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July 17, 2002

PUBLIC DOCUMENT

Case No. A-823-812
Total Pages: 14, plus
1 Exhibit and 1 diskette

VIA MESSENGER

The Honorable Donald L. Evans
Secretary of Commerce
Attn: 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

Dear Mr. Secretary:

The Ad Hoc Committee of Domestic Nitrogen Producers ("Ad Hoc Committee") hereby submits rebuttal comments in response to the Department's Notice of Opportunity to Comment on the Status of Ukraine as a Non-Market Economy Country, 67 Fed. Reg. 19394 (April 19, 2002).[1] In its comments submitted on June 17, 2002, the Ad Hoc Committee presented evidence that Ukraine has not sufficiently transitioned to a functioning market economy to warrant

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[1] The members of the Ad Hoc Committee are CF Industries, Inc., El Paso Corporation, Mississippi Chemical Corporation, PCS Nitrogen, Inc., and Terra Industries, Inc.

revocation of its non-market economy ("NME") status under U.S. antidumping law. In sectors such as energy and agriculture, Ukraine continues to operate under the legacy of Soviet-era control, which insulates these critical sectors from demand and supply conditions that generate market-based prices. As such, costs and prices in Ukraine do not reflect meaningful measures of value, a necessary prerequisite for revocation of the NME designation. Simply put, it is premature for the Department to graduate Ukraine to market economy status.

The parties advocating revocation of Ukraine's NME status have cited various laws, decrees and other factors to support their position that the Ukrainian economy now functions as a market economy. However, the Department determined in 1997 that the Ukrainian economy "did not qualify" as a market economy[2] and, as the Ad Hoc Committee demonstrated in its June 17th comments and will discuss further below, it is abundantly clear that since then, Ukraine has made only desultory progress in reforming its economy. Indeed, Ukraine has made minimal progress in several important respects, including addressing the hostile environment for foreign investors and the unevenness of its privatization efforts, which the Department cited in 1997 as among the factors that demonstrated that the Ukrainian economy was not functioning as a market economy.[3]

Despite the great potential wealth of the country, in terms of vast stretches of extremely fertile agricultural land, broad-based industrial infrastructure, and a well-educated population, the economy has floundered as opponents of economic liberalization have impeded reform.[4] The Ukrainian government has failed to display a sustained commitment to economic reform and,

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[2] Final Determination of Sales at Less Than Fair Value: Certain Cut-to-Length Carbon Steel Plate from Ukraine, 62 Fed. Reg. 61754 (Nov. 19, 1997).

[3] See id. at 61756.

[4] See, e.g., Freedom House, Nations in Transit 2001 at 393, *available at* www.216.119.117.183/research/nattransit/htm.

despite recent enactment of laws intended to further the transition to a market economy, it remains to be seen whether the government has truly embraced market principles and has the will to undertake real market-based economic reforms. As a result, Ukraine falls significantly short of the mark on several critical indicia of an economy operating under market principles. Ukraine must make much more progress toward a market economy before U.S. antidumping laws can operate meaningfully using market economy methodologies.

This submission identifies the critical issues that make it overwhelmingly clear that Ukraine does not merit revocation of its non-market economy status at this time.[5] Most importantly, continuing government involvement in the pricing and distribution of natural gas distorts production and the allocation of resources to an extent incompatible with a market economy. In addition, the government retains considerable control over the agricultural sector because land reform is far from complete. Further, privatization in Ukraine has been slow and lacking in transparency, which has contributed to extremely low levels of foreign direct investment. Finally, the Government of Ukraine has failed to fundamentally restructure the economy since independence, and the pace of reform is unlikely to proceed more quickly in the foreseeable future. The record before the Department simply fails to provide evidence to the contrary.

1. The Government of Ukraine Remains Significantly Involved in Pricing and Resource Allocation in the Energy Sector

Despite the claim of the Ukrainian Association of the Enterprises of Ferrous Metallurgy ("Ukrapchormet") that "pricing in the energy sector. . . [is] now subject only to the supply and

[5] There is substantial evidence already on the record discussing Ukraine's lack of reform under each of the statutory criteria. See the Ad Hoc Committee's June 17, 2002 submission; Bethlehem Steel, National Steel Corp., and United States Steel Corp. June 17, 2002 submission; and Co-Steel Raritan, Inc., GS Industries, Keystone Consolidated Industries, Inc., and North Star Steel Texas, Inc. submissions of Dec. 21, 2001 and March 13, 2002.

demand market mechanisms,"[6] the Government of Ukraine continues to exert extensive control over the pricing and allocation of energy. As discussed in the Ad Hoc Committee's June 17th submission, Ukraine purchases the vast majority of its imported natural gas from Russia at far less than Russia's normal export price.[7] Russia has been supplying approximately 65 percent of Ukraine's natural gas at a price, according to the U.S. Energy Information Agency, that was one-third the normal export price of Russian natural gas.[8] In June 2002, the Russian and Ukrainian governments extended this arrangement.[9] Under the terms of this recent agreement, Russia has committed to transporting gas to Europe via Ukrainian pipelines through 2013 and selling gas to Ukraine for about $50 per thousand cubic meters;[10] that is, for the same low price that the EIA reported is only one-third of Russia's normal export price.[11] In addition, although the agreement establishes a transit tariff of $1.09 per thousand cubic meters, the chairman of the board of Naftogaz Ukrainy, Ukraine's state-owned oil and gas company, has indicated that Ukraine preferred to receive payment in the form of gas rather than cash.[12] Finally, Ukraine's gas pipelines will not be privatized but will remain under government control, according to Ukrainian Prime Minister Kinakh.[13]

Thus, rather than ensuring that natural gas is priced according to market forces, this agreement merely continues the non-market based conditions of Ukraine's trading relationship in

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[6] Ukrapchormet June 13, 2002 submission at 19.

[7] Ad Hoc Committee June 17, 2002 submission at 20.

[8] See Ukraine Country Brief, U.S. Energy Information Administration (Sept. 2001), *available at* www.eia.doe.gov/emeu/cabs/ukraine.html.

[9] See "Russia, Ukraine to Control Gas Transit," Russia Journal (June 6, 2002), attached as Exhibit 1.

[10] See id.

[11] See Ukraine Country Brief, U.S. Energy Information Administration.

[12] See "Russia Annual Gas Transit Via Ukraine Seen at 110 bcm 2003-2013," Prime-TASS (June 5, 2002), *available at* www.ingfn.com.ua.

[13] See "PM Kinakh: Gas JV with Russia Not to Privatise Ukraine's Pipelines," Prime-TASS (June 20, 2002), *available at* www.ingfn.com.ua.

gas with Russia. The fact that Ukraine purchases the vast majority of its natural gas supply at a price that is not determined by the market distorts the economy as a whole since industrial users have access to non-market priced energy. Indeed, the Ukrainian government was recently considering whether to sell gas to nitrogen fertilizer producers at the even lower price of $32 per thousand cubic meters.[14] As noted by the Department, state intrusion in the purchase and sale of natural gas at non-market prices is a "significant distortion in the economy" that encourages "the wasteful use (mis-allocation) of . . . energy resources and slows the adoption of more efficient production methods."[15] This is particularly troublesome, since gas is the primary feedstock in the production of nitrogen fertilizers and the fertilizer industry in Ukraine is a significant exporter to the U.S. and other markets.[16] Because these conditions would render the Department's market economy methodology meaningless in any antidumping investigation of nitrogen products, Ukraine's graduation is inappropriate until the price of natural gas and other energy resources is market driven.

All indications are that the needed reform of the natural gas sector, and the energy sector in general, is not likely to occur in the near future. The Ukrainian government has not displayed

[14] See Ad Hoc Committee June 17th submission at 21.

[15] Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law, Department Memorandum (June 6, 2002), at 42 (hereinafter "Russia NME Memorandum").

[16] This distortion is evidenced by the antidumping duty measures against nitrogen fertilizer products from Ukraine in both the United States and European Union. See Antidumping Duty Order: Solid Agricultural Grade Ammonium Nitrate from Ukraine, 66 Fed. Reg. 47451 (Sept. 12, 2001); Continuation of Antidumping Duty Orders: Solid Urea from Belarus, Estonia, Lithuania, Romania, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan (64 Fed. Reg. 62653 (Nov. 17, 1999); Council Regulation (EC) 92/2002, O.J. L 17/1, 19 January 2002, imposing definitive antidumping duty on imports of urea from Belarus, Bulgaria, Croatia, Estonia, Libya, Lithuania, Romania, and Ukraine; Council Regulation (EC) 132/2001, O.J. L 23/1, 25 January 2001, imposing definitive antidumping duty on imports of ammonium nitrate originating in Poland and Ukraine; Council Regulation (EC) 1995/2000, O.J. L 238/15, 22 September 2000, imposing definitive antidumping duty on imports of solutions or urea and ammonium nitrate originating in Algeria, Belarus, Lithuania, Russia, and Ukraine. In addition, the Department is currently investigating imports of urea ammonium nitrate from Ukraine. See Initiation of Antidumping Investigations: Urea Ammonium Nitrate Solutions from Belarus, Lithuania, the Russian Federation, and Ukraine, 67 Fed. Reg. 35492 (May 20, 2002).

a commitment to reforming the energy sector. The International Monetary Fund stated that energy sector reform during 2001 fell behind the planned pace and that further reform is still required.[17] The Economist Intelligence Unit also has chronicled a number of factors that signal the government's reluctance to undertake needed reform. For example, reform of the electricity, coal and gas sectors has slowed "noticeably" under the leadership of the current prime minister as compared to the previous cabinet. The current government has "at times voiced strong reservations about energy privatisation and reform, including statements by the newly appointed fuel and energy minister, Vitaly Haiduk, that he is not in favour of radical reforms in the energy complex."[18] The government is even apparently willing to risk scaring off strategic investors, as shown by its reluctance to fulfill its contractual obligations to raise electricity prices, as required by the terms of the privatizations of regional energy distributors that occurred in early 2001.[19]

In addition, Prime Minister Kinakh "announced coal sector policies in September 2001 that are diametrically opposed to the World Bank's recommendations" by refusing to close inefficient mines and continuing the substantial subsidies to the sector.[20] Although a sizable reform-minded bloc currently exists in parliament as a result of the March 2002 elections, the reformers constitute only about a quarter of the members.[21] Reforms will be impeded by a parliamentary bloc of approximately equal size that represents business groups from major industrial areas that "will further entrench vested industrial sector interests."[22] The EIU's assessment is that "progress will be gradual at best. . . in particular {in} the all-important energy

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[17] See "IMF Urges Financial, Energy Reforms in Ukraine," Reuters (May 11, 2002), *available at* www.ingfn.com.ua.
[18] "Mixed Progress with Energy Reform," EIU Viewswire (Jan. 18, 2002).
[19] See id.
[20] See id.
[21] See "Investors' Watch-list: Ukraine After the Election," EIU Viewswire (Apr. 12, 2002).
[22] Id.

sector, which will remain opaque and inefficient while other favoured industries will also continue to enjoy state hand-outs and other privileges."[23] The EIU also notes that "the massive but inefficient metals industry" benefits from the government's "willingness to offer tax breaks and de facto energy subsidies to these producers," which "has resulted in a host of antidumping allegations from major markets."[24] Finally, there is evidence that payment arrearages for energy continue to be problematic, as shown by an increase in non-payment to Naftogas Ukrainy of nearly 15 percent for the period January-May 2002 as compared to January-May 2001.[25]

As these facts make clear, the Ukrainian government maintains significant control over the pricing and allocation of energy, which continue to be determined on a non-market basis. Given the fundamental importance of energy to the economy, the government's interference in the energy sector distorts prices not just in the energy sector, but throughout the economy. Neither the Ukrainian government nor producers have submitted any evidence that detracts from the inescapable conclusion that the government's resistance to withdrawal from the energy sector significantly hinders Ukraine's progress toward a functioning market economy. Unless and until energy prices are market-determined, the Department cannot be assured that Ukraine's prices and costs may be reasonably relied upon using the market economy methodology in its antidumping analysis.

2. The Government of Ukraine Continues to Exert Control Over the Ownership of Land

In their submissions, the Government of Ukraine and Ukrapchormet ("Ukrainian parties") claim that the new land code, adopted in October 2001, has established private property

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[23] Id.

[24] "Rising Protectionism Conflicts with WTO Objective," EIU Viewswire (Apr. 18, 2002).

[25] See "Naftogas: Consumer Debts Up 15% YoY in January-May," Prime-TASS (June 4, 2002), *available at* www.ingfn.com.ua.

rights in land.[26] These assertions, however, exaggerate the extent of land reform in Ukraine. While the new code finally codifies some basic market principles and mechanisms for land ownership, the privatization of land is very far from complete. For example, late in the legislative process, a compromise was reached that placed a moratorium on land purchases and sales until 2005.[27] Further, between 2005 and 2010, sales of agricultural land are limited to only 100 hectares per person.[28] The fact that this "compromise" was accepted implies that powerful factions within the government remain opposed to establishing an open market in land. The fact remains that, notwithstanding the introduction of a new land code, the Ukrainian economy remains characterized by severe restrictions on land transfers.

In fact, the Ukrainian government concedes that significant restrictions remain on the sale of land. In its June 17th submission, the government included, at Exhibit 1, excerpts from the new land code that explicitly ban ownership of agricultural land by foreign citizens or entities, even if inherited.[29] Foreign citizens and foreign legal entities may own land only in connection with buildings that they own that are situated on the land.[30] These restrictions on ownership are highly significant in a country where approximately 58 percent of its land mass is arable and 33 million hectares are in agricultural use.[31]

In addition, passage of the land code did not establish all the mechanisms that are necessary for a land market to function. Practical impediments that still must be resolved include the classification of land as communal or state land, which establishes who the seller is and

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[26] See Government of Ukraine June 17, 2002 submission at 7; Ukrapchormet June 13, 2002 submission at 15.
[27] See "Land Code Paves the Way for Farm Reform," EIU Viewswire (Jan. 18, 2002).
[28] See id.
[29] See Articles 81 and 82.
[30] See id.
[31] See CIA World Factbook 2001, *available at* www.cia.gov/cia/publications/factbook/index.html; "Land Unlocked," EIU Viewswire (Feb. 5, 2002).

whether sales are regulated by the local or federal government; creation of a land registry and regulations governing the conduct of sales and purchases of land; bankruptcy procedures; mechanisms for resolving land disputes; a basis for valuing land; and the development of an agricultural credit and insurance system.[32] Another substantial roadblock to a free market in land is the absence of a mortgage loan system, which the government does not intend to introduce until the first quarter of 2003, as well as laws to regulate the use of land as collateral and repayment guarantees for lenders.[33]

Thus, Ukrapchormet's claim that Ukraine has "created a transparent and efficient regulatory framework for the market of land resources" is unfounded, given the extent of the restrictions and practical impediments that remain on the free transfer of land. As the Department has recently stated, "the right to own private property is fundamental to the operation of a market economy,"[34] and until ownership of land in Ukraine is a practical reality rather than theoretical, the Department should not graduate Ukraine to market economy status.

3. The Government of Ukraine Has Been Insufficiently Committed to Privatization and the Creation of a Favorable Business Climate for Foreign Investors

Although the Ukrainian parties point to the number of enterprises that have been privatized since independence as an illustration of the restructuring of the economy,[35] these numbers are a misleading indicator of the extent of government control over the means of production. In fact, as stated in an International Monetary Fund report, "Ukraine's overall achievements in the area of privatization have been modest," and "the privatization of Ukrainian

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[32] See "Land Unlocked."

[33] See id.; see also "CabMin Sets Up Coordination Council to Develop Mortgage Loan System," Ukrainian News (July 11, 2002), *available at* www.ingfn.com.ua.

[34] Russia NME Memorandum at Sec. 4.

[35] See Government of Ukraine June 17, 2002 submission at 9; Ukrapchormet June 13, 2002 submission at 14.

enterprises has been marked by a wavering commitment of the authorities. . . ."[36] According to the IMF, Ukraine's privatization efforts are marked by "procedural weaknesses" that include the sale of only minority shares in enterprises, with the government retaining at least a blocking minority stake in a large number of enterprises; collusion among bidders and managers using front companies to gain ownership control; and a weak stock market that provides a vehicle for owners to expropriate minority interests.[37] No less important is the ongoing political interference in Ukraine's privatization program, which has led to delays in the privatization process as government decisions are reversed and investor interest in Ukrainian assets decreased.[38] Finally, the IMF recently observed that "influential interest groups have increasingly circumvented transparent sales procedures by resorting to such asset-stripping schemes as the bankrupting of previously attractive enterprises, with the aim of taking control of collateralized assets at minimum values."[39]

In addition, the very difficult business environment in Ukraine has negatively affected foreign investment, thereby limiting Ukraine's exposure to competition from market-based suppliers and, more importantly, limiting the pressure on the Ukrainian government to withdraw from the economy. Even though the economy has shown some positive trends, there are still "fundamental problems in the country's business environment" that limit the interest of foreign investors in Ukraine.[40] Ukraine's 1991-2000 cumulative per capita foreign direct investment, for example, was only $78, a fraction of the FDI in other countries in the region.[41] EIU forecasts

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[36] K. Elborgh-Woytek and Mark Lewis, "Privatization in Ukraine: Challenges of Assessment and Coverage in Fund Conditionality," International Monetary Fund, PDP/02/7 (May 2002), at 3-4, *available at* www.imf.org.

[37] See id. at 5-6.

[38] See id. at 6.

[39] See id. at 16.

[40] "Business Climate Overview," EIU Viewswire (Apr. 9, 2002).

[41] See Ad Hoc Committee June 17th submission at 7.

that for the period 2001-2005, Ukraine will attract foreign direct investment each year of a mere $21 per capita, which is the same as Belarus and the lowest in the region other than the Central Asian republics.[42] Reasons for this dismally low level of FDI include a lack of transparency in privatizations, unrealistic asking prices, interference from vested industrial interests, and the fact that the tax authorities often target foreign-owned firms in order to make up for low revenues from other sources.[43] In a development that EIU describes as the Ukrainian government "getting nasty" with investors and "true to form, {appearing} unconcerned by what the rest of the world thinks," the government has stripped some foreign investors of their holdings in Ukrainian joint ventures, which has undoubtedly added to the uncertain business climate.[44]

The privatization of state-owned assets is a hallmark of a country that has made a successful transition from a non-market to a market economy, but as the Ad Hoc Committee has discussed in its June 17th submission[45] and in the discussion above, Ukraine's privatization path is littered with government actions that demonstrate a lukewarm commitment, at best, to a genuine relinquishment of state ownership and control of the means of production. The opportunity for foreign investors to participate meaningfully in privatization is also key to successful transition, since foreign investment "tends to expose domestic industry to competition from market-based suppliers and the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the market, since foreign investors, as a general rule, demand a certain degree of autonomous control over their

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[42] See "Business Climate Overview."
[43] See id.
[44] See "Stake Out," EIU Viewswire (May 14, 2002).
[45] See pp. 12-18.

investments."[46] The Ad Hoc Committee respectfully submits, however, that Ukraine has not yet met the standards necessary under these criteria to merit graduation to market economy status.

4. Restructuring and Reform Have Proceeded Slowly and Will Continue to Proceed Too Slowly to Justify Revocation of Ukraine's NME Status At This Time

Ukrapchormet claims that Ukraine "since its independence in 1991 has committed itself to the market reform" of its economy,[47] but the overwhelming consensus of observers is that the Government of Ukraine has lagged far behind most other transition countries in restructuring its economy along market principles. The Deputy Director of the IMF's European Department stated very recently that the government is not restructuring the Ukrainian economy quickly enough and that "there's still a very strong opposition to reform."[48] In the Economist Intelligence Unit's estimation, Ukraine has made slow progress on reform and, consequently, its business environment is ranked at the bottom of ten countries in the region and near the bottom of 60 countries worldwide due to its failure to overhaul its economic and regulatory environment.[49] EIU observed that, "relative to almost all other countries in the region, Ukraine's bureaucracy is largely unreformed, corruption remains a serious problem, and reforms at the enterprise level proceed too slowly. In particular, Ukraine needs to dismantle many of the Soviet-era economic and administrative structures that continue to exist alongside newer market-based ones."[50] The report states that Ukraine has a "highly unstable hybrid economy that lacks the capacity for sustainable economic growth," with serious structural weaknesses such as weak enforcement of property rights, undercapitalized banks, and a highly inefficient energy sector.[51]

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[46] See Russia NME Memorandum at Sec. 3.
[47] Ukrapchormet June 13, 2002 submission at 23.
[48] "IMF Criticizes Ukrainian Leaders for Slow Pace of Reform," Ukrainian News (July 10, 2002)
[49] See "Business Environment Ranking Summary," EIU Viewswire (June 4, 2002).
[50] "Business Outlook," EIU Viewswire (June 4, 2002).
[51] See id.

In addition, as the Ad Hoc Committee discussed in its June 17th submission, the Organization of Economic Cooperation and Development characterized Ukraine as "among the least advanced transition economies," with a large informal economy that distorts competition, a flawed legal system that puts foreign investors at a disadvantage and provides inadequate protection to property rights, and laws governing business enterprises that do not adequately protect minority shareholders.[52]

These deep-rooted problems with Ukraine's economy can be solved only by concerted, unified effort on the part of the government. Unfortunately, however, that is unlikely to be the prevailing approach any time soon, as the Parliament remains divided between pro-reform and anti-reform blocs that cannot put aside their differences even to pass legislation required to receive much-needed funds from international lending institutions.[53] To the contrary, the evidence shows that the Ukrainian economy is not functioning according to market principles, the government continues to interfere in key sectors, particularly those important to international trade, land reform is incomplete, and the difficult business environment severely limits foreign investment. Taken together, these factors make it crystal clear that Ukraine has not reached the threshold level of a functioning market economy. Until Ukraine demonstrates the discipline and resolve necessary to advance its transition to a market economy, thereby making market economy antidumping analyses useful, the Department should not graduate Ukraine to market economy status.

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[52] See OECD Directorate for Financial, Fiscal and Enterprise Affairs, Ukraine Investment Policy Review, The Legal and Institutional Regime for Investment: Assessment and Policy Recommendations, Executive Summary and Recommendations (Mar. 2001), *available at* www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-document-705-nodirectorate-no-4-4570-30,00.html; see also Ad Committee June 17th submission at 9-10.

[53] See "Ukraine's Unruly Parliament Key to IMF Funds," Reuters (June 3, 2002), *available at* www.ingfn.com.ua.

If you have any questions about this submission, please do not hesitate to contact the undersigned.

Respectfully submitted,

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Chairman, Ad Hoc Committee
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