BEFORE THE U.S. INTERNATIONAL TRADE COMMISSION

CERTAIN RIPE OLIVES FROM SPAIN

TESTIMONY OF THOMAS PRUSA

May 24, 2018

<<Slide – Prusa name >> Good afternoon. My name is Tom Prusa. I am Professor and Chair of the Economics Department at Rutgers University. I am here today to discuss some of the economic issues that are relevant for your deliberations.

The first issue meriting discussion is the conditions of competition. First and foremost, as Mr. Somers has just spoken about, the U.S. industry has a chronic inability to obtain a reliable supply of raw olives. Mr. Somers' presentation relied on public data, mostly produced by the USDA or by UC-Davis.

I will use a different source to discuss the raw olive supply shortage – Bell Carter's end-of-the year letters to its customers. Over a series of years Bell-Carter tells the tale of supply shortages and the reasons for the shortages. These letters are particularly instructive. This might be the only case I have been involved in where many of the

Respondent's main arguments are based on public statements by the Petitioner. In fact, Bell Carter's public letters are more revealing as to the domestic industry's problems than anything found in the Petitioner's 36 page legal brief.

<<SLIDE>> In a late 2015 letter Bell-Carter talks of insufficient supply. Let me quote Bell-Carter as to the reasons for the shortage:

"The increases are largely attributed to reduced acreage from growers converting their land from olives to more profitable nut crops. This is further compounded by the ongoing drought and increased labor costs."

Interestingly, neither labor nor the drought receive any attention in the Petitioner's brief.

<<SLIDE>> 2015 was hardly the only year Bell-Carter wrote about the small olive crop size. In 2014 Bell-Carter stated that the 3-year <u>average</u> harvest (i.e., 2011-13 period) was 24% lower than the annual consumption rate; and that the 2014 harvest projection was down

by 50%; Bell-Carter further stated that "*California table olive receipts equate to 38% of the annual ripe olive consumption*".

<<SLIDE>> In that same letter Bell-Carter spends a lot of time explaining how mother nature was creating a serious raw olive supply problem. In light of Bell Carter's numerous public statements on this issue and the dozens of press articles, it is remarkable that the Petitioner's brief only uses the terms "mother nature" and drought when describing the crop in Spain.

The Petitioner's brief would have one believe the effects of the California drought are irrelevant. By the way, the severity of the drought was even worse than Bell-Carter's letter stated. Public data sources indicate that the 2011-14 was the driest since records keeping began in 1895. Yet, Petitioner's brief considers it so inconsequential that they don't even mention it.

<<SLIDE>> As discussed in the Staff Report, olives are naturally an alternating type crop, meaning a large crop is usually followed by a small crop. Because year-to-year ripe olive demand does not vary like

supply, processors must hold inventory so as to insure their ability to deliver product to customers. As seen in the slide, this is exactly what Bell-Carter tells its customers in its 2014 letter. Notice that Bell Carter talks of "*adequate fruit inventories*". There is no mention of Bell Carter being burdened by excessive inventories. With respect to inventories, it is critical for the Commission to be aware that inventories must be held of a variety of sizes – for instance, jumbo, large, medium small as so on – and also whole, slice, diced, etc.

<<SLIDE>> In fact, the only other Bell-Carter letter where there was any mention of excess inventory levels was in 2012. As seen on the slide, as of the writing of the 2012 letter Bell-Carter spoke of its inventory levels being in balance. Other than the 2014 letter, which was displayed on the previous slide, I found no other letter where Bell Carter spoke about inventories.

<<SLIDE>> What I did find in Bell Carter's letters, however, was strong statements indicating its price leadership in the market. In effect,

Bell Carter's letter confirm what the Staff Report found when they surveyed purchasers on price leadership.

In every letter Bell Carter announced to its customers that it was raising its prices. The exact reasons vary from year to year. In 2012 Bell Carter speaks of tight supply due to the drought, in 2014 it mentions higher fruit acquisition costs, and in <<Slide>> 2015 Bell Carter specifically mentions grower costs. The basic theme is the same across the years – Bell Carter is able to raise its prices in response to rising costs. The pricing product data collected confirms what Bell Carter states in its letters – namely, that the domestic industry has consistently raised its prices throughout the period.

<<Slide>> The Petitioner's brief states that the table olive acreage now stands at less than 20,000 acres and that about 52,000 acres are actually needed to meet ripe olive demand. In other words, the Petitioner has told you that the U.S. crop can only meet about 1/3 of US demand.

<<Slide>> In its prehearing brief the Petitioner says that U.S. processors can import raw olives to make up the shortage. I found this curious as it contradicts that the Commission was previously told. For instance, in the petition they stated "*Imported raw olives cost about 30% more than California-sourced raw olives due to costs of transportation and packaging*".

<<Slide>> They also complained about the problems sourcing raw olives from import sources at the Staff Conference. On this slide I quote their lawyer who said the industry must rely on domestic raw olives. Mr. Carter described importing raw olives as a "stop gap" measure. As seen on the slide, Mr. Musco's views were even harsher. Given these statements, I was surprised to read in the prehearing brief these same people saying that importing tens of thousands of raw olives was part of their plan. This is just one of many contradictory and false statements in the Petitioner's prehearing brief.

<<Slide>> With respect to subject import volume, the record shows that on both an absolute and relative basis they have declined. In terms of tons, the decline was 6.4% over the POI.

<<Slide>> Subject imports as a percentage of U.S. consumption are also down slightly over the period.

<<Slide>> Let me now talk about pricing. In its preliminary determination in this case, the Commission stated that it did not find price suppression or depression of the domestic like product. The same determinations continue to be valid at the final stage. The price for each pricing product increased over the period. Furthermore, the Staff Report shows that the domestic industry was able to raise its prices by more than COGS.

<<Slide>> In the two products where the volume of imports from Spain was the greatest – products 3 and 4 – the prices charged by the domestic industry increased quite significantly. By contrast, in product 1, where the volume of imports from Spain was substantially lower than that of other pricing products, the domestic price increase was the least of the

four products. The domestic price changes at the individual product level reveals are inconsistent with what the Commission normally views as price impacts.

Of the retail products, product 1 is characterized by consistent overselling and product 2 is characterized by consistent underselling. However, so little Spanish product is sold in product 2 it can't be meaningful. I encourage the Commission to look at **Exhibit 21** where the import volume of product 2 is put into perspective.

<<Slide>> Another key pricing issue is the role of non-subject imports. As stated earlier, the domestic industry gained volume, market share, and raised its prices across the board. They did so not only competing against Spain but against other non-subject countries, most notably Morocco. In fact, when one looks at the data, it becomes clear that the nature of competition is really about the domestic firms having a decided home market advantage and import suppliers competing against each other. Mr. Somers depicted similar patterns in his report using

public data. As shown in Tables 3 and 4 of our prehearing brief, Morocco consistently undersells Spain.

<<Slide>> Under almost all the traditional metrics the Commission looks at the Staff Report shows no evidence of injury. Capacity, production, shipments, average unit values, productivity, and gross profit all show an industry that was not only not injured in 2015 but also is an industry that grew stronger over the period.

<<Slide>> The domestic industry pointed to operating income as indicators of subject imports causing material injury. That is a false conclusion. Let me explain why. The factor that explains the fall in income is the lost acreage. In **Exhibit 15** I perform a pro forma financial analysis based on the financial information the processors submitted to the Commission. I consider how much Bell Carter and Musco's financial performance would have changed had the U.S. acreage devoted to raw olives in 2014 remained constant. This is not the Petitioner's fantasy scenario where 52,000 acres are available. Rather, I consider a much more modest change. I simply imagine acreage is

stable at the level where it was shortly before the beginning of the period. This allows me to isolate the effect of lost acreage on the processors' bottom-line.

Using pricing and cost parameters reported to the Commission I calculate revised production of ripe olives using the same per-acre production ratio that existed in 2014. Variable costs are adjusted with the greater volume. Fixed costs are held constant. As shown on the slide, the analysis implies that stable acreage would have resulted in a dramatic increase in the domestic industry's operating profit; and, importantly, it would have meant an essentially flat profit performance over the period. Neither the price nor the volume of ripe olive imports from Spain matter. This is an acreage story.

<<Slide>> The Petitioner's discussion of capacity utilization is particularly puzzling. To begin with, capacity utilization increased over the period. Secondly, the capacity utilization is low for structural reasons. U.S. producers can only process ripe olives if raw olives are available. As Mr. Somers demonstrated, forces beyond domestic

producers' control limit the supply of domestically grown raw olives. More to the point, the limited availability of domestically grown raw olives has nothing to do with imports of Spanish ripe olives. The Commission must take the structural deficit of raw olives into account when evaluating the importance of reported capacity utilization and what it means for the domestic industry's ability to increase supply.

<<Slide>> I also want to comment on is the question of inventories. The Petitioner's discussion was very deceptive. In fact, over the three year POI inventories are essentially FLAT. If measured relative to production, inventories are down over the period.

The Petitioner describes inventories without context. How can the Commission conclude that the inventories are large without knowing what is normal? The data on the record shows that their current inventories are <u>not large</u> but rather are simply the norm for this industry.

If one looks back at the inventory data collected at the preliminary stage, one can see that inventories are down --- down markedly. And, if one recalls the Bell-Carter letter where it is said that inventories are in balance, one realizes that must also mean that today's inventory levels are normal. Finally, I note that public data collected by the California Dept of Agriculture confirms that current inventory levels are not elevated.

<<Slide>> The Petitioner's lost sales and revenue allegations are unfounded. The Staff report makes it clear that customers that chose to buy Spanish ripe olives rather than U.S. produced ripe olives, they did so for reasons unrelated to price. Availability, reliability of supply, product packaging, and quality were all cited.

Moreover, the Commission must recognize that not all purchasers are the same in this case. Some are quite large, many are quite small. As soon as the Commission considers the volume purchased by each customer, the lost sales allegations essentially disappear. The evidence is overwhelming that nearly all Spanish olives are being purchased for non-price reasons.

<<Slide>> Finally, on threat, it should be noted that ripe olive imports from Spain has been falling over the recent past. Compared to the prior

year, imports in 2017 decreased in absolute terms, and as a share of the U.S. market. As noted in the Staff Report, most ripe olives are sold pursuant to contracts of one year or longer. Contracts are negotiated in the 4th quarter of the preceding year. This means 2017 volumes were essentially determined in late.

<<Slide>> In terms of imminent threat, inventory levels of imported Spanish olives were lower at the end of the period. The available capacity in Spain is modest. And, there is no evidence that at anytime during the period has excess capacity in Spain resulted in import surges. Therefore, Spanish capacity is not likely to lead to surges in the future.

Finally, markets outside the United States for Spanish olives are growing faster than the U.S. market, creating less of an incentive to ship ripe olives to the U.S. market