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VIA MESSENGER

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Acting Assistant Secretary for Import Administration
Central Records Unit, Room 1870
U.S. Department of Commerce
14th Street & Constitution Avenue, NW
Washington, DC 20230

Re: Status of Ukraine as a Non-Market Economy Country Under the Antidumping and Countervailing Duty Laws: Rebuttal Comments

Dear Mr. Assistant Secretary:

The Ad Hoc Committee of Domestic Nitrogen Producers ("Ad Hoc Committee")[1] hereby submits rebuttal comments to the Government of Ukraine's submission to the Department requesting it to graduate Ukraine from a non-market economy country under U.S. antidumping law.[2] See Submission of the Embassy of Ukraine to Department of Commerce, May 10, 2005 ("GOU Submission"). As the Ad Hoc Committee demonstrated in its July 11, 2005 submission

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[1] The members of the Ad Hoc Committee are CF Industries, Inc., PCS Nitrogen Fertilizer, L.P., and Terra Industries, Inc.
[2] These rebuttal comments are timely filed pursuant to the Department's Notice of Extension of Rebuttal Comment Period, 70 Fed. Reg. 46813 (Aug. 11, 2005).

to the Department,[3] the Ukrainian economy does not yet sufficiently operate on market principles to permit the Department to utilize domestic prices and costs in its antidumping analyses. The additional information provided below in response to the GOU's submission reinforces the fact that it is premature for the Department to revoke Ukraine's non-market economy ("NME") status pursuant to Section 771(18) of the Tariff Act of 1930, as amended.

A. The Government of Ukraine's Continuing Control Over the Energy Sector Is Incompatible with Market Principles

The Department simply cannot ignore the fact that the GOU has failed to take even basic steps to reform Ukraine's energy sector along market principles. As discussed in the Ad Hoc Committee Submission (at 16-17 and 21-25), the GOU continues to exert substantial control over the energy sector, particularly the natural gas sector. Virtually all aspects of the gas sector, including production, transmission, exploration, and trading of natural gas, are controlled by Naftohaz Ukrayiny, which is Ukraine's largest company in the energy sector and remains under government ownership.[4] This sector is of critical importance to the Ukrainian economy, with Naftohaz Ukrayiny alone accounting for 15 percent of Ukraine's GDP and almost 20 percent of government revenues.[5] However, neither the GOU nor Naftohaz Ukrayiny have undertaken the necessary structural reforms to transition the gas sector to market principles; rather, the

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[3] Submission of the Ad Hoc Committee of Domestic Nitrogen Producers to Joseph A. Spetrini, July 11, 2005 ("Ad Hoc Committee Submission").
[4] See World Bank, "Ukraine: Challenges Facing the Gas Sector," at 3 (September 2003) ("Challenges Facing the Gas Sector"), available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEST/UKRAINEEXTN/0,,menuPK:328539~pagePK:141159~piPK:141110~theSitePK:328533,00.html.
[5] See Zeyno Baran, "Energy Reform in Ukraine: Issues and Recommendations," The Nixon Center (March 2005) at 9 ("Energy Reform in Ukraine"), available at http://www.nixoncenter.org/ukraine-energy.pdf ("Energy Reform in Ukraine").

government's gas pricing methodology does not take account of market values, gas continues to be priced at below-cost recovery levels, and the company is a major tax debtor.[6]

The Ad Hoc Committee Submission also discussed Ukraine's highly political and non-commercial dealings with Russia and Turkmenistan in the energy sector. Russia and Turkmenistan supply Ukraine with substantial imports of natural gas used to satisfy Ukraine's domestic demand.[7] These relationships are characterized by non-commercial pricing, such as Russia's arrangement to pay Ukraine for the transit of gas to the European market via Ukraine's pipeline system with in-kind transfers of gas at a price that is fixed according to political, rather than commercial, considerations.[8] As discussed in more detail below, such arrangements enable the Ukrainian government to supply natural gas to domestic industrial customers at non-market prices, and particularly to its export-oriented industries to enable them to compete in global markets. Further, this policy continues to distort prices and costs throughout the Ukrainian economy.

In fact, there is no indication that the GOU will restructure the natural gas sector in the foreseeable future, despite its purported commitment to furthering market reforms of the Ukrainian economy. Rather, Ukraine's natural gas purchases and sales continue to be characterized by politically negotiated prices, not market-based prices. For example, on July 17 Naftohaz Ukrayiny signed an agreement with Gazprom, the Russian energy giant, to continue their non-market natural gas arrangements, under which Gazprom will use Ukraine's gas transit pipelines to export approximately 85 percent of its total anticipated exports to Europe.[9] Russia

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[6] See Ad Hoc Committee Submission at 22.
[7] See id. at 23-25.
[8] See id. at 23-24.
[9] See Vladimir Socor, "A Short-Term Solution to Ukraine's Supply of Russian Gas," Eurasia Daily Monitor (July 19, 2005), available at The Jamestown Foundation website, http://www.jamestown.org ("A Short-Term Solution").

will continue to pay for transit services in gas valued at a fixed, non-market based price of $50 per 1,000 cubic meters.[10] This "compensation and discount" arrangement will guarantee Ukraine sizeable volumes of low-priced natural gas, which are substantially discounted compared to European market prices. Further, the GOU has requested Moscow to continue this arrangement into 2006, which will enable the GOU to continue to supply gas to the domestic market at below-market levels in the run-up to parliamentary elections scheduled for March 2006.[11] [12]

Ukraine's recently-signed contract with Turkmenistan to purchase natural gas is also one that enables Ukraine to supply below-market gas to its industries. Ukraine's previous gas purchase contract with Turkmenistan provided that Ukraine would pay for only half of the gas in cash, with the remainder paid for in goods and services, largely steel products and construction services.[13] Even with this barter arrangement and the below-market price paid for Turkmen gas of $44 per 1,000 cubic meters in 2004 and $58 per 1,000 cubic meters in 2005,[14] by June 2005 Ukraine had failed to pay for $562 million in cash and barter value for its gas purchases, most of which had been delivered in the first half of 2005.[15] In an effort to reduce the level of debt, the

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[10] Id.

[11] See id.

[12] This agreement was signed even though Russian President Vladimir Putin publicly accused Ukraine of stealing from its transit system and storing 7.8 billion cubic meters of Russian gas exports that were destined for European markets. After Ukraine finally acknowledged having the gas, the recent agreement reached a political resolution to this dispute by reducing by 2.55 million cubic meters the amount of gas that Gazprom will deliver to Ukraine in 2005 as the in-kind payment for transit services, and by permitting Ukraine to return the remaining 5.25 billion cubic meters in three installments during 2005-2006. See Vladimir Socor, "Ukraine's Reputation at Stake in Gas Trade With Russia," Eurasia Daily Monitor (July 5, 2005), available at http:www.jamestown.org ("Ukraine's Reputation at Stake"); "A Short-Term Solution."

[13] See "Ukraine Bends Market Economics for Energy Supply Diversification," Eurasia Daily Monitor (June 21, 2005), available at http://www.jamestown.org ("Ukraine Bends Market Economics").

[14] See Ad Hoc Committee Submission at 24. Turkmenistan raised the price in 2005 after it realized that the $44 per thousand cubic meter price was less than half the prevailing world market price. See "Energy Reform in Ukraine."

[15] See "Ukraine Bends Market Economics."

chairman of Naftohaz Ukrayiny even suggested that Ukraine could deliver steel to Turkmenistan at 2004 prices, thus attempting to manipulate the price of the gas even further.[16]

In spite of Ukraine's failure to pay its debt and its blatant efforts to politicize the existing contract, Turkmenistan and Ukraine signed a new contract on June 24 for a total of 59.5 billion cubic meters of natural gas through December 2006.[17] The new contract also fails to conform to market principles, as it provides that Turkmenistan will supply Ukraine with the majority of the gas, 48.5 billion cubic meters, for only $44 per 1,000 cubic meters.[18] This is the <u>same</u> below-market price that Turkmenistan charged Ukraine during 2004, before it raised the price to $58 per 1,000 cubic meters in January 2005.[19]

The discussion above highlights in stark terms the unwillingness of the GOU to adopt market principles in the natural gas sector. Moreover, the GOU is quite public about its desire to maintain its non market-based purchase arrangements with Russia and Turkmenistan, exemplified by the statements of Naftohaz Ukrayiny chairman Oleksiy Ivchenko and the GOU First Deputy Prime Minister Anatoly Kinakh during a June 21 news conference. Not only did these officials call for a continuation of the cash and barter gas purchase agreements with Russia and Turkmenistan, they also stated that Ukraine could not afford higher gas prices and that <u>Ukrainian industry, particularly the steel and chemical sectors, would not be able to compete in world markets if their production costs rose due to having to pay higher prices for natural gas.</u>[20]

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[16] <u>See</u> "Ukraine Bends Market Economics."
[17] <u>See</u> "Ukrainian-Turkmen Gas Agreement Brings Radical Change," Eurasia Daily Monitor (June 27, 2005), available at <u>http://www.jamestown.org</u> ("Ukrainian-Turkmen Gas Agreement").
[18] <u>See</u> "Ukrainian-Turkmen Gas Agreement."
[19] The remaining 11 billion cubic meters of gas will be supplied by Turkmenistan as payment for the services provided by Ukrainian companies for several major construction and infrastructure projects, and Turkmenistan has agreed to accept payment in goods for Ukraine's accumulated arrearages for past deliveries of gas. <u>See</u> "Ukrainian-Turkmen Gas Agreement."
[20] <u>See</u> "This Year, Ukraine's Gas Woes Begin Early," Eurasia Daily Monitor (June 22, 2005), available at The Jamestown Foundation website, <u>http://www.jamestown.org</u>. (emphasis added.)

Such statements reveal that the GOU's commitment to market-based reform takes a back seat to the goal of protecting its industries and ensuring their ability to secure export markets for their goods, even if that requires maintenance of blatantly non market-oriented policies.

These very recently concluded natural gas purchase contracts underscore the gulf between the Government of Ukraine's public rhetoric, in which it professes a commitment to market reform, and the reality, that it is simply not prepared to make the difficult choices required to transition the natural gas sector to market principles. Rather, the GOU continues to take the expedient route and prolong non-market based arrangements rather than reform the gas sector in order to advance the country's integration into the world economy.

This ongoing government interference will ensure artificially low domestic gas prices for the foreseeable future. These non-market prices will, in turn, continue to severely distort costs and prices throughout the e-conomy. These distortions have a particularly striking impact on the nitrogen fertilizer industry, where natural gas is not merely an energy source but the single most important material input, representing a significant proportion of total production costs. Under these circumstances, U.S. antidumping law cannot be applied meaningfully to calculate normal value using domestic gas prices.

Therefore, if the Department should decide to graduate Ukraine to market economy status – despite the overwhelming evidence that the Ukrainian economy does not operate on market principles – it must, at a minimum, make clear that it will not use domestic prices when they are not in the ordinary course of trade. The Department recognized the necessity of such a statement when it graduated Russia to market economy status, where it stated that energy prices

> remain a significant distortion in the economy, as they encourage the wasteful use (mis-allocation) of Russia's energy resources and slow the adoption of more efficient production methods. . . . While some market distortions and resource

> mis-allocation characterize most market economies, energy is of such significance to the Russian economy that continuation of the Russian government's current energy price regulatory policies may warrant careful consideration of energy price data in future trade remedy cases.[21]

The need for careful consideration of natural gas price data is equally critical in any trade remedy case involving Ukraine, given the utter lack of reform of the gas sector and the overwhelming evidence of severely distorted gas prices. Thus, if the Department graduates Ukraine, it should

> retain its authority to disregard particular prices or costs when the prices are not in the ordinary course of trade, the costs are not in accordance with generally accepted accounting principles, the costs do not reasonably reflect the costs associated with the production and sale of the merchandise, or in other situations provided for in the Act or the Department's regulations.[22]

B. The Government of Ukraine Has Not Demonstrated that the Ukrainian Economy Has Transitioned to Market Principles

In its May 10, 2005 submission to the Department, the Government of Ukraine primarily cited various laws and statistics that purport to demonstrate that the Ukrainian economy has transitioned to market principles. While the Ad Hoc Committee respectfully submits that the GOU has failed to demonstrate that the Ukrainian economy has made this transition under any of the statutory criteria, the sections discussing privatization and state control over allocation and prices are notably weak. For example, the GOU acknowledges that "[p]rivatization is an effective tool of development of structural, sectoral, investment, antimonopoly-competitive, budget, foreign economic and social policies."[23] The GOU then merely provides data on the number of enterprises that have been privatized, with no discussion of the government's policies

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[21] Memorandum to Assistant Secretary Faryar Shirzad from Jeff May, Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law at "The extent of government control over the allocation of resources and over the price and output decisions of enterprises" (June 6, 2002).
[22] Id. at Summary. See also Submission to Joseph A. Spetrini from DLA Piper Rudnick Gray Cary on behalf of Eramet Marietta, Inc., Comments on Status of Ukraine as a Nonmarket-Economy Country, at Comment III (July 11, 2005).
[23] GOU Submission at Section 4.

regarding privatization or any ongoing efforts to privatize remaining state-owned or controlled enterprises.

As the Ad Hoc Committee discussed in its July 11 submission, however, the GOU does not appear committed to privatization and even seems to be seriously contemplating the re-nationalization of the most valuable enterprises.[24] The Ad Hoc Committee is particularly concerned that Naftohaz Ukrayiny remains under complete state control, and to the best of the Ad Hoc Committee's knowledge, the GOU has no plans to privatize it. Thus, the natural gas sector will continue to be used as a tool of state policy rather than operating on market principles.

Similarly, when discussing the level of government control over the allocation of resources and prices, the GOU cites various provisions of the law governing business operations, provides statistics on small business growth, and asserts that the economy "functions under conditions of market pricing."[25] While the GOU notes that prices for certain goods and services, including those "produced or provided by natural and artificial monopolies," including fuel and energy, are subject to state regulation, it provides no additional information that would enable the Department to evaluate the policies behind these price controls, the level of controlled prices and how they are determined, whether the controlled prices have any relationship to actual market prices, the effect the price controls have on the economy as a whole, or whether the GOU has any plans to phase out these price controls.[26] As the Ad Hoc Committee has demonstrated, however, the GOU continues to be heavily involved in setting prices in the energy sector,

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[24] See Ad Hoc Committee Submission at 14-16.
[25] GOU Submission at Section 5.
[26] Id.

particularly the natural gas sector.[27] These government distortions of the marketplace render graduation inappropriate at this time.

Moreover, the GOU has not shown that the Ukrainian economy is sufficiently open to foreign investment. The GOU asserted in its May 10 submission that "Ukraine has certain advantages for investors," including a "capacious consumer market... basic industrial infrastructure... {and} a legislative base."[28] The GOU also cites various foreign investments in Ukraine and statistics on foreign investment in order to demonstrate that Ukraine has established a favorable climate for foreign investors.[29] However, as discussed in the Ad Hoc Committee's Submission, foreign investors have not shown that they concur with this assessment, as per capita foreign direct investment was only $140 in 2004, one of the lowest levels in the region.[30]

The continuing reluctance of foreign investors to participate in the Ukrainian economy was recently highlighted during an economic roundtable hosted by the GOU in June. Many participants expressed concern that President Yushchenko and his government have wasted the opportunities presented by their dramatic rise to power to introduce economic reforms. As one participant said, "speeches are great, but big businessmen want to see things happen on the ground level."[31] The roundtable participants drafted a ten-point "Action Plan" to increase foreign investment in Ukraine and urged its adoption by July 1, but rather than embracing market

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[27] See Ad Hoc Committee Submission at 21-25 and the discussion above.
[28] GOU Submission at Section 3.
[29] See id.
[30] See Ad Hoc Committee Submission at 11.
[31] "Ukrainian Economic Roundtable Fails to Convince Investors," Eurasia Daily Monitor (June 29, 2005), available at http://www.jamestown.org ("Ukrainian Economic Roundtable").

reforms, the Ukrainian parliament has repeatedly failed to adopt legislation necessary to reform the economy and bring it into compliance with international norms.[32]

Indeed, a key political ally of President Yushchenko has admitted that foreign investment is "slower than we hoped" and "[t]he majority of investors don't like the political situation too much."[33] In addition, the president of Kiev's American Chamber of Commerce has said that the GOU has sent contradictory signals about its commitment to reforming the economy that have confused the business community, and that "[w]hat we'd really like to hear is a reaffirmation that the government will have an organized and consistent dialogue with the private sector."[34] Rather than working with the private sector to improve the economy, however, the GOU has sent negative signals to the business community in recent months by imposing some price controls, making contradictory statements about privatization and re-privatization, raising some taxes on businesses, suddenly removing all rights under free trade zones, and dramatically increasing public expenditures for wages and pensions.[35] In short, rather than adopting policies and legislation to encourage additional foreign investment, the GOU has recently created an atmosphere that discourages foreign investors from operating in Ukraine.

C. Conclusion

The weakness of the GOU's submission accentuates the fact that the economy of Ukraine simply has not made sufficient strides in the transition to market principles for the Department to consider graduating Ukraine to market economy status at this time. Rather, the Ukrainian government must undertake significant structural reforms to further transition the economy to

[32] See "Ukraine Parliament's No Vote a Major Setback Regarding Possible New Major International Trade Agreements," June 13, 2005, available at http://www.unian.net/eng/news/print-77817.html ("Ukraine Parliament's No Vote"); "Ukrainian Economic Roundtable."

[33] "Ukraine's Political Change Unnerves Investors," June 15, 2005, Financial Times, London, available at http://www.unian.net/eng/news/print/77998.html ("Ukraine's Political Change").

market principles before domestic prices and costs will be reliable measures of normal value under U.S. antidumping law. The Ad Hoc Committee further respectfully emphasizes that the Department must very closely examine the energy sector, in particular the natural gas sector, in its analysis and recognize the distorting effects of the GOU's continued ownership control and involvement in the sector. Therefore, if the Department decides to graduate Ukraine to market economy status, it must recognize the need to disregard costs and prices that do not reflect market principles in its antidumping analyses.

The original and six copies of these comments, along with a CD-Rom version, are hereby submitted to the Department. Electronic addresses for supporting documentation are provided in the citations. The Ad Hoc Committee would, of course, be pleased to provide hard copies upon request.

Respectfully submitted,

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[34] Id.
[35] See "Ukraine Parliament's No Vote."