

Free and Fair Trade for Copper Scrap

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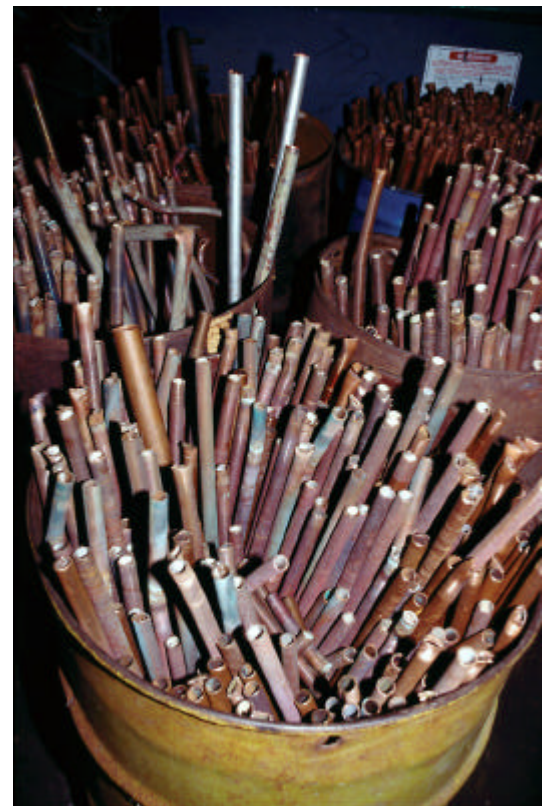
-- Joseph L. Mayer, President
Copper & Brass Fabricators Council, Inc.
November 4, 1987

Summary

The U.S. copper and brass industry is facing a number of problems; however, copper scrap supply is not one of them. The concern over currently high copper prices (cathode and scrap) is only one small part of the industry's larger problem, and one that the market will correct on its own, based on well-documented historical evidence. As with any "quick fix," export controls will not address the larger problem and could very well cause additional harm.

For the record:

- There is no shortage of available copper scrap.
- Export controls are not needed and are counter to overall U.S. trade policy.
- Exports are vital to the US trade balance and restricting such exports would eliminate the market for a large portion of copper scrap that is not, and likely cannot be, used domestically.
- In 2003, copper scrap made a positive contribution to the balance of trade exceeding \$716 million.
- Copper is a global commodity. Thus, prices, which are based on international markets, would not be lowered by export controls and could be forced higher.
- Traditional market volatility suggests the current price peak will soon be followed by a price trough.
- The domestic copper and brass industry infrastructure has dramatically changed over the last ten years. The secondary smelting industry has all but disappeared from the U.S., primarily because of environmental and other regulatory concerns, resulting in significantly diminished production capacity.
- There are more appropriate, longer term remedies that ISRI would support to address alleged unfair trade practices.



Introduction: An Industry in turmoil...

By most measures, the domestic copper industry is struggling. For many decades, ever-increasing financial, regulatory, and global market challenges have all but wiped out certain segments of the industry while other parts of the industry have felt the financial strain of competitiveness. The last several years have been particularly troublesome, and worrisome, for primary copper producers, secondary producers, manufacturers and consumers of brass mill products, and scrap recyclers.

Published statistical and financial data confirms that the market participants that make up the majority of this industry have not participated uniformly in the recent economic recovery that most economists believe began in late-2001.

The percentage of copper recycled in the US, and hence its contribution to total copper supply, has also continued to trend lower. According to the London-based Commodities Research Unit, Ltd (CRU), the percentage of copper recovered from scrap in 1998 was 36 percent while during the 1980s it was 47.9 percent. The decline, they note, was a reflection of changes in copper end-use applications, developments within the US secondary industry, falling prices for copper scrap and cathode, and tighter environmental restrictions.¹ Although the above dates offer a convenient reference point, and some perspective, the issues that continue to negatively affect these important U.S. industries in 2004 have much deeper roots.

Identifying and correcting potential solutions to the industry's woes has taken on a degree of urgency. However, history has shown that "quick fixes" to complex problems never work.

Export controls on copper and copper alloy scrap recently proposed by certain copper industry segments are a prime example of an unworkable quick fix. This poor choice of industry remediation aims its guns at the scrap processing industry that, in any circumstance, reflects only a small fraction of the problems faced by the domestic copper industry in general, and the nations' brass mills in particular.

From the standpoint of supply, export controls are simply not needed. Supplies of the grades of scrap used by the domestic copper industry are readily available to meet the industry's needs. No company at the scrap processing or scrap consuming side has been denied copper-bearing scrap. In fact, many scrap processors are experiencing delays in shipping appointments.

Hence, it appears that the issue in question is one of price rather than supply. Using export controls as a means of price control is, at best, an unnecessary departure from accepted U.S. trade policy. At worst, there is evidence that export controls could cause greater industry harm, not only to the domestic copper and brass industry but, potentially, to U.S. consumers of finished products as well.

Scrap Has Been Diverted From Domestic Smelters to the Overseas Market Due to Capacity Shutdowns. The Demise of an Industry...

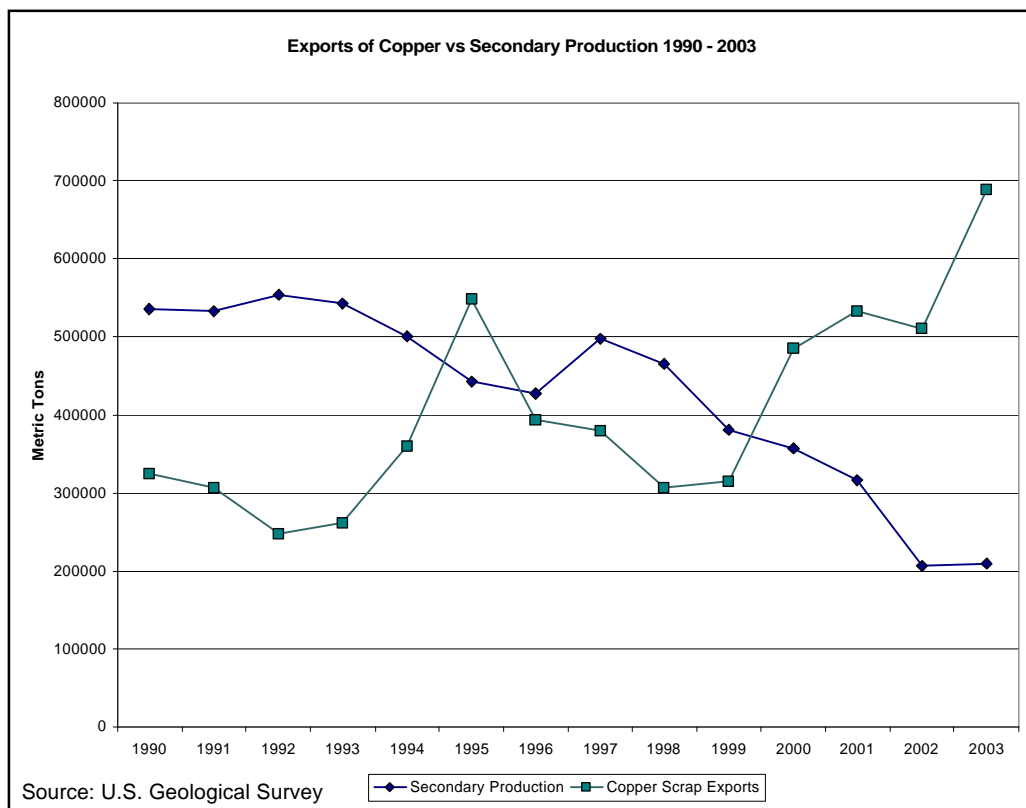
The secondary copper smelting industry has all but disappeared from the United States over the past 10 years (see table below). There are no independent secondary smelters operating in this country anymore. As noted by the Copper Development Association (New York City), "Lower copper prices and higher environmental costs over the past several years have created a cost squeeze that contributed to the closure of all U.S. secondary smelters and associated electrolytic refineries." The total annual amount of capacity that has been lost since the mid-1990s is estimated to be 443,000 tons.

¹ Secondary copper production worldwide declined 25% in the period between 1995 and 2003.

Today, the secondary processing industry consists of fire refiners, ingotmakers, brass mills, foundries, chemical plants and other manufacturers. For feedstock, these industries purchase and consume prompt/industrial scrap (sometimes called "new" scrap) as well as obsolete material (otherwise known as "old" scrap).

The demise of domestic secondary smelters has eliminated a significant portion of the domestic market for obsolete scrap, leaving this material with only two appreciable means of disposition: export markets or domestic landfills. The export market has, historically, been an important outlet for U.S. obsolete scrap. The growth in the export market in recent years reflects *both* global demand and, significantly, the lack of domestic secondary smelters to consume scrap for processing of products useful to domestic mills.

U.S. Secondary Copper Industry Closures (1994 - 2001)			
Company	Location	Capacity (tons per year)	Closed Date
Gaston Recycling Ind.	South Carolina	110,000	1994
Franklin Smelting & Refining	Pennsylvania	18,000	1997
Cerro Copper Products	Illinois	40,000	1998
Southwire	Georgia	140,000	2000
Chemetco	Illinois	135,000	2001
Total lost capacity		443,000	



History clearly shows the *decline* in domestic secondary production has been followed by a corresponding *increase* in copper scrap exports. As domestic smelters shuttered their operations, more and more of this low-grade material found its way to export markets in general, and to China in particular.

Supporters of copper scrap export controls point to the rising level of exports over the past 13 years. In fact, copper scrap exports reached 689,000 metric tons in 2003, an all-time record. However, the vast majority of the scrap earmarked for offshore consumers is so-called No.2 and lower grades of

copper-bearing materials - the very same materials that used to be consumed by the now-nonexistent domestic secondary smelting industry. This lower grade copper includes such materials as electric motors, copper brass castings, sheet copper, gutters, bus bars, insulated copper wire, and radiators to name a few, items for which copper recovery is labor-intensive or otherwise not cost effective to process. The recoverable copper content generally ranges from around 15% to percentages in the high 90s. High grades of copper scrap, such as chopped copper wire, are also sometimes exported.

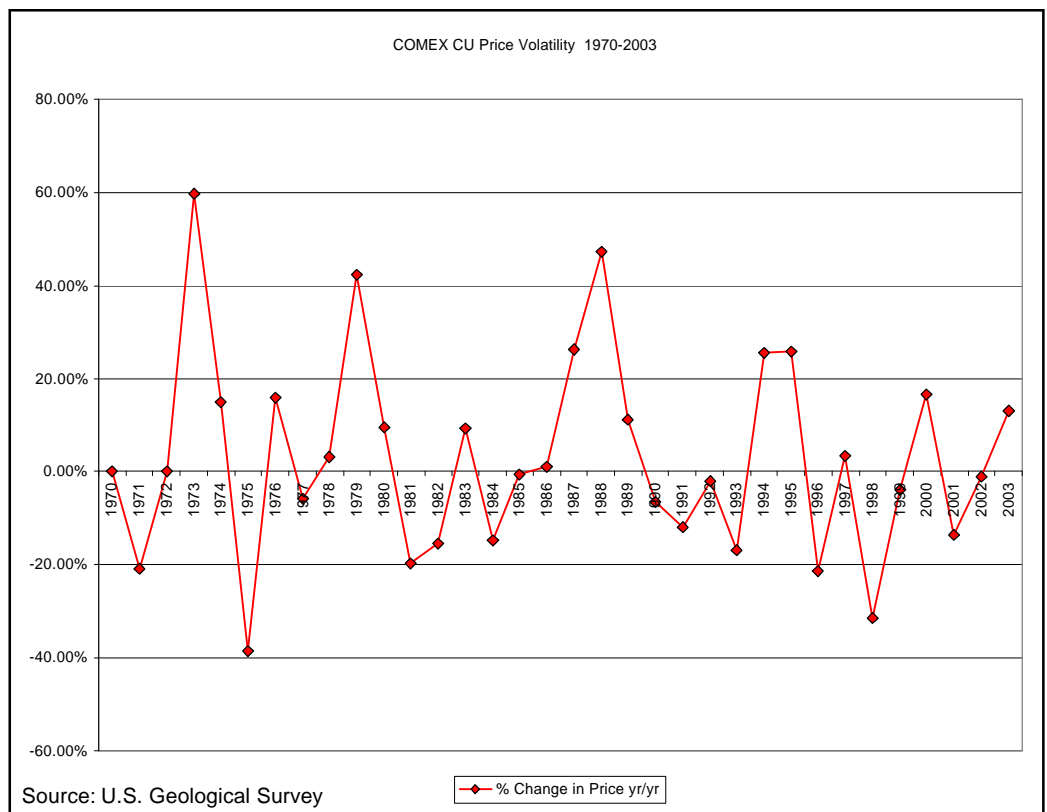
Note that the petitioners concede that, while they would arbitrarily reduce the flow of scrap to export markets, they have no valid way of knowing whether the amounts of detained material could, or would, be used by domestic brass mills as an acceptable feedstock. If indeed the material were not consumed domestically, the effect on the scrap recycling industry would be immediate and devastating, with significant yard closures and job losses. Furthermore, decades of environmental protection activities would be jeopardized, as this material would no longer be recycled.

Where Is The Evidence To Show That A Physical Shortage Exists? Isn't It All About Price?

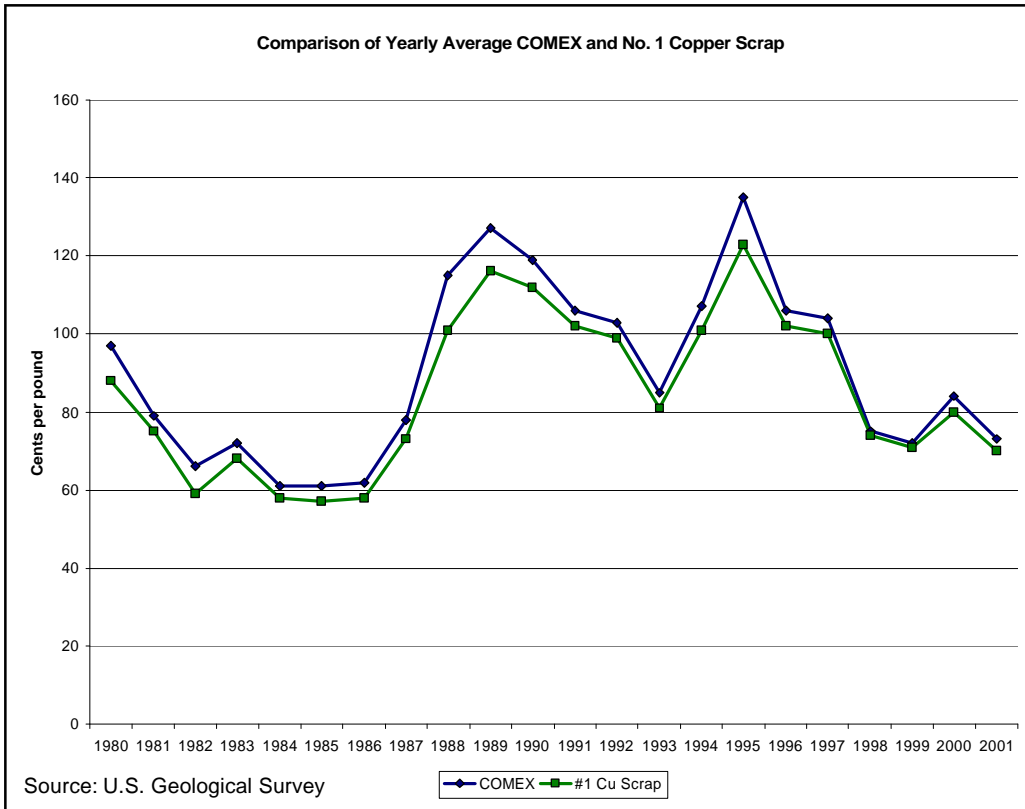
There is no evidence of a scrap shortage in copper and copper alloy scrap. In fact, many processors are reporting that mills are delaying receipt of purchased scrap due to excess inventories of raw materials at the mills. The lack of evidence of an actual shortage of copper scrap suggests the export control petition is simply a smokescreen to control the price of scrap, rather than a legitimate attempt to address a supply availability problem.

Copper prices are highly cyclical and volatile in nature, subject to global fundamental supply/demand considerations, as well as to speculative influences of commodity hedge funds and commodity trading advisors. And while, over time, most would argue that copper prices tend to reflect true global fundamentals, short-term factors do come into play that can temporarily distort the market.

The price of copper can be extremely volatile. One classic example includes a period in the mid-1990s when a rogue copper trader from the Sumitomo Corporation was credited for the price gyrations that were apparent during that time. Other examples can be found in the 1973-74, when export controls were placed on certain metal commodities, in 1979-1980, when a petition for copper export controls was threatened, as well as in the late 1990's through 2001, when low prices were attributed in part to the Asian economic crisis and to large above-ground stocks built up earlier. As can be seen, copper price peaks are soon followed by price troughs -- most of which reflect the market dynamics of the time period in question.



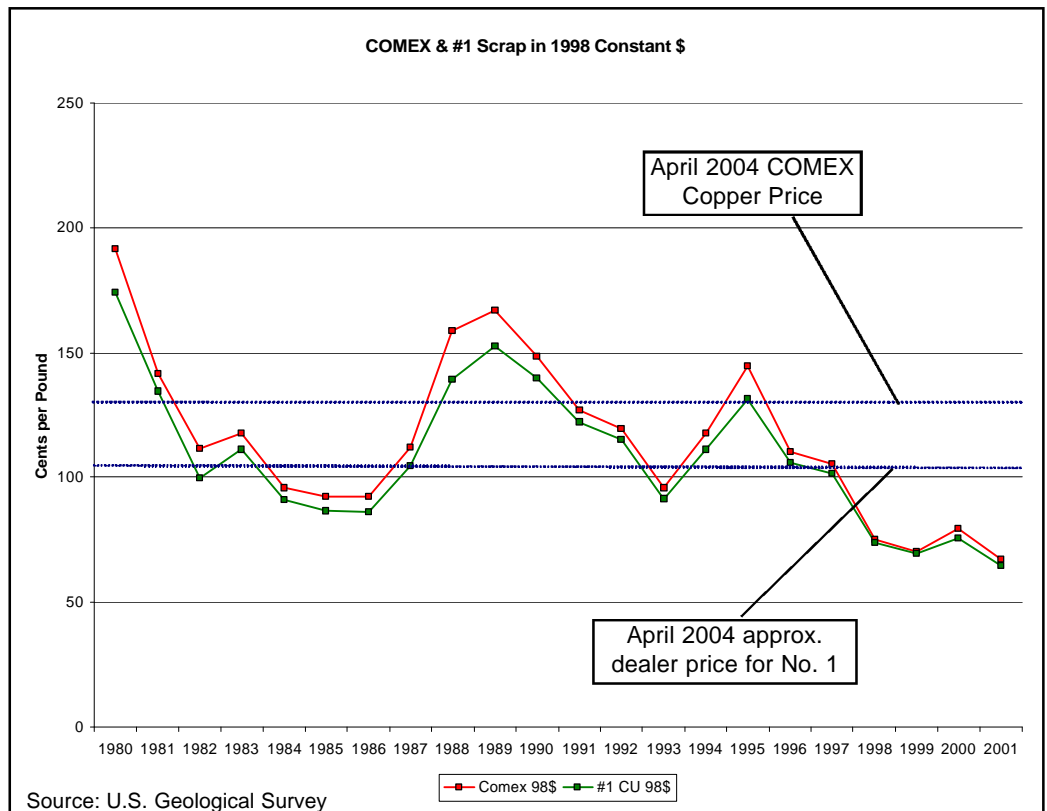
Generally speaking, brass mills and other scrap copper consumers offer prices for scrap copper based upon a discount to the spot price of copper on the COMEX division of the New York Mercantile Exchange.



Depending on short-term market fundamentals, however, certain grades of scrap (e.g., "bare bright" copper) can and do occasionally command premiums to the COMEX quotations. However, this is the exception. The price of obsolete copper scrap, so-called No. 2, also correlates to the COMEX price, but at a greater discount, and accurately trends with market dynamics. Premiums are also paid above the prevailing spot COMEX price for copper cathode. Depending on current market conditions, these premiums can range from a penny or two above the spot price to five cents or more. As an example, cathode premiums in April 2004 were reportedly fetching seven cents above the COMEX spot market.

A better indication of the health of the market is the spread between #1 and cathode, NOT #1 and COMEX. Scrap is used by brass mills as a substitute for cathode. Thus, as the spread between cathode and #1 widens, brass mills use more scrap. Conversely, as the spread narrows, the mills are more likely to use cathode. Scrap copper plays virtually no role in the pricing of cathode. However, cathode pricing plays a tremendous role in the pricing of scrap copper. Currently, cathode is in a global short-supply, which accounts for copper prices that are approaching record highs.

In absolute numbers, today's prices for copper and copper alloy scrap are not unprecedented.



While price volatility is always present, both buyers of scrap and sellers of brass mill products have at their disposal the means to hedge their respective metal positions as a means of prudent risk management. Hedging metal exposure should be a routine exercise for the domestic brass mill industry as it has proven to be an effective way to mitigate the volatility in COMEX prices described above. We assume many brass mills do hedge and are therefore able to control their risk in long term contractual situations.

Copper Is A Global Commodity. Cathode Prices Set The Standard And Price References...

The petitioners suggest domestic copper prices, as expressed on the New York and London commodity exchanges, are at their present levels because of the so-called "shortage" of domestically generated copper bearing scrap. We find it implausible to suggest that domestic scrap prices are driving the global copper market when virtually all available independent research indicates that transacted prices on both exchanges are responding to a statistical *world shortfall of copper cathode* when matched against the total available refined supply of material and the increases in global demand being forecast for copper. Speculative activity has also added to the upward price pressure.

To date, there has been no demonstrable "shortage" of domestic copper bearing scrap. Further, historical evidence shows that high prices tend to bring more metal scrap to the market, rather than less. Hence, the petitioners' representation that a failure to impose export controls could result in shortages of copper bearing scrap are simply unsupported by the data. In fact, the only support for petitioners' contentions is the speculations of mostly unidentified "traders" and "analysts" in trade publication news articles. These unidentified "authorities" should be given all the consideration they deserve: none.

In sum, copper's *global* fundamental picture must first be taken into account before any conclusions can be made concerning the prices paid for prepared scrap by a domestic brass mill. Given the current underpinnings that are supporting COMEX price, and the premium structure that is currently in place for cathode, and the market's traditional ability to regulate its own supply and price, any attempt to artificially restrict world copper supplies at this point in time through domestic export controls, whether one is referring to copper scrap or cathode, would only exacerbate the price reaction on the world market.

Brass Mills Have Their Own Unique Structural Problems: Rising Costs, Imports, Material Substitution (To Name A Few)

As noted at the outset, the domestic copper industry is struggling, and the brass mill industry has suffered due to cost pressures resulting from governmental regulation, cathode availability, environmental controls, and increased competition in their finished product from other domestic industries, as well as overseas markets. Domestic brass mill rationalization has been an on-going feature. The industry's contraction began more than 25 years ago.

In addition, the industry has faced increased competitive pressures from imports of brass mill products as well as product substitution. Imports of brass mill products in 2000 hit a record 784 million pounds while brass mill exports have declined.

Unintended Consequences: "Control Reversal" Examined

To support the above-mentioned concern that the implementation of scrap export controls could harm the domestic industry, we refer to a 1977 study that reviewed the after-effects of the scrap export controls that were placed on iron and steel scrap during the 1973 - 1974 period. The research revealed that, during that

time frame, scrap values actually spiked higher than they would have had the market been left alone. The restrictions on supply created what the author attributed to "control reversal" - a somewhat counter-intuitive consequence, or phenomenon, that reveals a result opposite of the original intent. It is our contention that a similar outcome (*i.e.*, higher copper scrap prices) could very well result should the free market in copper scrap trade be arbitrarily restricted.

As a corollary to the above, ISRI also believes that withholding several hundred thousands tons of copper scrap from the global marketplace would only exacerbate an already supply-tight world refined copper market in 2004 (and beyond), resulting in increased speculation and "panic buying" for the limited available copper units. Higher copper prices, as expressed on the world market (LME and COMEX), would logically follow as manufacturers scramble for refined cathode and copper-bearing scrap substitutes. Since the U.S. is also dependent upon imports of copper-containing products, the resultant higher prices would logically be passed on to the domestic consumers of finished copper and brass goods. As stated above, the US remains a significant net importer of brass mill products.

It is interesting to note the problems caused by export controls imposed by other countries.² Their effect has been to decrease supply globally. While still not creating a supply shortage, they have resulted in increased global demand for US copper scrap. The US government would be better served working with these other governments to remove barriers to free and fair trade rather than to impose additional artificial market barriers.

Better Remedies In Support Of Free and Fair Trade

There are likely other more appropriate trade remedies available to address the petitioners' multi-faceted problems. For instance, if petitioners can substantiate with data that any unfair trade practices are occurring with any nation, ISRI would support efforts to address these grievances. Although ISRI has several members in common with the petitioners, we do not possess the data necessary to initiate an action such as a 301 trade petition. If petitioners were to undertake such an action, ISRI would be supportive of their action.

Finally, it should also be noted that the very petitioners for the control of U.S. scrap in 2004 vigorously opposed similar restrictions that were placed on the exportation of copper, copper alloy and zinc scrap by certain countries in the European Community in 1987.

We note this from a 1987 letter to leaders of ISRI: "*We do not in any way wish to restrict the activities of the U.S. scrap industry, and in fact, feel that ending distortions in the world scrap market caused by foreign export restrictions will benefit the scrap industry as well as scrap consumers.*"³

We could not agree more.

² For example, Russia's export of copper scrap went from 357,000 tons in 1998 to 19,000 tons in 2000 due to new export duties.

³ Joseph L. Mayer, then and present President, Copper & Brass Fabricators Council, Inc., November 4, 1987.