japan - Taxes on Alcoholic Beverages*. While it is clear that the WTO panel found “like” to be a narrower concept than “directly competitive or substitutable,” (the phrase used in Article III:2), it is equally clear that the panel did not question the basic requirement of Article III:2. Namely, that a consideration of both “like” and “directly competitive or substitutable” products is *required*.

Commissioner Crawford further notes that past Commission practice does not provide clear guidance on this question of domestic industry since there has been no consistent approach to this issue. In the majority of escape clause investigations during the past twenty years, the Commission has simply discussed “like or directly competitive” articles without explicitly addressing the issue posed here. In other investigations, the Commission has

(continued...)

and "directly competitive" are separate concepts, as opposed to a unitary concept.[18] To view "like or directly competitive" as a unitary concept would blur the distinction between "like" and "directly competitive" contrary to Congressional intent.

In view of the above, we believe that if there are identifiable domestic producers of a product that is "like" the imported product, there is a domestic industry producing a "like" product and the Commission is not required to look further for an industry producing products that are "directly competitive" but not "like" the imported products. This analysis is generally consistent with past Commission practice. Even when the Commission has not drawn a distinction between like and directly competitive products, past decisions reflect that the Commission has generally found the industry to consist of the domestic facilities producing the product that is like the imported product.[19]

The Commission has identified several factors to be considered in identifying the like or directly competitive product and hence the domestic industry or industries subject to investigation. The Commission has traditionally considered such factors as the physical properties of the article, customs

---

[16] (...continued)
taken directly contradictory approaches. In *Certain Canned Tuna Fish* (Inv. No. TA-201-53, USITC Pub. 1558, August 1984, Views of Commissioners Eckes, Lodwick, and Rohr), the Commission explicitly adopts a two-stage approach. In the very next escape clause investigation, *Potassium Permanganate* (Inv. No. TA-201-54 USITC Pub. 1682, April 1985, Views of Chairwoman Stern and Commissioners Lodwick and Rohr), the Commission reverts to a consideration of both like and directly competitive products. (*Potassium Permanganate*, at 5). In *Electric Shavers and Parts Thereof* (Inv. No. TA-201-57, USITC Pub. 1819, March 1986, Views of Chairwoman Stern, Vice Chairman Liebeler, and Commissioners Eckes, Lodwick, Rohr, and Brunsdale), the Commission clearly considered both like and directly competitive producers. *Shavers* at 5, and at 5, n. 7. *See also* the views of the Commission majority in *Fresh Winter Tomatoes* (cited above) for discussion of like and directly competitive products.

[17] *See, e.g., Mushrooms*, Inv. No. TA-201-43, USITC Pub. No. 1089 (August 1980), at 8--"the intent of the drafting committees was that 'like' has to do with the physical identity of the articles themselves, while 'directly competitive' relates more to the notion of commercial interchangeability."

[18] This interpretation has been recognized in an international context as well. *See* the reports of the WTO panel and WTO Appellate Body reviewing similar language in Article III:2 of GATT 1994 in *Japan--Taxes on Alcoholic Beverages*. The WTO panel made clear that "like" is a narrower concept than "directly competitive or substitutable" (the phrase used in Article III:2), and requires that two conditions be present--(1) the domestic and imported products must share essentially the same physical characteristics, *and* (2) they must share a commonality of end-uses. The panel said that only the second of the two conditions need be present to find that goods are directly competitive or substitutable. *See Japan--Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS8/R, WT/DS10/R, WT/DS11/R, adopted 1 Nov. 1996, at para. 6.22. *See also Appellate Body Report on Japan--Taxes on Alcoholic Beverages*, WT/DS8/AB/R, at 21.

[19] *See, e.g.*, views of Chairman Rohr and Commissioners Newquist, Crawford, and Watson in *Fresh Tomatoes and Bell Peppers*, Inv. No. TA-201-66, USITC Pub. 2985 (August 1996) at I-8, where they found that "domestic fresh tomatoes . . . are like or directly competitive with the imported tomatoes. All tomatoes, whether imported or domestically produced, are members of the Nightshade family. Domestic growers produce all of the types of tomatoes consumed in the United States." They also found that tomatoes grown for processing, which were not part of the scope of the investigation, were not part of the industry. They noted that tomatoes grown for processing were distinguishable in physical properties, were harvested mechanically (which made them unsuitable for the fresh market), and were grown under different arrangements (under contract). Views at I-6, n. 4. *See also* views of Chairman Newquist and Commissioners Rohr and Nuzum in *Extruded Rubber Thread*, Inv. No. TA-201-63, USITC Pub. 2563 (Dec. 1992) at 9 (the imported article subject to the investigation is extruded rubber thread, and there is one domestic product, extruded rubber thread, that is like or directly competitive with the imported article; accordingly, the domestic industry consists of domestic manufacturers that produce extruded rubber thread).

treatment, where and how it is made, uses, and marketing channels.[20] Each of the factors is relevant, but the weight given to each factor will depend upon the facts in the particular case.

Arguments of the Parties. Petitioner argues that the domestic industry consists of the domestic producers of "all forms of vital wheat gluten," including certain vital wheat gluten that has been modified (modified wheat gluten) for use in the baking and pet foods industries.[21] Petitioner argues that there are no significant differences in the physical characteristics of the imported and domestic products, and that any differences in quality, color or texture of the imported and domestic products are not such as would permit consumers to distinguish domestic from imported wheat gluten.[22] Petitioner asserts that imported wheat gluten is perceived by consumers to be comparable to that produced in the United States, and that production methods and facilities of domestic and imported wheat gluten are virtually identical, and that domestic and imported wheat gluten are sold in the same channels of distribution.[23] Petitioner also argues that domestic and imported wheat gluten have the same commercial uses (chiefly, to add "vitality" to bakery products and certain pet foods), and are "interchangeable."[24]

Respondents do not contest the domestic industry definition proposed by petitioners.

Finding. We find that domestically produced wheat gluten is "like" imported wheat gluten and that the domestic industry consists of the domestic producers of all forms of vital wheat gluten, including modified wheat gluten that is used in the baking and pet foods industries.[25] The evidence reflects that imported and domestic wheat gluten have substantially the same physical characteristics. The evidence also shows that imported wheat gluten "is perceived to be roughly of the same quality as that produced in the United States."[26] It further shows that wheat gluten has no substitutes that have the functional properties of "vitality" that are needed in the baking and pet food applications in which it is used.[27] Furthermore, domestic and imported wheat gluten are classified under the same HTS classifications. Domestic and foreign wheat gluten plants utilize similar production processes and technology. Domestic and imported wheat gluten are used for the same purpose, namely, to add "vitality" to bakery products and pet foods. Also, both domestic and imported wheat gluten are sold through the same channels of distribution, with the majority of the product sold to end users (primarily wholesale bakeries and pet food

---

[20] *See, e.g., Broom Corn Brooms*, Inv. No. TA-201-65, USITC Pub. 2984 (August 1996) at I-9, n. 5; *Fresh Winter Tomatoes*, Inv. No. TA-201-64 (Provisional Relief Phase), USITC Pub. 2881 (April 1995) at I-7; *Certain Metal Castings*, Inv. No. TA-201-58, USITC Pub. 1849 (June 1986) at 7-8 (examining production processes, facilities, physical characteristics, uses, and markets); *Stainless Steel and Alloy Tool Steel*, Inv. No. TA-201-48, USITC Pub. 1377 (May 1983) at 15-16 (examining physical characteristics and production facilities); *Wood Shakes and Shingles*, Inv. No. TA-201-56, USITC Pub. 1826 (March 1986) at 5; and *Nonelectric Cooking Ware*, Inv. No. TA-201-39, USITC Pub. 1008 (Nov. 1979) at 5, 9. *See also* Views of Chairman Newquist and Commissioners Rohr and Nuzum in *Extruded Rubber Thread*, Inv. No. TA-201-63, USITC Pub. 2563 (Dec. 1992) at 8: "in defining the like or directly competitive product, the Commission generally considers such factors as production facilities, manufacturing processes and employees, product characteristics and uses, marketing and distribution channels, and occasionally, price." (Case cites omitted.)

[21] Petitioners' Prehearing Brief on injury, at 20.

[22] Id. at 20-21.

[23] Id. at 21.

[24] Id.

[25] Commissioner Crawford concurs with the basic discussion of facts in the following paragraph. She also considered whether there were any products that were directly competitive with the imported article. No party identified any such candidate products and the record did not indicate the existence of any such products. Based on the evidence in the record, she finds that domestically produced wheat gluten is the only product that is like or directly competitive with the imported article and that the domestic industry consists of the domestic producers of all forms of vital wheat gluten, including modified wheat gluten that is used in the baking and pet foods industries.

[26] Report at II-5.

[27] Id.

producers).[28] Finally, the absence of substitute products with the functional "vitality" of wheat gluten suggests that there are no other domestic products that are "like" imported wheat gluten.

Increased Imports

Statutory Framework. Under section 202 of the Trade Act, the criterion of increased imports may be met when the increase is "either actual or relative to domestic production."[29] Because section 202 is a global safeguard law, the Commission considers imports from all sources in determining whether imports have increased. In investigations under section 202, the Commission traditionally has considered import trends over the most recent 5-year period, but has considered longer and shorter periods when it found it appropriate to do so. There is no minimum amount by which imports must have increased. A simple increase is sufficient.

Finding. During the period examined, imports of wheat gluten increased from 128 million pounds in 1993 to 177 million pounds in 1997.[30] Virtually all[31] of this increase occurred during the last two years of the period examined, when imports surged from 128 million pounds in 1995 to 156 million pounds in 1996 and 177 million pounds in 1997.[32] Thus, between 1995 and 1997, imports increased by nearly 40 percent. The ratio of imports to production followed a similar trend, rising from 100.6 percent in 1993 to 145.4 percent in 1997.[33] Respondents conceded that imports of wheat gluten have increased.[34]

Based on the foregoing, we find that this criterion is satisfied.

Serious Injury or Threat

Statutory Framework. The factors and definitions relating to serious injury and threat of serious injury are set out in section 202(c) of the Trade Act. "Serious injury" is defined as "a significant overall impairment in the position of a domestic industry."[35] Threat of serious injury is defined as "serious injury that is clearly imminent."[36]

The statute sets forth several economic factors that the Commission must consider in determining whether serious injury or threat thereof exists. Section 202(c)(1) provides that the Commission is to consider "all economic factors which it considers relevant, including (but not limited to)" the following--

> (A) with respect to serious injury--
>
> (i) the significant idling of productive facilities in the domestic industry,
>
> (ii) the inability of a significant number of firms to carry out domestic production operations at a reasonable level of profit, and
>
> (iii) significant unemployment or underemployment within the domestic industry;
>
> (B) with respect to threat of serious injury--
>
> (i) a decline in sales or market share, a higher and growing inventory (whether maintained by domestic producers, importers, wholesalers, or retailers), and a

---

[28] Report at II-9.
[29] Section 202(c)(1)(C).
[30] Report at II-12.
[31] Imports declined to 124 million pounds in 1994. Report at II-12.
[32] Report at II-12.
[33] Report at II-15.
[34] Transcript of injury hearing (Dec. 16, 1997) at 155-56, 181.
[35] Section 202(c)(6)(B).
[36] Section 202(c)(6)(D).

> downward trend in production, profits, wages, productivity, or employment (or increasing underemployment) in the domestic industry,
>
> (ii) the extent to which firms in the domestic industry are unable to generate adequate capital to finance the modernization of their domestic plants and equipment, or are unable to maintain existing levels of expenditures for research and development,
>
> (iii) the extent to which the United States market is the focal point for the diversion of exports of the article concerned by reason of restraints on exports of such article to, or on imports of such article into, third country markets.

The statute further provides that the term "significant idling of productive facilities" includes the closing of plants or the underutilization of production capacity.[37] Also, the statute provides that the presence or absence of any of these factors is not "necessarily dispositive" in evaluating serious injury or threat of serious injury.[38]

Arguments of the Parties. Petitioner argues that the domestic wheat gluten industry is seriously injured or, in the alternative, threatened with serious injury. Petitioner cites the decline in industry capacity utilization from 78.4 percent in 1993 to 44.5 percent in 1997, the *** as a result of low priced imports, and the *** at U.S. plants to support its argument that there has been a significant idling of productive facilities in the industry.[39] Petitioner asserts that a significant number of firms are unable to operate at a reasonable level of profit. In support, petitioner points to the increase in profitability of wheat gluten operations between 1993 and 1994, the decline in 1995, and further declines that resulted in losses in 1996 and 1997.[40] Petitioner also alleges that there is significant unemployment or underemployment within the domestic industry. While noting that a certain minimum workforce is needed to maintain and run wheat gluten plants, petitioner argues that at the current low capacity utilization levels, employees are being dramatically underemployed.[41] Petitioner also relies on the reduction of throughput on existing machines to a level of a 4-day week, ***, declining income received by production workers, and losses of managerial and administrative jobs at domestic facilities.[42]

Petitioner cites additional evidence relating both to serious injury and threat of serious injury, including increasing production capacity in Europe, declining domestic production, shipments, and sales of wheat gluten, declining industry productivity, increasing inventories, and the inability of domestic producers to generate adequate capital for investment and research and development.[43]

EU respondents argue that the statutory test of serious injury has not been met. They argue that serious injury must be evaluated in light of the most recent information, and that such information does not support a finding of serious injury.[44] They allege that Midwest has restored salary cuts, raised salaries, and increased its workforce; that prices have risen and purchasers are unable to find adequate wheat gluten;

---

[37] Section 202(c)(6)(B).

[38] Section 202(c)(3).

[39] Petitioner's Prehearing Brief on Injury, at 26, 29-30.

[40] Id. at 30. In noting that the production process yields both wheat gluten and wheat starch, petitioner asserted that whether the financial conditions of the industry were viewed on the basis of wheat gluten operations alone, or on the basis of combined wheat gluten and wheat starch operations, the injury that began during 1994/1995 has become more severe in the 2 most recent years and is clearly "serious." Id. at 34.

[41] Id. at 37.

[42] Id. at 38.

[43] Id. at 40-50.

[44] Posthearing Brief on Injury of the Association des Amidonneries de Cereales de L'U.E. (hereafter "EU Posthearing Brief on Injury"), at 40.

and that domestic producers have refused to sell to companies that also have imported.[45] They also assert *inter alia* that the Commission should give little or no weight to the domestic industry's reported profitability data for wheat gluten, or for wheat gluten and wheat starch combined.[46] In particular, they argue that the allocation of costs between wheat gluten and wheat starch based on sales revenue distorts the profitability data.[47]

They also argue that the domestic industry is not threatened with serious injury. They cite recent improvements in several indicators, including an increase in consumption and declining inventories; high capacity utilization in Europe; and evidence relating to wages, employment, and access to capital, which they believe indicates that serious injury is not "imminent."[48]

Finding. We find that the domestic industry producing wheat gluten is seriously injured. In reaching this conclusion, we examined a wide array of factors relating to the condition of the industry, including capacity utilization, plant closings, production, shipments, inventories, financial data, unit values, prices, employment levels, productivity, wages, and other employment-related data.

In making our determination, we examined the entire record. We agree that the Commission should consider the most recent data and must assure itself that the domestic industry is seriously injured (or threatened with serious injury) at the time it makes its injury determination. Indeed, remedying an injury that no longer exists because economic conditions in the industry have improved or because the industry has completed an adjustment process (e.g., closed plants have long been converted to other uses, separated workers have long been reemployed elsewhere) would be contrary to the purpose of the safeguards law. At the same time, the Commission must also examine recent data in a broader context. A recent minor improvement in data relating to one or more factors does not necessarily mean that serious injury no longer exists, just as a recent downturn in one or more factors would not necessarily mean that a recently healthy industry is now seriously injured. We have carefully reviewed information in the entire record on all of the factors relevant to the question of serious injury and have concluded that the domestic wheat gluten industry is seriously injured.

There was a significant idling of productive facilities in the industry over the period examined. Capacity utilization fell significantly, from 78.3 percent in 1993 to as low as 42.0 percent in 1996 before rising slightly to 44.5 percent in 1997.[49] Some of this decrease in capacity utilization is explained by the fact that domestic capacity to produce wheat gluten increased during the period of investigation in anticipation of significant increases in domestic consumption.[50] Most of this increase in capacity was in place by June 1995, that is, before the surge in imports that occurred in crop years 1996 and 1997. Had there been no increase in imports from 1993 levels, the industry likely could have operated at 61 percent of capacity in 1997.[51] Also, one plant in the industry, *** as a result of low-priced imports.[52]

Industry production declined during the period of investigation. Industry production of wheat gluten, which increased early in the investigative period from 128 million pounds in 1993 to 143 million pounds in 1995, fell sharply to 112 million pounds in 1996 and then increased to 122 million pounds in 1997, a decrease of 4.5 percent over the five-year period of investigation.[53] Domestic shipments followed a similar trend, initially rising and then falling, and they were at their lowest level of the investigative

---

[45] Id. at 40-42.
[46] Id. at 35.
[47] Id. at 35-36.
[48] Id. at 42-47.
[49] Report at II-15.
[50] Domestic consumption increased by 17.8 percent between 1993 and 1997. Report at II-25.
[51] This calculation assumes that 1997 U.S. apparent consumption would have remained the same, and that domestic producers would have supplied all of the increase in consumption.
[52] Report at II-14, note 37; *** Producer Questionnaire at 13.
[53] Report at II-15.

period in 1996 and 1997.[54] End of period inventories more than doubled during the period examined, as did the ratio of domestic producer inventories to shipments.[55]

The Commission received usable financial data on wheat gluten operations from three of the four domestic producers of wheat gluten, Midland, Manildra, and Heartland. These three firms accounted for the substantial majority of domestic production of wheat gluten.[56] Each of the companies produces wheat gluten and wheat starch in a joint production process. Each of the companies also produces other by-products or related products, especially alcohol. We carefully considered the arguments made by respondents with respect to the allocations made by domestic producers in providing financial data on their wheat gluten operations. Based on a careful review of the allocation methodologies used by domestic wheat gluten producers in responding to the Commission's questionnaire, we find those allocations to be appropriate.[57]

The financial data obtained by the Commission show that the domestic industry is unable to operate at a reasonable level of profit. The industry's wheat gluten operations were profitable early in the investigative period, but operated at a loss in 1996 and 1997. More specifically, gross profit and operating income increased between 1993 and 1994, and then fell sharply in 1995; further declines in 1996 and 1997 resulted in overall industry losses on wheat gluten operations in both of those years.[58] Profitability reflected the trend in average unit value prices, which initially rose and then fell. Average unit values peaked in 1994 and then declined and were at the lowest level of the investigative period in 1997.[59] This decline in average unit values occurred at the same time that average unit costs were rising.[60]

There is evidence of unemployment and of significant underemployment in the industry. Production of wheat gluten is extremely capital intensive and requires very few production workers.[61] Nonetheless, a minimum work force is required to keep a plant running, and producers have little flexibility in changing the level of employment in response to changes in production levels.[62] While employment and hours worked increased during the period of investigation,[63] largely to provide minimum production staffing for the increased capacity planned and brought on stream before imports surged in 1996 and 1997, there is evidence of layoffs of managerial and administrative workers. For example, Midwest reported that while production worker employment was being maintained at minimum necessary levels, losses of managerial and administrative jobs at domestic facilities were incurred.[64] Also, jobs were lost ***.[65] There is also evidence of underemployment in the industry. The average number of hours worked (per worker) by production and related workers fell from *** annually for 1993-95 to *** in 1996 and *** in 1997.[66] Hourly wages ***.[67] However, the 1997 hourly wage rate was still *** the 1994 rate.[68]

---

[54] Report at II-16.
[55] Report at II-16.
[56] The fourth firm, ADM, provided combined data on its U.S. and Canadian wheat gluten and wheat starch operations. Report at II-17, note 45.
[57] Report at II-20, 19-21 (supporting information on these pages of the report is confidential business information).
[58] Report at II-18-19.
[59] Report at II-15, 16.
[60] Report at II-16.
[61] Report at II-17.
[62] Report at II-17.
[63] Report at II-16.
[64] Petitioner's Prehearing Brief on injury, at 38.
[65] Id.
[66] Derived from data in table 8, report at II-16.
[67] Report at II-16.
[68] Report at II-16.

Worker productivity was at its highest level of the investigative period in 1994 and at its lowest level in 1997.[69] As a result, unit labor costs almost doubled during the period examined.[70]

In summary, by the end of the period examined, virtually all of the factors relevant to industry performance were negative. Industry capacity utilization has declined significantly, production and shipments have declined, end-of-period inventories have more than doubled, the industry has gone from being profitable to operating at a loss, average unit values have declined and were at their lowest level in 1997 at the same time that unit costs were rising, hourly wages have been relatively flat, worker productivity has declined due to the decline in capacity utilization, and unit labor costs have almost doubled. While there has been minor improvement in several factors during the most recent year, these improvements are isolated and do not change our conclusion that the domestic industry is presently seriously injured. Thus, we find that the domestic wheat gluten industry is seriously injured.

Causation

Statutory Framework. The third criterion requires a finding that the article is being imported into the United States in such increased quantities as to be a "substantial cause" of serious injury or threat thereof. The term "substantial cause" is defined in section 202(b)(1)(B) to mean "a cause which is important and not less than any other cause."[71] Thus, the increased imports must be both an important cause of the serious injury or the threat thereof, *and* a cause that is equal to or greater than any other cause. The latter requires a weighing of causes.

In determining whether increased imports are a substantial cause of serious injury or the threat thereof, the statute directs the Commission to take into account all economic factors that it finds relevant, including but not limited to--

> . . . an increase in imports (either actual or relative to domestic production) and a decline in the proportion of the domestic market supplied by domestic producers.[72]

The statute directs that the Commission consider "the condition of the domestic industry over the course of the relevant business cycle," but it provides that the Commission "may not aggregate the causes of declining demand associated with a recession or economic downturn in the United States economy into a single cause of serious injury or threat of injury".[73] Also, the statute directs that the Commission "examine factors other than imports" that may be a cause of serious injury or the threat thereof to the domestic industry and include such findings in its report.[74] The legislative history of the Trade Act includes examples of other causes “such as changes in technology or in consumer tastes, domestic competition from substitute products, plant obsolescence, or poor management,” which, if found to be more important causes of injury than increased imports, would require a negative determination.[75]

Arguments of the Parties. Petitioner argues that increased imports are an important cause of serious injury to the domestic industry and the only cause of serious injury.[76] Petitioner argues that the condition of the domestic industry has deteriorated dramatically despite continued strong domestic demand

---

[69] Id.
[70] Id.
[71] Section 202(b)(1)(B).
[72] Section 202(c)(1)(C).
[73] Section 202(c)(2)(A).
[74] Section 202(c)(2)(B).
[75] *Trade Reform Act of 1974, Report of the Committee on Finance. . . on H.R.. 10710*, S. Rep. 93-1298, 93d Cong., 2d Sess. (1974), at 121.
[76] Petitioner’s Prehearing Brief on Injury, at 52.

for wheat gluten, and that the increase in imports--particularly from the EU--correlates directly with the decline in industry production, market share, shipments, financial performance, and prices.[77] Petitioner asserts that a combination of prohibitive trade barriers and governmental practices insulate EU producers from competition. Petitioner points out that the EU import tariff on wheat gluten is 11 times higher than the U.S. tariff on wheat gluten, and the EU import tariff on wheat starch is 27 times higher than the U.S. tariff on wheat starch.[78] Petitioner also alleges that European producers benefit from a variety of government measures which amount to subsidies, including a wheat export tax, export subsidies, subsidies to starch end users, and quotas or limits on production of various competitive starch products.[79] Petitioner argues that these trade barriers and practices create incentives to overproduce wheat starch, and, thereby, wheat gluten, and give EU producers the ability to undersell the U.S. market.[80]

EU respondents, on the other hand, argue that changes in co-product markets have had a substantially greater impact on the domestic industry than imports of wheat gluten.[81] More specifically, they claim that weak U.S. market conditions for wheat starch have had a greater effect on wheat gluten production and sales than has import competition. In support of that argument, they note that co-products account for a large, relatively fixed share of the volume of wheat consumed in the production process (close to 90 percent), that the processing operation results in the production of about five times as much wheat starch as wheat gluten, and that the integrated nature of the production process means that production decisions must also be made on an integrated basis.[82] EU respondents state that the manner in which wheat starch is marketed or consumed affects wheat gluten production volumes and profitability, including how much goes to alcohol production versus premium wheat starch production. They cite competition between wheat starch and corn starch in the U.S. market as a key factor affecting the production of wheat starch, and by extension wheat gluten.[83] In particular, they argue that Midwest's poor financial performance is explained by developments relating to its alcohol operations. EU respondents point out that Midwest's sales revenue for wheat gluten declined in 1995, before the increase in imports. EU respondents argue that this decline is correlated with an increase in the relative cost of wheat to corn/milo in that year as well as to weakness in the ethanol market. EU respondents argue that these developments caused Midwest to reduce the volume of wheat starch used as the feedstock for its alcohol operations, which led to ***.[84]

EU respondents further claim that large-scale importing by U.S. producers is indicative of co-product economies, since it can make more sense to import the product, rather than produce the product along with the co-product, subject to weak demand. They also claim that domestic producers, by bargaining with European producers for increased import quantities at prices below the U.S. market price, have contributed to the price undercutting and reduced market share that they complain of.[85]

EU respondents also assert that nothing can change the economic reality that imports can have had no more than a negligible price effect when there is strong competition between U.S. producers, a new domestic producer, and less than full levels of capacity utilization by domestic producers.[86]

Respondent Shoalhaven, an Australian producer and exporter, argues that the Commission should take into account Australia's role as long-term, reliable supplier to the U.S. market, and apply a

---

[77] Id. at 52-57.
[78] Id. at 3.
[79] Id.
[80] Id. at 4.
[81] EU Respondents' Prehearing Brief on Injury, at 13-27.
[82] *See, e.g.*, EU Respondents' Prehearing Brief on Injury at 14-15, and Attachment 5 to their brief.
[83] Id. at 18.
[84] Id. at 20-21.
[85] EU Respondents' Posthearing Brief on Injury, at 5.
[86] EU Respondents' Prehearing Brief on Injury, at 2.

"disaggregated analysis" that focuses on the impact of EU imports. Shoalhaven asserts that the "tariff wall and subsidy schemes" of the EU are the "sole 'factor'" causing the increase in imports of wheat gluten.[87] Shoalhaven claims that U.S. law provides support for such an analysis, citing the first sentence of section 202(c)(5) of the Trade Act.[88] While Shoalhaven acknowledges that the Commission must consider all imports in determining whether imports have increased in such quantities as to be a substantial cause of serious injury or threat thereof, it asserts that it would be "inappropriate for the Commission not to conduct an analysis of imports by country source where, as in this case, the factual record shows that only imports from one source dramatically increased and were driving prices well below the U.S. producers' cost of production."[89] Shoalhaven further claims that such a disaggregated analysis is consistent with U.S. obligations under the WTO Safeguards Agreement.[90]

Finding. We reviewed carefully the alternative causes of injury suggested by the parties and other possible causes, and have concluded that increased imports are both an important cause of serious injury and a cause that is greater than any other cause.

As we established in the "increased imports" section of these views, imports have increased significantly, both in actual terms and relative to domestic production. The quantity of imports also increased relative to domestic consumption. Imports, as a share of U.S. consumption, were relatively stable during the first three years of the investigative period, declining slightly from 51.4 percent to 50.1 percent.[91] The ratio of imports to consumption then increased sharply to 58.9 percent in 1996 and 60.2 percent in 1997.[92] The record reflects that most of this increase consisted of imports from the EU. The record also shows that imports from the EU consistently undersold domestic wheat gluten. This surge in relatively low-priced imports in 1996 and 1997 coincided with the decline in industry performance described above. There is a direct correlation between the dramatic increase in wheat gluten imports and the significant decline in domestic wheat gluten industry performance in 1996 and 1997. In the face of rising domestic demand and consumption, domestic production, shipments, capacity utilization, unit prices, industry financial performance, and worker productivity all declined during the period of greatest import penetration.

We carefully reviewed EU respondents' arguments about the co-product markets. While there is evidence that wheat gluten production decisions are affected by market conditions in the wheat starch market, we conclude that changes in the co-product markets were not a more important cause of serious injury than increased imports. We examined U.S. selling prices of wheat starch, which is the major co-product of wheat gluten production. In contrast to the domestic selling price of wheat gluten, the domestic selling price of wheat starch showed a gradual increase over the period of investigation. Weighted-average wheat starch prices were at their highest level of the investigative period in 1997.[93] Thus, there has been no decline in wheat starch prices that either parallels the sharp decline since 1994 of domestic wheat gluten prices or explains the sharp decline in the financial performance of domestic wheat gluten producers. In addition, the relative stability of, and gradual increase in, domestic wheat starch prices suggests that competition between corn starch and wheat starch is not likely to have had much if any effect on wheat gluten production. While there is evidence that Midwest reduced its wheat gluten production in 1995, for reasons related at least in part to conditions in the alcohol market (Midwest further processes wheat starch into alcohol), Midwest is but one of four domestic producers. Midwest's action in 1995 explains, at most, only part of the problem faced by one producer. It does not explain the significant deterioration in 1996

---

[87] Posthearing Brief on Injury of Shoalhaven Starches Pty., Ltd., at 12.
[88] Id.
[89] Id. at 13.
[90] Id. at 13-14.
[91] Report at II-25.
[92] Id.
[93] Report at II-37.

and 1997 of the other three domestic producers, who account for the majority of domestic production, nor does it fully explain Midwest's declining financial performance on its wheat gluten operations.

We do not regard the ongoing importation of wheat gluten by domestic producers as being a more important cause of the serious injury, as argued by respondents. First, U.S. producers' imports remained relatively steady during the period examined.[94] Thus, U.S. producers were not responsible for the surge in imports that occurred in 1996 and 1997. Second, the U.S. market depends in part on imports to meet domestic demand. In all but one year (1996) during the period of investigation, U.S. apparent consumption of wheat gluten exceeded U.S. producers' capacity to produce wheat gluten.[95]

We considered other possible causes of injury, including competition among domestic producers, increased capacity, and rising raw materials (wheat and wheat flour) costs. The domestic wheat gluten market is very competitive. Producers have ample excess capacity to meet higher demand. Also, wheat gluten is a commodity product that sells primarily on the basis of price, and wheat gluten from different sources is highly interchangeable. One new domestic producer, Heartland, entered the market in 1996. In addition, the domestic industry added substantial new capacity early in the period of investigation. This increased capacity was added in anticipation of continued strong growth in domestic demand and consumption. Industry projections of continued growth in demand and consumption were largely correct, as apparent consumption increased nearly 18 percent between 1993 and 1997. As indicated above, but for the increase in imports, the industry would have operated at 61 percent of capacity in 1997, which is much closer to the level at which the industry operated early in the investigative period when it operated reasonably profitably. We therefore conclude that neither domestic competition nor increased domestic capacity was a more important cause of serious injury than increased imports.

Nor do we consider rising prices of wheat and wheat flour, which are the major inputs into wheat gluten/wheat starch production, to be a more important cause of serious injury than increased imports. We note that raw material costs increased over the period examined, particularly in 1996 and 1997.[96] Consumption also increased significantly during this period. Because demand for wheat gluten is relatively insensitive to changes in price, we would expect that wheat gluten producers would be able to pass on these cost increases to their customers. U.S. producers testified that, historically, higher raw material costs had been passed through to their customers.[97] In 1996 and 1997, however, unit selling values declined,[98] notwithstanding increased demand and higher raw material costs. We find that this unusual development is explained by the dramatic increase in relatively low-priced imports during this period, which had the effect of driving down wheat gluten prices.

We find no basis in the statute for the Commission to undertake the disaggregated analysis that Shoalhaven advocates. In our view, Shoalhaven has misconstrued the meaning of section 202(c)(5). Section 202(c)(5) requires that the Commission investigate any factor which in its judgment may be contributing to increased imports and directs the Commission, if it has "reason to believe" that the increased imports are attributable in part to circumstances which come within the purview of the antidumping and countervailing duty laws, section 337 of the Tariff Act of 1930, or other remedial

---

[94] Report at II-12.

[95] Report at II-15, 25.

[96] Report at II-31-32.

[97] Testimony of John T. Stout, President and CEO, Manildra Milling Corporation, transcript of hearing on injury phase of investigation (Dec. 16, 1997), at 35; and Ladd M. Seaberg, President and CEO, Midwest Grain Products, Inc., id. at 45-46.

[98] Report at II-31-32.

provisions of law, to notify the appropriate agency so that appropriate action may be taken.[99] We disagree that this provision may be construed to direct the Commission to undertake a disaggregated analysis.

We disagree with Shoalhaven's argument that Article 5:2 of the WTO Safeguards Agreement supports a disaggregated approach. Article 5:2 relates to the manner in which quantitative restrictions may be applied. That Article does not provide authority for examining only certain imports in determining whether increased imports are a substantial cause of serious injury or the threat of serious injury to the domestic industry. Nothing in Article 4 of the Agreement, which defines key terms and sets out the factors to be considered in determining whether an industry is injured, suggests that a country should look at anything less than all imports in determining whether imports have increased, and whether increased imports cause or threaten serious injury to a domestic industry. Moreover, Article 2:2 of the Agreement states that safeguard measures shall be applied to a product being imported irrespective of its source.

Nor do we find any basis to undertake a disaggregated analysis based on the EU tariffs and alleged subsidies, as Shoalhaven argues. Foreign tariffs and subsidies could theoretically be two of the reasons why imports are increasing, but do not provide a basis for examining certain imports and ignoring others in determining whether increased imports are a substantial cause of serious injury to the domestic industry.

Finding with Respect to NAFTA Imports

Section 311(a) of the NAFTA Implementation Act provides that if the Commission makes an affirmative injury determination in an investigation under section 202 of the Trade Act, the Commission must also "find" whether--

> (1) imports of the article from a NAFTA country, considered individually, account for a substantial share of total imports; and
>
> (2) imports of the article from a NAFTA country, considered individually or, in exceptional circumstances, imports from NAFTA countries considered collectively, contribute importantly to the serious injury, or threat thereof, caused by imports.

Thus, in order to make an affirmative finding with respect to imports from Canada or Mexico, the Commission must make an affirmative finding on both conditions. If the Commission finds that either condition is not satisfied, it must make a negative finding.

Section 311(b)(1) states that imports from a NAFTA country "normally" will not be considered to account for a substantial share of total imports if that country is not among "the top 5 suppliers of the article subject to the investigation, measured in terms of import share during the most recent 3-year period."

Section 311(c) defines "contribute importantly" to mean "an important cause, but not necessarily the most important cause." The Commission considers this test to require a lesser causal connection than the "substantial cause" test in section 202(b)(1)(B), since the latter is defined to mean "a cause which is important and not less than any other cause." In determining whether imports have contributed importantly to the serious injury or the threat thereof, the Commission is directed to consider "such factors as the change in the import share of the NAFTA country or countries, and the level and change in the level of imports from a NAFTA country or countries.[100] Imports from a NAFTA country or countries

---

[99] While general allegations were made during the investigation concerning EU programs and subsidies, the Commission has not received evidence that would warrant sending a notice to the Department of Commerce or any other agency, nor have any of the parties asked the Commission to do so.

[100] Section 311(b)(2) of the NAFTA Implementation Act.

"normally" will not be considered to contribute importantly to the serious injury or the threat thereof "if the growth rate of imports from such country or countries during the period in which an injurious increase in imports occurred is appreciably lower than the growth rate of total imports from all sources over the same period."[101] In "exceptional circumstances" imports from NAFTA countries may be considered collectively in determining whether NAFTA imports have contributed importantly to the serious injury or threat. The NAFTA Statement of Administrative Action states that "the ITC is likely to consider imports from NAFTA countries collectively when imports from individual NAFTA countries are each small in terms of import penetration, but collectively are found to contribute importantly to the serious injury or threat of serious injury."[102]

We make a negative finding with respect to both Mexico and Canada. There were no reported imports of wheat gluten from Mexico during the period examined.[103] Thus, Mexico does not account for a substantial share of total imports. Having found that the first prong of the test is not met, we have made a negative finding with respect to Mexico. Canada, on the other hand, was the third largest supplier (after the EU and Australia) of wheat gluten imports during the most recent 3-year period, accounting for an average of 10.2 percent of the subject imports. Therefore, we find that imports from Canada account for a substantial share of total imports.[104] However, imports from Canada declined significantly during the period examined, while imports overall increased, and by 1997 Canada accounted for 8.9 percent of total imports.[105] In addition, petitioner stated in its petition that imports from Canada are not contributing importantly to the serious injury caused by imports.[106] We therefore find that imports from Canada are not contributing importantly to the serious injury caused by imports. Having found that Mexico does not account for a substantial share of imports, we do not address the question of whether imports from Canada and Mexico considered collectively contribute importantly to the serious injury caused by increased imports.

---

[101] Id.

[102] Statement of Administrative Action Accompanying the North American Free Trade Agreement, as published in H. Doc. 103-159, 103d Cong., 1st Sess. (1993), at 565.

[103] Official statistics of the U.S. Department of Commission.

[104] Commissioner Crawford does not reach the question of whether imports from Canada account for a substantial share of total imports. Rather, she makes a negative finding with respect to Canada based on her finding that imports of the article from Canada do not contribute importantly to the serious injury caused by imports. *See* discussion below.

[105] Report at II-12.

[106] Petition at 27-28.

VIEWS OF THE COMMISSION ON REMEDY

Findings and recommendations

For the reasons set forth below, we find that the following remedy will address the serious injury that we have found to exist and will be the most effective in facilitating the efforts of the domestic industry to make a positive adjustment to import competition. More specifically-

(1) We recommend that the President impose a quantitative restriction, for a four-year period, on imports of wheat gluten that are the subject of this investigation, in the amount of 126 million pounds in the first year, to be increased by 6 percent in each subsequent year that the action is in effect;

(2) We recommend that, within the overall quantitative restriction, the President allocate separate quantitative restrictions for the European Union, Australia, and "all other" non-excluded countries, taking into account the disproportional growth and impact of imports of wheat gluten from the European Union;

(3) Having made negative findings with respect to imports of wheat gluten from Canada and Mexico under section 311 of the NAFTA Implementation Act, we recommend that such imports be excluded from the quantitative restriction;

(4) We recommend that this import relief action not apply to imports of wheat gluten from Israel, or to imports of wheat gluten from beneficiary countries under the Caribbean Basin Economic Recovery Act or the Andean Trade Preference Act; and

(5) We recommend that the President undertake international negotiations to address the underlying cause of the increase in imports of wheat gluten or otherwise to alleviate the injury to the domestic industry.

Introduction

In deciding what relief to recommend, we took into account the considerations set forth in section 202(e)(5)(B) of the Trade Act, including the form and amount of action that would remedy the serious injury we have found to exist, the objectives and actions specified in the adjustment plan submitted by petitioner, individual commitments submitted in the course of the investigation, information available to the Commission concerning the conditions of competition in domestic and world markets, and likely developments affecting such conditions during the period for which action is being requested, and whether international negotiations may be constructive to address the serious injury or to facilitate adjustment. We begin our discussion by first discussing competitive conditions affecting the industry and the industry's adjustment plan and individual commitments.

Competitive Conditions

Market conditions.[107] We have considered the conditions of competition in domestic and world markets, and likely developments affecting such conditions during the next several years. During 1993-97 the U.S. wheat gluten market was subjected to significant changes in market conditions. Changes in demand conditions in the U.S. market have led to generally steady, but sometimes significant, increases in consumption of wheat gluten. These have resulted from increasing use of wheat gluten in specialty breads, white bread, and pet food, and from occasional weather related effects on the wheat crop that lead to, at such times, increased use of wheat gluten to supplement inadequate protein levels in the wheat flour used to make bread. Demand is also expected to increase in the future, especially as recently developed modified wheat gluten products move to volume production and marketing. Since wheat gluten is a commodity product, supply from different sources is highly substitutable. This is not expected to change in the near future, although modified wheat gluten products will most likely utilize wheat gluten produced in the United States. Available supply in the U.S. market increased as a result of two major factors; a massive increase in capacity and shipments by EU producers and a large increase in capacity by U.S. producers. EU capacity is expected to continue to increase in the near future; whereas U.S. capacity will not likely increase from its current level.[108]

Demand conditions. U.S. demand for wheat gluten, as measured by total U.S. apparent consumption, increased significantly during 1993-97, from 249.7 million pounds in 1993 to 294.2 million pounds in 1997, or by about 18 percent. This increase in consumption was supplied primarily by the increase in imported wheat gluten during this period.

Demand for wheat gluten is largely insulated from changes in the overall economy because about 80 percent of the product is used as a necessary ingredient in bread, a low-price food staple. Another 15 percent of the wheat gluten is used in canned pet foods, and the remaining 5 percent is used in a variety of other products where substitutes exist. In its two major uses, bread and certain types of canned pet food, wheat gluten is used for its unique visco-elastic properties as well as its protein content. As a result, no other products, other than high-protein wheat flour in the use of bread, are commercially substitutable for wheat gluten in these uses.[109] Because wheat gluten represents only a small share of the cost of producing the downstream products and generally lacks substitutes, the demand is not sensitive to price changes in wheat gluten.[110]

Most of the increase in apparent consumption in wheat gluten during 1993-97 appears to have resulted from continuation of long-run growth in demand as well as some structural changes in demand in the final products noted above, rather than from any significant substitution caused by changes in the price of wheat gluten. Throughout this period demand for wheat gluten rose as consumption increased for products such as bread and pet food, which contain wheat gluten. Particularly notable are the increases in wheat gluten demand in 1994 and in 1997. The increase in demand for wheat gluten in 1994 to 256.6 million pounds, up 2.8 percent from the level in 1993, resulted at least in part from a weather-related

---

[107] Most annual data reported in the Commission's report are for 12-month "crop years" running from July through June. Unless specified otherwise, annual data discussed in the opinion are for the 12-month periods ending June 30.

[108] As a result of U.S. producers' recent expansions in capacity, they now have significant flexibility to respond to changes in demand for their wheat gluten. At least part of the new capacity could be used to provide the vital wheat gluten required to produce modified wheat gluten products. For a full discussion of U.S. producers' supply responsiveness see Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 3-6.

[109] When asked in the questionnaire to suggest products that substitute for wheat gluten, the 19 responding U.S. importers/purchasers to this question listed no such products (Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 12).

[110] Such sensitivity is heightened somewhat by limited substitution between wheat gluten and high-protein wheat flour.

deficiency in protein content in the wheat crops of the major producing countries, including the United States, during 1993. Demand for wheat gluten increases during periods when the protein level in wheat is low, since more wheat gluten is needed to supplement the protein level in wheat flour used for baking bread. In contrast, when the protein level in wheat is high, less wheat gluten is demanded to add to the baking flour. U.S. market prices in 1994 jumped almost 22 percent from the year earlier, reflecting a large increase in demand and only a modest increase in supply. In 1997, demand for wheat gluten jumped by 11.1 percent or 29.5 million pounds over the level in 1996. This increase is likely attributable to several factors. First, there was an increase in demand for canned cat food formulations that feature product in gravy instead of the regular loaf-style canned cat food.[111] The three major U.S. pet food producers of this product *** their purchases of wheat gluten by a total of almost *** pounds in 1997, accounting for about *** of the increase in total apparent consumption in that year. Second, the use of wheat gluten increased as bakeries shifted to high-speed mixing equipment.[112] Third, wheat gluten consumption rose due to the increasing popularity of high-fiber breads and other products, like bagels, that are particularly high in wheat gluten.[113] Fourth, it is likely that anticipation by purchasers and importers to the section 301 action taken by the domestic wheat gluten industry in January 1997 led to some increase in apparent consumption.[114]

Demand for wheat gluten is expected to continue to grow, with possible sharp fluctuations in demand due to weather-related effects on the wheat crop Future demand for U.S. wheat gluten will also increase when domestic producers begin commercial production of modified wheat gluten products for non-traditional food and other uses. But, according to petitioners, production of these products will only occur if trade relief allows higher profits to fund the production facilities for the modified products.

Supply conditions. The U.S. wheat gluten market is a competitive market that has traditionally depended on both imports and U.S. production to supply U.S. demand. During 1993-95, imports from multiple suppliers of wheat gluten accounted for about 50 percent of U.S. apparent consumption, while U.S. producers supplied the remainder. During 1996 and 1997, however, the U.S. market share of imported wheat gluten increased to an average of about 60 percent. During this period, however, the four U.S. producers had the capacity to supply more than 90 percent of the domestic market. Thus, even with significantly lower levels of imports, U.S. consumers would not experience any shortfall in supply at either existing or expected levels of consumption.

U.S. imports of wheat gluten, particularly from the EU, increased by almost 38 percent, or 48.7 million pounds, during 1993-97, with much of this increase occurring in 1996 and 1997. U.S. imports of EU wheat gluten increased most notably in 1996 and 1997 and in relative terms exceeded the increase in U.S. consumption during this period. During much of this two-year period, the EU wheat gluten was priced lower than the domestic product, with margins of underselling ranging from *** percent to ***

---

[111] Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 13.

[112] Recently, bakers have been increasing their use of wheat gluten in the production of white bread as they have been switching to high-speed dough mixing equipment. High-speed mixers process 220 to 250 1-pound loaves per minute compared to the traditional mixers that process 100 to 150 1-pound loaves per minute. Because the higher mixer speed tends to break down the vitality of the flour, additional wheat gluten must be added to the flour to prevent production of poor quality bread, i.e., loaves of bread that rise poorly or collapse (Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 12).

[113] Wheat gluten must be used in the production of high-fiber and multi-grain breads and in the production of bagels. Production of these breads has been increasing in recent years as consumers have become more health conscious. Bakers traditionally used little wheat gluten in white breads, except when the protein content in the wheat crop was low.

[114] If kept in cool dry storage, wheat gluten should last for up to a year or more. End users of wheat gluten reported in their questionnaire responses, however, that they typically prefer to use wheat gluten within the first few months after it is produced.

percent.[115] In fact, prices reached the lowest level of the period during the final quarter of 1997, at *** per pound for the domestic product,[116] despite rising U.S. apparent consumption.[117] The low pricing of the EU product is expected to continue because the EU production of wheat gluten is largely dependent on the demand for wheat starch, and therefore appears to be relatively non-responsive to changes in wheat gluten prices.[118] High prices for EU-produced wheat starch in the EU market, which is subject to high tariffs, can allow the sale of wheat gluten at a lower price than otherwise.

The increase in U.S. imports of wheat gluten occurred as EU producers significantly increased wheat gluten production capacity. Between 1993 and 1999, when EU capacity increases currently underway are brought on line, EU wheat gluten capacity will have increased by 87.6 percent, or by 332.4 million pounds. The increase in EU wheat gluten capacity appears to have resulted from an effort to increase production of wheat starch,[119] a co-product of wheat gluten. Wheat gluten production capacity in the other principal supplying countries, Australia and Canada, remained steady for much of the period before declining somewhat in 1997; capacity in these countries is projected to remain at the 1997 level through 1999. Excess wheat gluten capacity in the top supplying countries, however, was significant at the end of 1997.[120] With such capacity foreign producers, and in particular the EU producers, have significant flexibility to adjust supply levels in response to changes in U.S. demand for their wheat gluten.

In contrast, U.S. capacity increased by 68.2 percent, or 111 million pounds, during the 1993-97 period of investigation. The U.S. increases in capacity are already in place; no significant additional increases in capacity are planned.[121]

Summary. The conditions of competition in both domestic and world wheat gluten markets have undergone important changes during the past several years and are expected to continue to evolve in the near future. U.S. demand has increased significantly due to increasing use of wheat gluten in bread and pet food, as well as changes in weather conditions. Demand is expected to increase in the future, especially as recently developed wheat gluten products move to volume production and marketing. Available supply in the U.S. market has increased significantly as a result of added U.S. wheat gluten capacity, but no major additions are expected in the near future. Wheat gluten capacity among foreign producers in the EU and elsewhere has grown even more rapidly and is expected to increase further. In particular, EU producers have rapidly expanded and will continue to expand their wheat starch and wheat gluten capacity, primarily to produce wheat starch to serve their home market. These EU market conditions appear to allow EU producers to sell their wheat gluten at a relatively lower price. Trade and

---

[115] Report at II-44.

[116] Prices of the EU wheat gluten were also *** per pound during this period and this was only marginally higher than the lowest price of the EU wheat gluten, which was *** per pound in the last quarter of 1996.

[117] Increases in the supply of wheat gluten to the U.S. market during 1996-97 outstripped increases in demand and as a result the U.S. market price of wheat gluten fell in both years.

[118] Depreciating currencies of the principal supplying countries had only a minimal impact on prices of the imported wheat gluten during 1993-97 because frequently used dollar-denominated supply contracts blunted the impact of currency fluctuations during this period.

[119] The EU operates four main programs to enhance the production of wheat starch; these programs are the wheat export tax, the cereal starch production refund program, the starch export restitution program, and various other quotas and production limits on other starches. Although likely affecting wheat starch production, the effect of these programs has not been examined by the Commission. To the extent that these programs increased wheat starch production, the supply of wheat gluten would also have increased. In addition, the EU imposes higher import tariffs on wheat starch and wheat gluten than does the United States. (Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 9-10.)

[120] Report at II-28–II-34.

[121] The U.S. industry intends to carry out pre-existing goals to improve efficiency and productivity and to develop, market, and produce promising new products derived from modified wheat gluten and wheat starch (petitioner's adjustment plan, Jan. 13, 1998, at 5).

consumption patterns have shown that U.S. consumers readily accept foreign supplies of wheat gluten and view it as largely substitutable for U.S.-produced wheat gluten.[122]

Industry Adjustment Plan

We closely examined the industry's adjustment plan and the commitments contained therein. (There were no significant commitments submitted outside of those contained in the industry plan.) Should import relief be granted, the wheat gluten industry's adjustment plan provides that the bulk of its adjustment effort will be to continue to develop and market new products made from modified wheat gluten and modified wheat starch, while also continuing to enhance its efforts to improve efficiency and productivity.[123]

Midwest has spent about *** since 1994 developing such new products. Midwest has been selling a modified wheat gluten product used as a calf-milk replacer since ***; this product competes with skim milk and whey protein. During 1997 Midwest obtained patent protection on several of its modified wheat gluten products; these products are Gliadin, Glutenin, Pasta Power, Glutenin Resin for pet chews, Gluten resin for biodegradable knives, spoons, forks, cups, plates, etc. As of December 1997, Midwest has a patent allowed for modified wheat gluten used in the fabrication of films, with the following products protected: FP 6000-Edible Film and Wheat Protein Isolate. On February 3, 1998, Midwest received a patent on Gliadin-containing cosmetic formulations and Gliaden-applications in hair sprays with low volatile organic chemicals. Finally, Midwest produces Wheatex, a textured wheat protein that can be used to produce vegetarian type products or used as a meat extender. This latter product has no patent protection, but Midwest's production process is unique and kept secret by the firm. Midwest's 5-year goal is to produce *** percent of its wheat gluten as modified wheat gluten products. In addition to developing modified wheat gluten products, Midwest has directed significant effort into developing modified wheat starch products, which constituted about *** percent of its total wheat starch sales in 1997.[124]

If granted relief, Midwest, Manildra, and Heartland indicated in the adjustment plan that they plan to spend a combined amount of *** to develop modified wheat gluten and modified wheat starch products, construct production facilities in which to produce these products, and develop markets for them.[125] The market potential for modified wheat gluten and modified wheat starch products is reportedly huge, and the

[122] Bread and pet food producers have demonstrated a willingness to purchase from the lowest priced supplier, regardless of the source (Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 13-16).

[123] The petitioner states in its adjustment plan that "U.S. producers are using the most modern equipment available to produce the highest quality wheat gluten in the most cost effective manner possible. This is not a case where the bulk of the adjustment effort for the U.S. industry must be to 'modernize' to become more cost effective." Since 1992, U.S. producers have spent *** investing in new plant and equipment to expand and modernize their wheat gluten production facilities. Nonetheless, Midwest intends to spend at least $400,000 during the relief period to continue to improve its efficiency and reduce costs in producing wheat gluten. Transcript of remedy hearing (Jan. 10, 1998), at 23.

[124] A detailed discussion of new product development by the U.S. wheat gluten producers is found in the petitioner's adjustment plan (submission of Jan. 13, 1998) and in the Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 26-29.

[125] Central to Manildra's adjustment will be the construction of a plant at Hamburg, IA, costing about ***, to produce modified wheat gluten and wheat starch, particularly wheat protein isolates to be used in the non-dairy cream products and as a meat extender (posthearing brief–remedy phase, at 43). ADM did not report any specific adjustment plan efforts, but did note in its questionnaire response that if granted relief that led to higher prices, the firm would consider ***.

market for modified wheat gluten products could, in time, dwarf the current market for vital wheat gluten.[126]

Recommended Relief

Selection of Import Quota. We examined the different forms of relief that the Commission is authorized to recommend, to determine which would be most effective in remedying the serious injury and facilitating positive adjustment to import competition. As a general matter, we prefer a simple tariff increase over tariff-rate quotas and quantitative restrictions (quotas) because a tariff tends to be least distortive of trade and easiest to administer. However, in this case we consider a tariff increase to be inappropriate for three reasons. First, it is difficult to estimate the effect that a tariff in any given amount might have on imports. Because of the co-product nature of wheat gluten production, the supply and price of wheat gluten is dictated in part by demand for wheat starch. When demand for wheat starch rises, the production of wheat starch--and, consequently, wheat gluten--also tends to rise. Thus, any assumptions about the effect that a tariff on wheat gluten might have on imports of wheat gluten must take into account both foreign demand for wheat gluten and foreign demand for wheat starch and the effect that this demand will have on the supply and price of wheat gluten. Given the large number of variables, we found it impossible to predict the effect of any tariff increase within an acceptable margin of certainty.

Second, the pricing data we collected demonstrates that imports from the EU consistently undersold the U.S. market during the last two years of the period of investigation. U.S. market prices in 1996 and 1997 were below U.S. producers' cost of production. It appears that higher prevailing market prices for wheat starch in the EU give EU producers more pricing flexibility than U.S. or other foreign producers.[127] In light of this pricing evidence and the ongoing expansion of EU wheat gluten capacity, it is possible that even a 50 percent ad valorem increase in tariffs, the maximum permitted under U.S. law, would prove inadequate. EU capacity to produce wheat gluten increased by 44 percent from 1993 to 1997 and is projected to increase by an additional 30 percent from 1997 to 1999.[128] This increase exceeds the projected increase in demand in the U.S. market for wheat gluten. Assuming that the EU industry continues to operate at a high level of capacity, it is possible that much of any additional production will be directed towards the U.S. market at whatever price is necessary to produce a sale. Thus, we believe it is possible that EU exporters would choose to absorb any tariff increase permitted under current law.

Third, a tariff would be applied against imports from all suppliers,[129] including those who have maintained a stable market share. Because we believe that EU producers have significantly greater pricing flexibility than other foreign suppliers, imposition of a high tariff would be inequitable in that it is likely to further drive these suppliers from the U.S. market.

We also considered a tariff-rate quota, which is a form of tariff. However, as in the case of a straight tariff, the maximum increase in tariffs that could be imposed on over-quota imports is 50 percent ad valorem. For the reasons noted above, we conclude that a tariff-rate-quota would be inadequate.[130]

---

[126] The petitioner's adjustment plan (at 10) noted that if only 1 percent of the 80 billion pounds of U.S. consumption of the plastic food service and film coating products was produced with a modified wheat gluten that made these products biodegradable, it would consume 800 million pounds of wheat gluten annually.

[127] Petitioner argues that the higher EU wheat starch prices are the result of the various government programs and policies affecting wheat starch production and sales that are maintained by the EU.

[128] Report at II-34.

[129] Except those excluded under preferential trade programs such as NAFTA, the U.S-Israel Free Trade Agreement, the Caribbean Basin Economic Recovery Act, and the Andean Trade Preference Act.

[130] Commissioner Crawford emphasizes her reluctance to recommend a quota, particularly in light of the URA's elimination of most quotas. As is well known, the probable welfare costs to the United States of quotas are higher

(continued...)

We also considered whether adjustment measures, including trade adjustment assistance, might remedy the serious injury and be most effective in facilitating the efforts of the domestic industry to make a positive adjustment to import competition. In our view, the industry is not in need of the kinds of technical assistance offered by existing trade adjustment assistance programs. We note that the domestic wheat gluten industry operates efficient, state-of-the-art plants and, because of the capital intensive nature of production, the level of employment in the industry is low. Accordingly, we do not believe that adjustment assistance is the appropriate remedy.

Because we have concluded that the other possible remedies would not be effective or appropriate in the circumstances facing the wheat gluten industry, we have determined that a quota would be the most effective form of relief to remedy the serious injury and facilitate the industry's positive adjustment to import competition.

Quota Amount. Section 203(e)(4) provides that any quantitative restriction

> shall permit the importation of a quantity or value of the article which is not less than the average quantity or value of such article entered into the United States in the most recent 3 years that are representative of imports of such article and for which data are available, unless the President finds that the importation of a different quantity or value is clearly justified in order to prevent or remedy the serious injury.

Petitioner argues that the Commission should base any quota on average market shares during the period 1990-92, which is the period referenced in the U.S.- EU Grains Agreement. However, petitioner acknowledges that average market shares during the period 1992-94 would also be "representative" and could constitute the basis for establishing the quota.[131] EU respondents argue that 1995 should be considered the representative period.[132]

---

[130] (...continued)
than for tariffs, due to the capture of "economic rents" by foreign producers rather than retaining them domestically and due to the potential for unanticipated changes in demand conditions that lead to distortions in supply and demand balances. In the wheat gluten market, the latter problem is somewhat mitigated by the ample excess capacity of domestic producers.

Commissioner Crawford also considered proposing a remedy consisting of a combination of a tariff rate quota and a quota ("TRQ-Quota"), as is permitted under section 202(e)(2)(E). Under such a remedy, an initial quantity of imports might enter duty free, an additional quantity might be subject to a tariff of up to 50 percent, and any further imports would be prohibited. Such a remedy would minimize the potential distortive effects of a quota by allowing some imports above the duty-free quota amount in the event of changes in demand conditions, while providing the certainty of an absolute ceiling on imports. To the extent that the duty-free portion of the TRQ-Quota was subsequently filled and additional imports entered under the tariff portion of the TRQ-quota, this would provide a signal regarding the ability of the EU to sell in the U.S. market even with a high ad valorem tariff. Such information would be useful when considering any extension of the remedy.

Finally, Commissioner Crawford considered recommending that the President implement an auction system to allocate quotas, as authorized under 19 U.S.C. 2581. This provision authorizes the President to sell import licenses at public auction under such terms and conditions as he deems appropriate. The legislative history states that "[a]uctioning of such licences may be a more desirable method to achieve the purposes of the particular quantitative restriction and could be used to capture any 'quota premium' associated with the restriction." S. Rep. No. 249, 96th Cong., 1st Sess. 258 (1979). Such an auction would generate revenues otherwise lost to foreign producers in the form of economic rents. The USDA has indicated that the cost of administering an auction is minimal compared to the expected returns. Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 20.

[131] Transcript of remedy hearing (Feb. 10, 1998), at 7.

[132] EU Respondents' Posthearing Brief on Remedy, at 34.

We note that the statute was amended in 1994 to provide that any quantitative restriction should be based on average import levels "in the most recent 3 years that are representative of imports," unless a different amount is "clearly justified" to prevent or remedy the serious injury. Accordingly, we conclude that, in the absence of anomalous circumstances that render any of those years unrepresentative of imports, any quantitative restriction should take into account average import levels during the most recent three years.[133] In this case, the most recent three years are crop years 1995, 1996, and 1997.[134] Imports from the EU, Australia, and all other countries (excluding Canada) averaged 138 million pounds during this period.

We find, however, that continued imports at or above this level would not remedy the serious injury to the domestic industry. Accordingly, we believe that a different quantity is "clearly justified" in this case, within the meaning of section 203(e)(4). We based this different quantity on average market shares of imports (excluding Canada) during the period 1993-95 (approximately 43 percent), as applied to total domestic consumption of 294 million pounds in 1997 (the most recent period for which we have data). We selected the average market shares from 1993-95 because these years preceded the significant increase in imports that occurred in 1996 and 1997 and because the domestic industry was profitable during this period. Our economic analysis indicates that a quota that restores imports approximately to the relative market shares prevailing in 1993-95 would allow the domestic industry to return to reasonable operating profits. Accordingly, we recommend that any quota initially be established in the amount of 126 million pounds.

Pursuant to section 203(e)(2), we find that a quota in this amount would not exceed the amount necessary to remedy the serious injury we have found to exist. Under the quota we are recommending, imports would continue to supply a large share of the U.S. market and would continue to be an important competitive force in the U.S. market.

Duration and Degressivity. We recommend that the quota be imposed for a four-year period. Petitioner's adjustment plan indicated that four years would allow the industry sufficient time to make substantial progress in developing new products and adjusting to import competition. We recognize that a relief action of more than three years duration will require that the Commission conduct a mid-course review under section 204(a)(2) of the Trade Act. Such an investigation would provide the Commission with an opportunity to review, among other things, the progress of the industry in implementing its plan. It would also provide the President, after receiving the Commission's report, with the opportunity to reduce or terminate relief if the industry has not made adequate efforts to make a positive adjustment to import competition.

---

[133] We generally would not consider an increase in imports during the most recent three years to mean that any or all of those years are not "representative" of imports.

[134] Vice Chairman Bragg believes that crop years 1993-95 are the most recent 3 years that are representative of imports of wheat gluten. She concludes that it would be inappropriate to include crop years 1996 and 1997 in the "representative" period because these were the years in which the surge in imports occurred that caused the serious injury to the domestic industry. She does not believe that elevated, injurious levels of imports should be regarded as "representative" of imports. To include such imports might suggest an inconsistency between the injury determination and remedy recommendation because, presumably, "representative" levels of imports would normally not be a substantial cause of serious injury. She believes that the clause "unless the President finds that the importation of a different quantity or value is clearly justified" in section 203(e)(4) should be interpreted to be an exception to the general rule that the minimum quantitative restriction level be the "most recent 3 years that are representative of imports" in that it would allow the President to set an even lower quantitative restriction when conditions clearly justified such action.

Vice Chairman Bragg concurs with the methodology used to calculate the proposed quantitative restriction, and recommends the establishment of a quota of 126 million pounds for wheat gluten imports from all non-excluded countries during the first year of the remedy period. She notes that imports of wheat gluten from the European Union, Australia, and "other" countries (excluding Canada) averaged 109 million pounds during crop years 1993-95, significantly less than the 126 million pounds that she is recommending for the first year of a quota.

We also recommend that after the first year the quota be expanded by 6 percent in each subsequent year that it is in effect. This rate of increase would permit a faster rate of growth in imports than the average 4.2 percent growth over the period of investigation.[135] We believe this rate of increase would allow for a reasonable rate of growth in imports and would further encourage the industry to adjust to import competition.

Country Allocation. Within the overall quota, we recommend that the President establish specific allocations for the EU and Australia--the two major sources of imports subject to the recommended quota--and all other countries (other than those specifically excluded from the recommended action). In making any such specific allocations, we believe it would be appropriate for the President to take into account the disproportional growth and impact of imports of wheat gluten from the EU. We note, in this regard, that the share of the U.S. market held by imports from the EU increased from 17.6 percent in crop year 1993 to 31.0 percent in crop year 1997. This surge was caused in large part by the rapid growth in EU wheat gluten capacity, described above. In addition, during 1996 and 1997, imports from the EU consistently undersold the domestic market by significant margins. In contrast, the shares of the U.S. market held by Australian and Canadian producers, the two other major suppliers, were stable or declined during the period of investigation. Moreover, imports from these countries generally oversold the domestic market.

Exclusion of Canada, Mexico, Israel, and CBERA and ATPA Countries. Having made a negative finding under section 311(a) of the NAFTA Implementation Act with respect to imports from Canada and Mexico, we recommend that the President exclude Canada and Mexico from any relief action.

The Caribbean Basin Economic Recovery Act, the Andean Trade Preference Act, and the U.S.-Israel Free Trade Agreement Act require the Commission to state whether and to what extent its findings and recommendations apply to an article that is the subject of an affirmative determination under section 202 of the Trade Act when imported from beneficiary Caribbean Basin or Andean countries or from Israel.[136] The Commission's findings and recommendations in this case do not apply to these countries. With the exception of one importation from Ecuador during the period of investigation,[137] there were no reported importations of wheat gluten from any of these countries during the period of investigation.[138] None of those countries are known to be significant producers or exporters of wheat gluten.

International Negotiations. We recommend that the President consider undertaking international negotiations to address the underlying cause of the increase in imports of wheat gluten or otherwise to alleviate the serious injury to the domestic industry. We note that EU practices with respect to wheat gluten and wheat starch were a subject of discussion during the negotiations that led to the signing, on July 22, 1996, of the "Understanding Between the European Community and the United States on a Settlement for Cereals and Grains." We understand that, as part of that agreement, the United States and the EU agreed to consult with a view to finding a mutually acceptable solution if the market share of EU-origin wheat gluten imports into the United States increases in comparison to the 1990-92 market share. Given the different market conditions in the U.S. and European markets, we believe that international negotiations may be the most effective means of remedying the injury to the domestic industry in the long-term.

Short- and Long-term Effects of the Commission's Recommended Remedy

---

[135] Petitioner argued that a 5 percent rate of increase in the quota would be appropriate. Petitioner's Prehearing Brief on Remedy, at 3.

[136] 19 U.S.C. 2703(e)(2): 19 U.S.C. 3203(d)(2); 19 U.S.C. 2112 note.

[137] Since Ecuador is not a known exporter of wheat gluten, it is not clear whether this single importation reflects an actual shipment or is the result of a data entry error.

[138] Based on a review of data compiled by the U.S. Department of Commerce.

The quota increase that we are recommending will provide the minimum level of relief that is necessary to address the serious injury to the domestic industry and will be the most effective, in our view, in facilitating the efforts of the wheat gluten industry to make positive adjustment to import competition.

Our recommended remedy should allow the domestic industry to increase its market share and profitability to levels similar to those that prevailed during 1993-95, prior to the surge in imports that began in 1996. This remedy will also allow U.S. producers to more fully utilize their recently increased capacity and eliminate the underemployment of their work force, thereby raising productivity and lowering unit operating costs. With increased levels of profitability and sufficient time over the 4-year relief period, domestic producers should be able to become more competitive with imports by developing and moving to volume production and sales of modified wheat gluten and modified wheat starch products. These products generally carry higher profit margins than ordinary wheat gluten and wheat starch and will offer a respite from import competition.

Our proposed quota in the first year of the remedy period, is approximately equal to the level of targeted imports that would have entered the United States in 1997 based on average import market shares during 1993-95. During the final three remedy years the quota would expand at 6 percent annually, somewhat higher than the 4.2 percent average annual growth in U.S. wheat gluten consumption during 1993-97. We propose this front-loaded remedy for several reasons. First, the U.S. industry intends to devote considerable financial resources to the construction of production facilities to produce commercial volumes of several modified wheat gluten and wheat starch products that have already been developed and test-marketed. Such investments will initially strain the financial resources of the wheat gluten producers until volume sales of these products commence. In addition, the new construction, purchases of specialized machinery, and organization of new production processes will take some time to complete. At this critical stage of the adjustment process, the quota would enable U.S. producers to achieve profitability levels that would afford the industry's adjustment plans the greatest chance of success. While in the short run competition will be constrained and social costs of the quota will exceed benefits, in the long run the domestic industry will be profitable and more competitive with social benefits exceeding the costs.

The Commission estimates that the quota we are recommending for the domestic wheat gluten industry, based on actual figures in 1997, would initially raise prices of the domestic product to between 3.2 and 8.3 percent over 1997 levels, raise U.S. producers' domestic sales volume by 14.0 to 19.8 percent, and raise their sales revenues by 20.8 to 27.0 percent. Domestic capacity utilization is estimated to increase from a level of 44.5 percent in 1997 to between 50.7 and 53.3 percent with the imposition of the quota on wheat gluten. The number of U.S. workers producing wheat gluten is expected to increase in the short term by 10 to 14. These benefits to the domestic industry will decline over the period of relief as the restrictiveness of the quota is phased down.

The quota that we are recommending should have a small incremental effect on domestic industries that supply raw materials, particularly wheat, to the wheat gluten industry, but have a greater effect on downstream industries, primarily producers of bread and pet food. Initially, the overall prices of wheat gluten in the U.S. market are estimated to increase by 5.9 to 13.4 percent and the overall costs to purchasers of wheat gluten will range from $10.0 million to $22.8 million.[139] U.S. wheat gluten producers will purchase more wheat,[140] but such purchases will likely not affect prices of wheat. On the other hand, wheat

---

[139] A significant portion of this cost results from the increase in prices of targeted imports of wheat gluten that occur when the supply of such imports is restricted below the import level that would have been shipped without the quota restriction. The revenues associated with these higher prices of the targeted imports, which are estimated to range from $6.7 million to $15.6 million, are called quota rents and normally accrue to foreign producers or exporters, or U.S. importers.

[140] U.S. wheat gluten producers' annual purchases of wheat have accounted for less than *** percent of the total U.S. annual hard red winter and hard red spring crops. These are the most popular types of wheat used in the

(continued...)

gluten is a vital ingredient for bakeries and they will continue to purchase the product, even at higher prices. Pet food producers require wheat gluten in certain pet food formulations and also will likely continue purchasing wheat gluten at higher prices. Some purchasers indicated that they were willing to accept a price increase to assure a continuing supply of wheat gluten from U.S. producers.[141] The initial price increases to wheat gluten purchasers will moderate over the relief period as the quota is relaxed.

The quota remedy is likely to have a minimal impact on end-consumers. Bakeries are likely to absorb most, if not all, of any wheat gluten price increase.[142] Competition among pet food producers may limit the amount of any increase in wheat gluten that is passed on to consumers. The development of modified wheat products will eventually draw some wheat gluten supply away from bakeries and other traditional users.

Short- and Long-term Effects of Not Taking the Recommended Action

In the absence of relief, we believe that a significant portion of the domestic wheat gluten industry would be forced to scale down in the near term and possibly shut down in the long term. This assessment is based on the fact that the U.S. industry has incurred substantial operating losses during the last two years. It is unlikely that the industry would continue to operate for any length of time if such losses continue. We note that *** due to competition from low-priced imports.[143] We believe this conclusion is supported by the large and increasing share of imports, especially from the EU, in the U.S. market, the persistence of U.S. wheat gluten prices below U.S. producers' costs of production cost, the rapid increase in wheat gluten capacity in the EU, and the importance of raw material costs in producing wheat gluten. Many of the domestic wheat gluten plants are located in small communities where the closing of a plant would have a significant and disproportionate impact on the local economy. Closure of these plants would have an adverse impact on domestic bakeries and pet food producers, which are the primary users of wheat gluten. Bakeries and pet food producers would become dependent on foreign wheat gluten suppliers, and potentially could be forced to accept significant price increases if domestic competition is eliminated. As discussed above, the wheat industry, which supplies the major raw material used in the production of wheat gluten, should experience minimal adverse effects.

---

[140] (...continued)
production of wheat gluten. The bulk of these wheat crops are used in the production of wheat flour for bread.

[141] Final Remedy Memorandum, EC-V-012, Mar. 4, 1998, at 20. In particular, see testimony of Charles Sullivan, Chairman and CEO of Interstate Bakeries Corp., in transcript of the injury hearing (Dec. 16, 1997) at 31-32:

> As the main consumer of wheat gluten perhaps in the whole world, we should be happy to buy it cheaper; in fact, we are not. We are worried. Worried that one day soon the only wheat gluten for sale will come from Europe. We do not know what the price then will be or how reliable the supply. We do not want the domestic gluten producers to go out of business.

[142] The petitioner asserts that the cost to purchasers would be borne solely by producers of bread and pet foods, but not by purchasing consumers. The petitioner asserted that an increase in the price of wheat gluten of 20 percent would result in an increase of a fraction of a cent per loaf of bread. Petitioner's Posthearing Brief on Remedy, at 54.

[143] Report at II-8.