THE AD HOC COMMITTEE
OF
DOMESTIC NITROGEN PRODUCERS

1401 Eye Street, N.W.
Suite 340
Washington, D.C. 20005

Telephone (202) 371-9279
Facsimile (202) 371-9169

April 8, 2002

PUBLIC DOCUMENT

Case No. A-821-816
Total Pages: 22
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 the Russian Federation 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 final rebuttal comments on the issue of Russia's status as a non-market economy country for purposes of U.S. antidumping laws .[1] The purpose of this submission is to respond to claims made by Russian steel producers and by representatives of the Russian Federation that the Russian government's continuing role in Russia's energy sector cannot be distinguished from energy regulatory activities of market economy country governments around the world. This argument is unsupported by information in the record of this unusual proceeding and, indeed, is thoroughly contradicted by abundant information available to the Department.

At the outset, the Ad Hoc Committee submits that the Department's recent explanation of the crux of its analysis in deciding whether to graduate a non-market economy country to market economy status is particularly instructive here. The Department explained that the statutorily prescribed factors it examines:

> . . .have a common focus which is to ensure that market forces in the country are developed sufficiently to rely on a country's prices and costs in the Department's antidumping process. Prices and costs are central to the Department's analysis and calculation of fair value. Prices and costs that the Department uses must therefore be meaningful measures of value. However, NME prices and costs are not, as a general rule, meaningful measures of value because they do not sufficiently reflect demand conditions or the relative scarcity of resources used in production. The problem with NMEs is not one of distorted prices, per se, since few, if any, market economy prices are perfect measures of value, free of all distortions (e.g., taxes, subsidies, other government regulatory measures). The problem, instead, is the price formation process in NMEs (i.e., the absence of the demand and supply elements that individually and collectively make a market-based price system work and make the resulting prices reliable).[2]

As the Ad Hoc Committee has discussed in previous submissions[3] and will further discuss below in rebuttal to new claims made by proponents of revocation, the Russian Government's continuing central control of Russia's critical energy sector distorts production costs and prices in the Russian Federation to the point where a market economy analysis under U.S. antidumping law cannot be meaningful. In particular, the Russian Government's natural gas pricing practices and policies – rather than demand conditions or the scarcity of resources – continue to determine the economics of nitrogen fertilizer production and pricing in Russia. Indeed, the Russian

---

[1] Final rebuttal comments were invited by Assistant Secretary Shirzad at the Department's hearing held on March 27, 2002 . Transcript of Hearing, March 27, 2002 at 9 and 199 (hereinafter cited as "Tr. at__").
[2] Memorandum from George Smolik to Faryar Shirzad, "Antidumping Duty Investigation of Silicomanganese from Kazakhstan-Request for Market Economy Status" Mar. 25, 2002, at 4 (hereinafter cited as "Kazakhstan NME Memo").

government's control of energy pricing and distribution is much closer to the practices typical of a centrally planned economy than of a market determined one.

It is critical that the Department recognize that Russia's direction of its energy sector reverberates throughout the Russian economy because of the country's reliance on energy-based industry, exports and tax revenues. As noted by the OECD, "{i}n size, scope and economic importance, the natural gas and electricity sectors occupy a central place in the Russian economy."[4] In another report, the OECD states that "[n]atural gas and electricity occupy a central place in the Russian economy. . .[T]hese industries are striking in their sheer size and scope. Russia possesses roughly one-third of the world's natural gas reserves . . . and currently supplies one-fourth of all gas on the world market."[5] It is no wonder that the Department itself has concluded in its most recent Country Commercial Guide that the "uneconomically low prices" in the energy sector have "distorted the economic landscape" within Russia.[6] The Russian government's substantial control in Russia's key energy sector cannot be dismissed, therefore, as a minor problem in Russia's transition to a market economy. To the contrary, government control of the energy sector has suppressed Russia's transition on a broad scale, has left the nitrogen fertilizer industry with costs and prices determined by the state rather than the market, and has rendered it premature for the Department to revoke Russia's NME status at this time.

---

[3] Submissions of the Ad Hoc Committee, December 10, 2001 and February 7, 2002.

[4] See Bethlehem Steel, National Steel Corp. and United States Steel Corp. submission of March 29, 2002, at Attachment 1, Organisation for Economic Cooperation and Development, Economic Survey of the Russian Federation, 2002, at 7 (OECD Survey").

[5] OECD Centre for Co-Operation with Non-Members, 2001 Economic Review –Russian Federation (draft) (Dec. 4, 2001) (CCNM/ECO/EDR(2001)), at 63 (hereinafter cited as "OECD 2001 Economic Review").

[6] Department of Commerce, Country Commercial Guide: Russia, Fiscal Year 2002, Ch. 2, "Economic Trends and Outlook," at "The Government's Role in the Economy."

A. The Nature of the Russian Government's Control Of The Energy Sector Distorts The Russian Economy And Is Not Simply The Type Of Regulation Commonly Seen In Market Economy Countries

Proponents of graduation claim that price controls in Russia are limited to the regulation of pricing in natural monopoly sectors and that "authorities must base the regulated price on the actual cost of producing the regulated good or service."[7] The record of this proceeding does not, however, include evidence demonstrating clearly that, even on a *de jure* basis, the Russian government sets prices for natural gas or electricity on a basis that covers costs and allows a reasonable return on investment.[8] There is, however, abundant evidence that, regardless of any *de jure* requirements, in practice the government continues to set prices for natural gas that are well below the cost of production and do not provide a return on investment. Moreover, the Russian Government's regulation of the natural gas industry, as well as the electricity sector, is not comparable to the regulatory systems in the United States or in other market economies. In fact, the Russian Government's central control of domestic industrial gas prices distorts the market for gas and, consequently, distorts the "price formation process" for products that use gas as either a raw material or energy source, rendering these prices unreliable for purposes of U.S. antidumping law.

1. Natural Gas Is Sold in Russia at Prices That Are Below the Cost of Production

The Russian parties have argued that the requirement under Russian law that the agencies responsible for regulating natural monopolies calculate prices on the basis of actual costs of

[7] Rebuttal Brief of JSC Severstal, et al. (Feb. 7, 2002) at 127 (hereinafter "Russian Steel Producers Rebuttal Brief").
[8] Although, at the hearing, the Russian Federation claimed that prices are set on a "cost-plus" basis (testimony of Deputy Minister Sharonov at 18), even the limited information that has been provided does not permit a firm conclusion that the law requires prices to be set so as to cover costs and allow a profit. Thus, for example, even the Russian steel producers argue that the "prices for . . . gas and electricity reflect their actual cost of production or provision," not that a profit is built in. Russian Steel Producers Rebuttal Brief at 127.

production is sufficient proof that these prices are established according to accepted market principles.[9] There is substantial evidence to indicate that, in reality, natural gas and electricity producers are required to sell at prices that do not enable them to recoup their costs of production. Given the tremendous importance of these sectors to the Russian economy – energy accounts for around 13 percent of GDP[10] and, in 2000, 30 percent of all federal budgetary revenues came from taxes on gas and electricity[11] – it is critical that the Department examine the *de facto* situation regarding state-set energy prices, rather than rely on the law alone as an adequate measure of the operation of market principles in setting prices.[12]

In fact, prices set for domestic natural gas do not cover the cost of producing the gas, and certainly do not provide a profit to Gazprom. There are numerous sources documenting this fact. For example, the U.S. Energy Information Agency reported that "Gazprom continues to be hurt by low domestic prices for natural gas. The company currently is forced by the Russian government to sell gas to domestic users for . . . less than it costs to produce. . . ."[13] The EIA further notes that the "Russian government's determination to keep domestic gas prices artificially low forces Gazprom to look abroad for hard currency earnings."[14]

This U.S. Government conclusion concerning the state-determined domestic gas prices in Russia is echoed repeatedly in other sources. For example, in an in-depth discussion of Russian gas and electricity regulation and reform, the OECD Economic Review concludes, *inter alia*, that

---

9 See, e.g., Tr. at 18, Russian steel producers Feb. 7, 2002 submission at 127.
10 See U.S. Department of Energy, Energy Information Agency, "Russia Country Analysis Brief (Oct. 2001) at 1, *available at* www.eia.doe.gov/emeu/cabs/russia2/html (cited in the Ad Hoc Committee's Dec. 10, 2001 submission) (hereinafter "EIA Russia Analysis Brief").
11 See OECD 2001 Economic Review at 63.
12 Assistant Secretary Shirzad indicated at the hearing that the Department is carefully examining the de facto situation in Russia ("[O]ur economists have begun to look carefully at . . . whether the *de facto* environment is fully reflective of the *de jure* conditions."). Tr. at 57.
13 EIA Russia Analysis Brief at 3.
14 Id. (emphasis added).

while Gazprom registered profits in 2000 and 2001 "due to much stronger world gas prices," its balance sheet information "offers indirect confirmation that domestic sales are currently loss making" and may even understate the extent of the loss. The report notes that further evidence of the unprofitable nature of domestic gas sales "is Gazprom's own strategy to reduce domestic gas supplies, even to the point of investing (at a loss) in alternative energy sources."[15] It also refers to the "large wedge in return between export and (loss-making) domestic activities" of Gazprom.[16]

The reason that domestic natural gas prices continue to be set at levels below cost – despite any *de jure* requirement to the contrary – is clear. Although the Federal Energy Commission (FEC) and Regional Energy Commissions (RECs) are the bodies legally responsible for price regulation, the OECD Economic Review explains succinctly the current situation:

> The Federal Energy Commission was created in 1992 and made formally independent of other government bodies in 1994. In practice, however, the FEC operates with little actual independence. There exist no basic laws or conditions that protect the FEC from the interference of the government. The FEC Charter obliges conformity not only to Russian laws, but to various presidential and governmental decrees . . . as well. Basic conditions for gas and electricity pricing have been highly unstable during the transition period. Discrete administrative increases lagged far behind inflation in 1992, leading to sharp falls in real energy prices. Beginning in 1993, however, gas and electricity prices were increased and explicitly indexed to the PPI. This policy came to an end in October 1996 with a freeze on nominal energy prices, thus initiating their continual relative decline. This decline accelerated in the context of the rapid inflation of 1998-99. . . . Since the financial crisis of 1998, gas and electricity pricing have come under the influence of two rather contradictory sets of conditions. On the one hand, the FEC and RECs have been delegated the task of setting prices on the basis of a detailed

[15] OECD Economic Review at 80.

[16] Id. See also OECD, "Reforming Russian Infrastructure for Competition and Efficiency" (2001), at 53 ("There is at least some evidence that Gazprom is not earning sufficient revenue in its sales to some domestic customers to cover its marginal costs – it has recently offered to invest substantially in a project to increase the use of coal as a fuel in the production of electricity. It is difficult see why Gazprom would voluntarily increase the demand for alternative fuels if it were selling above marginal costs on sales to electricity generators.").

> analysis of costs. On the other hand, maintaining repressed energy prices has become a deliberate policy goal of the Russian government, viewed by some policymakers as a means of promoting growth in the manufacturing branches of industry. Government instructions to the FEC since 1998 not to account fully for fixed capital investment costs . . . in its cost calculations represent one manifestation of this contradiction.[17]

The OECD report goes on to explain that the FEC is now responsible for setting wholesale prices on gas and that "the basic price setting methodology is cost-based (rate of return), without any commitment to medium or long-term stability," but that "[s]ince prices are currently determined as much on a political as economic basis, . . . costs cannot automatically be passed through to prices at present. Recent legislation has required the separation of accounting in production, transmission and distribution for RAO UES and Gazprom as a means of improving the monitoring of costs and other activities" by government regulators.[18] But the OECD finds that "these efforts to improve the economic basis for regulatory policies stand in contrast to the political constraints on regulation" noted previously.[19] The OECD report concludes that reform of the Russian energy sector depends in part on reforming current regulation that is currently "too myopic and politicised."[20]

As the OECD has recognized, domestic energy pricing in Russia remain a tool for promoting industrial growth – a hallmark of a non-market economy. The artificially low prices set by the government for energy have provided substantial subsidies to industrial sectors of the economy. The OECD estimates that the "highly repressed prices and payment problems" in the

[17] OECD Economic Review at 69.
[18] Id. at 70 (emphasis added).
[19] Id.
[20] Id. at 84. The extreme politicization of energy regulation, and the failure of the regulatory scheme to establish prices that cover costs and provide a reasonable rate of return were evidenced this year when Russian Prime Minister Kasyanov repealed an FEC tariff decision. See Ad Hoc Committee's Feb. 7, 2002 submission at 9-12 and Attachment 1. Gazprom's Deputy Chairman, Alexander Riazanov, stated in reaction that the permitted price increase was insufficient to guarantee production investments and that the "energy security of the country is in

electricity and gas industries provided subsidies throughout the economy of close to five percent of GDP in 2000.[21] Both the OECD and the European Bank for Reconstruction and Development (EBRD) have characterized Gazprom and RAO UES, the electricity monopoly, as "quasi-fiscal institutions" because of the subsidies they provide.[22] The subsidies provided via energy policy to Russian industry, according to the OECD, "remains quite large" and take several forms. Understanding these types of "subsidies" and their pervasiveness is key to realizing the extent to which they distort the Russian economy. The OECD has listed several types of subsidies provided through the gas and electricity sectors, including:

(1) prices charged for gas and electricity, including subsidies administered through low prices;
(2) non-payment for gas and electricity, including various non-equivalent barter and offset schemes;
(3) direct and substantial financing by Gazprom and RAO UES of significant social assets in regions where employees are concentrated, to the extent that Gazprom "has entire small cities on its balance" in northern regions of Russia;
(4) Gazprom and RAO UES may directly finance public goods in many regions as part of the political bargaining with regional authorities; and
(5) RAO UES and particularly Gazprom have taken over a number of loss-making firms with accumulated gas and electricity debts, along with a public service commitment of preserving employment.[23]

The OECD report discusses at length each of these economically distortive practices.[24] Of key interest, however, in the report is that, in addition to being forced to charge domestic prices that do not cover production costs, payment for energy through barter remains

---

question because of the present level of the price of gas." See The Financial Times (Feb. 11, 2002), *available at* www.FT.com

[21] OECD Survey at 7.

[22] See id.; EBRD Transition Report 2001: Energy in Transition at 84 (hereinafter "EBRD Transition Report"). As noted in the Ad Hoc Committee's February 7, 2002 submission at 8, the EBRD Report also cited (at 86) a recent study that found that Gazprom and other utilities "systematically used offsets to transfer liquidity to the enterprise sector, primarily to large loss-makers."

[23] OECD Economic Review at 71.

[24] The Ad Hoc Committee respectfully urges the Department to carefully consider the information in this recently released report. The Ad Hoc Committee believes that the Department has access to this report, which is available

significant[25] and, in 2000, even including payments received in that year for past debts, Gazprom received payment for only 62 percent of current energy deliveries.[26] Nonpayment remains a serious problem.

In the fertilizer sector, as the Ad Hoc Committee has previously discussed, the state control of gas pricing at rates unrelated to cost have seriously distorted the economics of nitrogen production, have led to barter of gas for fertilizer, and has led to the situation whereby nitrogen fertilizer production in Russia is not driven by market determined costs or economics.[27] When the government intervened and scaled back an FEC-announced price increase, a respected international fertilizer industry publication reported that

> Gazprom suffered a major blow earlier this year when the proposed increases i Russian gas prices ere scaled back by the government. . . . this was good news for the Russian fertilizer industry – gas prices for a typical Russian nitrogen producer are now the equivalent of $0.65/mmBtu – but ws bad news for Gazprom. Current domestic gas prices are not meeting production costs and Gazprom only remains profitable because of its export sales.[28]

The distortions that are created in the economy as a whole through continuing government use of energy pricing and supply as a macroeconomic tool are reflected with particularly direct and striking impact in the nitrogen fertilizer sector. Under these circumstances, the antidumping law cannot be applied meaningfully to Russian exports without use of non-market economy methodologies.

---

through the OECD bookstore, but will be pleased to provide a copy of this lengthy document if the Department does not have it available.

[25] See OECD Economic Review at Table III.5, "Forms of Payment to Gazprom and RAO UES."

[26] See OECD Economic Review at 73-74.

[27] See Ad Hoc Committee's Dec. 10, 2001 submission at 19, 26; Feb. 7, 2002 submission at 5, 8.

[28] Fertecon "FSU Update," Issue 2002/No. 1, at 3 (Mar. 5, 2002).

2. The Russian Government's Regulation of the Energy Sector Is Not Consistent with Regulatory Practices in Market Economies

Although the Russian parties argue that the regulation of natural monopolies in Russia is similar to regulatory practices in the United States and other market economies, Russia's regulatory system differs from the systems found in market economy countries in several significant respects. The difference of most fundamental concern to the Ad Hoc Committee involves the regulation of natural gas prices for industrial users. Regulating the price of gas to consumers and the price to industrial users, and the conduct of price regulation so as to allow gas generators and distributors to operate on a commercial basis, are crucial distinctions that illustrate the pervasive involvement of the Russian Government in the Russian economy through energy regulation.

a. Federal Regulation in the United States

The Russian steel producers have attempted to compare Russian monopoly regulation with energy regulation schemes in the United States.[29] In the United States, the Federal Energy Regulatory Commission (FERC) regulates the "transportation of natural gas in interstate commerce {and} the sale in interstate commerce of natural gas for resale for ultimate public consumption."[30] Because public utilities are businesses "affected with a public interest," the purpose of this regulatory authority is to protect consumers from the inherent monopoly power of the public utilities.[31] In this way, the regulatory agency can ensure "just and reasonable" prices and non-discriminatory access to power.[32] The establishment of reasonable prices, however,

[29] See Russian steel producers Feb. 7, 2002 submission at 128. This is despite the fact that at the hearing, counsel for the Russian steel producers argued that Russian practices should not be compared with those in the United States. See Tr. at 175 (Mr. Ellis).
[30] See Section 1(b) of the Natural Gas Act, 15 U.S.C. §717(b).
[31] Energy Law and Transactions, §2.01.
[32] See id.

"involves a balancing of the investor and consumer interests" and recognizes that "it is essential to the company's economic health that the enterprise cover not only its operating expenses but also its capital costs. Revenues should be sufficient to reward investors for the risk they incur and should attract new capital."[33]

The same concern for consumer welfare does not apply when a gas producer sells directly to an end user, such as an industrial user. The statute, therefore, explicitly excludes from the regulatory scheme "any other transportation or sale of natural gas," i.e., sales made directly to end-users, from FERC's jurisdiction.[34] The law presumes that an industrial user and gas provider can negotiate an arm's-length, market-determined transaction for the sale of gas, without any concern that inflated costs resulting from monopolistic practices will be passed on to the consumer. As the statutory language makes clear, such sales to end users are not regulated by the federal government. In addition, the statute clearly gives FERC the authority to regulate only the transportation of gas in interstate commerce, not the price of the gas itself.

b. Previously Graduated NMEs Did Not Maintain Artificially Low Prices for Energy

As noted by the Ad Hoc Committee in its previous submissions, previously-graduated NME countries did not exhibit the continuing control on their energy sectors that characterizes Russia.[35] For example, Poland regulated gas prices but had allowed them to rise in response to market forces, thereby reducing subsidies.[36] In the Czech Republic, controlled prices for consumer goods and services rose in response to inflation and increases in the cost of

[33] Id. at §2.01[3], citing Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968).
[34] 15 U.S.C. §717(b); see also Energy Law and Transactions, §50.04.
[35] See Ad Hoc Committee Dec. 10, 2001 submission at 28 and Feb. 7, 2002 submission at 8.
[36] See Department Memorandum, Respondent's Request for Revocation of Poland's NME Status (June 21, 1993), at 23.

production.[37] Although these consumer prices were still controlled to a certain extent, industrial prices were not, and the Department recognized that the governments were responding to market forces in establishing prices,[38] unlike the current situation in Russia.

c. Russia's Regulatory System Is Not Market-Oriented

Russia's regulation of natural gas and electricity goes far beyond the protection of consumers from monopolistic price setting, establishing rates for gas transportation, or ensuring equal access to electricity transmission grids. As noted above, the FEC is not in reality an independent regulator, and it is widely recognized that the regulation of natural gas in Russia is politicized, keeping prices artificially low and preventing the introduction of competition into the sector.[39] For example, the FEC's decision in September 2001 to raise domestic gas prices was countermanded by the government in January 2002.[40]

In addition, the EBRD observed that low gas prices and the chronic problem of non-payment for energy has created a major disincentive for industrial restructuring.[41] Because industrial firms have been allowed to accumulate massive debts to energy providers – industry accounted for approximately one-third of the debt owed to the energy sector at the end of 2000 – firms have been protected from the competitive pressures of the marketplace, which has permitted unprofitable enterprises to continue operating. In effect, low prices and payment arrearages in the energy sector have reversed the usual goal of monopoly regulation, i.e., preventing the monopoly enterprise from abusing its position by charging unfairly high prices,

---

[37] See Department Memorandum: Antidumping Investigation of Certain Small Diameter Carbon and Alloy Seamless Standard Line and Pressure Pipe from the Czech Republic: Non-market Economy Country Status (Nov. 29, 1999), at 12.
[38] See, e.g., id.
[39] See, e.g., OECD Survey at 8-9; EBRD Transition Report at 84; Unlocking Economic Growth in Russia, McKinsey Global Institute at 2, cited in the Ad Hoc Committee's Dec. 10, 2001 submission at 20.
[40] See the Ad Hoc Committee's Feb. 7, 2002 submission at 10.
[41] See EBRD Transition Report at 96.

and, instead, have been used to force energy providers to transfer benefits to industrial customers, allowing inefficient industries to operate and creating widespread economic distortion. In contrast to the type of market-oriented energy regulation, which is intended to encourage competition by opening the market to private firms but to ensure an adequate return, there is no incentive for a private firm to enter the gas or electricity sector in Russia because it will not be able to recoup its investment.

Gazprom's dominance of the natural gas sector illustrates the substantial differences between Russia's regulatory system and the practices outlined above. Not only does Gazprom produce over 90 percent of all Russian gas, it also processes gas and owns 51 percent of the only other gas processing company, it owns the only gas storage facilities in Russia, and it has a monopoly over gas transmission.[42] Although Russia's gas law provides that 15 percent of the gas transmission capacity is to be available to independent shippers, Gazprom has not fully disclosed information on transmission capacity and there is no evidence that independent firms have gained access to Gazprom's pipelines.[43] Thus, the principles of separating producers from companies that distribute gas and of non-discrimination are not a reality in the Russian gas industry. Moreover, even if the FEC were a truly independent regulator, Gazprom has consistently failed to provide reliable information on its costs and revenues, which makes effective oversight by the regulator impossible.[44]

B. The Russian Economy Has Not Progressed Toward Market Principles to the Same Extent As Kazakhstan

During the Department's hearing, counsel for the Russian steel producers contended that Russia's progress toward a market economy compared favorably with conditions in Kazakhstan

[42] See OECD, Reforming Russian Infrastructure for Competition and Efficiency at 47-48 (2001).
[43] See id. at 49.

and, therefore, the Department should revoke Russia's NME status as it has done for Kazakhstan.[45] An examination of several key factors demonstrates, however, that Russia, while certainly making progress, lags behind Kazakhstan in its transition toward a market economy and has not, in fact, made the requisite progress for graduation to market economy status for antidumping purposes.

1. The Government of Kazakhstan Does Not Exercise Central Control of its Energy Sector

As the Department noted in its determination to revoke Kazakhstan's NME status, the Government of Kazakhstan implemented the "Decree on Price Liberalization" in 1992 that introduced market prices for most goods. The "Law on Natural Monopolies," enacted in 1998, and the "Law on Competition and Limitation on Monopolistic Activities," enacted in 2001, establish the only exceptions to market-driven prices. Those laws delineate the natural monopoly sectors in which the government regulates prices, including "gas and gas condensate products transportation via pipelines {and} transmission and distribution of heat and power" but, notably, not the price of natural gas itself.[46] The Government of Kazakhstan has, in fact, significantly reformed the country's energy sector by privatizing power generation assets and introducing market forces, through permitting large consumers to purchase power supplies from competing generators and establishing a spot market for wholesale power trading.[47] In addition, Kazakhstan has addressed the problem of payment arrearages in the electricity market by establishing a system that permits large customers and generators to enter into bilateral supply

---

[44] See id. at 51.
[45] Tr. at 26 (Mr. Ellis).
[46] See Kazakhstan NME Memo, discussion of the extent of government control over the allocation of resources and over the price and output decisions of enterprises at "Legal Framework" and "Developments in the Economy."
[47] See the Department's Kazakhstan Country Commercial Guide FY 2002 at Ch. 2, Sec. B, "Principal Growth Sectors."

contracts. The contracts are for three-month periods and ensure that suppliers are paid according to their costs and, in the event of non-payment, are not renewed.[48]

In contrast, as discussed above, in Russia prices for natural gas and electricity are established by the government, not by the market, and are not set in a manner that ensures even a reasonable approximation of commercial considerations such as production costs and profit. Moreover, Russia has not yet sufficiently addressed the very significant problem of payment arrearages, which further erodes the operation of market forces in the energy sector.

2. Extensive Privatization in the Energy Sector in Kazakhstan Has Ensured That Market Forces Establish Prices

There are important distinctions between Kazakhstan and Russia regarding the extent and nature of government direction of the critical energy sectors in these countries and the impact of that government activity on the economy as a whole. First, even though the Kazakh Government continues to own enterprises that operate in the energy sector, significant foreign investment has created a competitive environment such that the SOEs operate according to market principles.[49] This is evident, for example, in the substantial level of foreign direct investment in the country, much of which has gone to the oil and gas sectors.[50] Cumulative per capita foreign direct investment for the period 1989-2000 was $571, which compares favorably with Poland ($751) and Slovakia ($669), and is in stark contrast to Russia's per capita FDI for the same period of

[48] See EBRD Transition Report at 103.
[49] See Kazakhstan NME Memo, discussion of extent of government ownership or control of the means of production at "Developments in the Economy."
[50] See id. In fact, the Department noted that the oil and gas sectors have attracted such a large share of investment capital that non-energy related small- and medium-sized enterprises have had difficulty raising capital. See id., discussion of government control over the allocation of resources at "Developments in the Economy."

only $85.[51] The level of FDI in Kazakhstan is a strong indicator that the market is robust and that foreign investors find the competitive environment attractive.

Second, ownership in the energy sector of Kazakhstan is more diversified and, therefore, the natural gas and electricity industries are not dominated by a single firm. In the electricity sector, plants accounting for 82 percent of generating capacity have been privatized or placed under management contract.[52] In addition, the transmission grid has been broken out into a separate entity from producers.[53] Similarly, there are numerous companies operating in the natural gas industry, so production is not concentrated in only one or two enterprises,[54] unlike the situation in Russia, where government-controlled Gazprom thoroughly dominates the sector.

In sum, the degree of privatization and lack of government control in the energy sector in Kazakhstan is much more advanced toward market principles than is the case in Russia. Similar to Russia, Kazakhstan is an oil- and gas-rich country and heavily dependent on tax and export revenues from these industries. Kazakhstan, however, has abandoned central state control in the energy market, in contrast to Russia where central government control continues to create distortions that reverberate throughout the Russian economy.

C. Information On The Record Makes Clear That The Department's Market Economy Methodologies Cannot Be Meaningfully Applied To Determine Fair Pricing Of Nitrogen Fertilizer Produced In The Russian Federation

The market does not determine the economics of nitrogen fertilizer production in the Russian Federation. The industrial price of natural gas is set by the Russian Government, and is a highly political decision. As a result, domestic industrial gas prices do not cover costs and do

[51] See Freedom House, Nations in Transit 2001 at Table F, cited in the Ad Hoc Committee's Feb. 7, 2002 submission at 13, n.50.
[52] See World Bank Country Office in Kazakhstan, "Kazakhstan: Joint Private Sector Assessment," Executive Summary at para. 30, *available at* www.worldbank.org.
[53] See Kazakhstan Country Commercial Guide at Ch. 2.B, "Principal Growth Sectors."

not allow for a reasonable return on investment. While the government's continuing central control of the energy sector distorts production economics throughout the economy of the Russian Federation, as discussed above, the impact on the nitrogen fertilizer sector is particularly striking. Natural gas is used in nitrogen fertilizer production as a feedstock – the primary raw material input – and only secondarily as a source of energy. Fifty to eighty percent of the cost of producing nitrogen fertilizers is accounted for by the price of the natural gas. The continuing non-market orientation of the Russian natural gas sector, therefore, has a particularly direct impact on Russia's nitrogen fertilizer industry. The formation of natural gas prices in Russia is utterly separated from the "demand and supply elements that individually and collectively make a market-based price system work and make the resulting prices reliable."[55]

The Ad Hoc Committee understands and agrees that energy sector regulation is not uncommon in market economy countries. Such regulation, however, typically covers monopoly transmission and distribution services and, to the extent that price regulation is an element of these regulatory schemes, the prices regulated are typically consumer, not industrial, prices. Even then, price regulation treats the supply and distribution as a commercial venture and ensures that costs are covered and that the supplier obtains a reasonable return on investment. This is not the type of regulation and control still in place in Russia today. Russia continues to set prices for industrial gas supply and sets prices that, as our own government recognizes, do not cover the cost of production, much less guarantee any rate of return.[56] Indeed, as the OECD as

---

[54] See Energy Information Administration, "Kazakhstan: Oil and Natural Gas Projects," (Jan. 2002).
[55] Kazakhstan NME Memo, March 25, 2002 at 4.
[56] See EIA Russia Analysis Brief at 3.

recently recognized, energy regulation is still used in Russia as means to implement industrial policy and to effect broad economic goals.[57]

Accordingly, the Ad Hoc Committee respectfully submits that the Department should not, and may not reasonably at this time, graduate Russia to market economy status for purposes of the antidumping laws. The Ad Hoc Committee also submits, however, that if the Department finds that it must – for whatever reasons – take some action to change Russia's status, the law provides the Department with the flexibility to ensure that market economy methodologies will continue to apply to the nitrogen fertilizer sector.

As the Department is aware, the policies concerning non-market economy countries that are in transition have evolved through administrative practice. That practice has long recognized that certain sectors of the economy may become "market-oriented" in advance of others, and may be treated as market-oriented for antidumping purposes. These sectors may be identified as "market oriented industries" or "MOIs". The MOI approach allows the Department to "identify those situations where we would apply the market economy methodology and calculate normal value based on domestic prices or costs in the NME."[58] In adopting its current antidumping regulations, however, the Department declined to codify the MOI approach, explaining as follows: "[g]iven the changing conditions in NMEs, we believe that we should continue to develop our policy in this area through the resolution of individual cases . . . . This area of the law continues to be extremely important to the agency and will receive the Department's careful attention".[59]

---

[57] See OECD Economic Review at 69.
[58] Antidumping Duties; Countervailing Duties: Final Rule, 62 Fed. Reg. 27296, 27364 (May 19,1997).
[59] Id. at 27365.

The Department's recognition that there are interim steps between market economy status and "complete" non-market economy status, i.e., a situation in which no industries within an economy could operate on a market-determined basis, and the recognition of the need for reacting to "changing conditions in NMEs" may be instructive here. In this case, the Ad Hoc Committee believes that the evidence before the Department demonstrates conclusively that Russia has not, in general, progressed to the point whereby a market economy analysis would be meaningful in antidumping cases. Moreover, whatever debate there may be with respect to the economy in general, there certainly cannot be any real suggestion that market principles determine costs or prices in the nitrogen fertilizer sector. That being the case, if the Department will not (improperly, in our view) decline to graduate Russia at this time, the MOI approach provides options for ensuring that the antidumping law is not rendered a nullity as to the nitrogen fertilizer industry.

First, the Department may certainly consider graduating sectors other than those that are energy-intensive by treating them as market oriented industries. This approach is consistent with the idea of "graduating" sectors of the economy that have progressed sufficiently to render market economy methodologies meaningful in advance of those sectors which have not. If the Department has the authority to graduate certain industries individually, it certainly may graduate many, without graduating all.

Alternatively, the Department may consider indicating that, if there has been sufficient progress within the Russian economy as whole, industries other than those that are energy intensive will be <u>presumed</u> to be MOIs. By establishing a presumption with respect to Russia for MOI status for most industries, the Department leaves open the possibility for examination of individual industries. This, of course, would entail a significant departure from the Department's current presumption that MOIs "do not occur because non-market economies are riddled with distortions."[60]

Third, rather than graduate Russia and leave the nitrogen fertilizer industry without meaningful access to the antidumping laws, the Department may indicate its intention to review its approach to MOIs and invite Russian industries (or producers) to seek MOI status in particular cases. Presumably, if Russia believes that its economy as a whole has progressed to the point where it should be considered a market economy, particular sectors (or perhaps producers) should be able to qualify as MOIs. This approach, again, has the benefit of recognizing transition where it has occurred, but not treating the Russian nitrogen industry as if its costs and prices were market-determined.

To be clear, the record of this proceeding provides strong evidence that the Russian Federation has not satisfied the criteria for graduation to market economy status. The Ad Hoc Committee submits that Russia should not be graduated. If, however, the Department nevertheless intends to exercise its discretion to graduate Russia, the Ad Hoc Committee submits that the Department has the authority to proceed in a manner that will ensure that the antidumping laws will not be rendered a nullity as to the nitrogen fertilizer sector. If the Administration cannot refuse graduation at this time – as it should – the Ad Hoc Committee urges the Department to consider carefully options other than full graduation and to be mindful of its own expressed resolve to develop its policies and approaches to NME transition issues on a case-by-case basis. The Department has never addressed a graduation request with the complexities and potential impact as that currently before it. The situation with respect to the Russian energy sector is unique: no other graduation request has ever presented the set of

---

[60] Final Determination of Sales at Less Than Fair Value: Steel Concrete Reinforcing Bars from Moldova, 66 Fed.

continuing controls and government manipulation in a sector so central to the economy as whole. The Ad Hoc Committee urges the Department to recognize that Russia's graduation would be premature at this time. The Department must ensure, however, that U.S. antidumping law will remain a viable tool for the U.S. nitrogen fertilizer industry in addressing the waves of unfairly traded imports that continue to occur as a direct result of Russian government control of Russia's critical natural gas sector.

D. Conclusion

The Ad Hoc Committee of Domestic Nitrogen producers has submitted detailed comments in this proceeding addressing each of the statutory criteria relevant to the Department's consideration of Russia's request for market economy status under U.S. antidumping law. Substantial evidence on the record of this proceeding makes clear that, despite significant progress, the current state of the Russian Federation's transition does not, in general, permit U.S. antidumping laws to use Russian costs and prices in determining whether sales have been made at or above fair value. Many legal changes that have occurred are *de jure* changes only, or are too recent to provide meaningful information as to whether these changes will occur in fact. In the case of the energy sector, there is abundant evidence that legal and regulatory requirements are not followed and that domestic gas prices do not even cover costs. The Ad Hoc Committee respectfully submits that, despite great progress in U.S.-Russia relations, the time has not yet arrived to treat Russia as a market economy country under U.S. antidumping laws.

* * * * * * *

Reg. 33525 (June 22, 2001).

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

Respectfully submitted,

Valerie A. Slater, Esq.

Counsel to the Ad Hoc Committee of
Domestic Nitrogen Producers
(202) 887-4112