

UNITED STATES INTERNATIONAL TRADE COMMISSION

WHEAT GLUTEN: EXTENSION OF ACTION

Investigation No. TA-204-4

DETERMINATION AND VIEWS OF THE COMMISSION

(USITC Publication No. 3407, April 2001)

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WHEAT GLUTEN: EXTENSION OF ACTION

DETERMINATION

On the basis of the information in this investigation, the Commission unanimously determines, pursuant to section 204(c) of the Trade Act of 1974 (Trade Act) (19 U.S.C. § 2254(c)), that action under section 203 of the Trade Act with respect to imports of wheat gluten continues to be necessary to prevent or remedy serious injury and that there is evidence that the domestic wheat gluten industry is making a positive adjustment to import competition.

BACKGROUND

Following receipt of a petition filed on behalf of the Wheat Gluten Industry Council, the Commission, effective November 30, 2000, instituted investigation No. TA-204-4, *Wheat Gluten: Extension of Action*, under section 204(c) of the Trade Act to determine whether action under section 203 of the Trade Act with respect to imports of wheat gluten continues to be necessary to prevent or remedy serious injury and whether there is evidence that the domestic wheat gluten industry is making a positive adjustment to import competition.

Notice of the institution of the Commission's investigation and of a public hearing to be held in connection therewith was given by posting copies of the notice in the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and by publishing the notice in the *Federal Register* on December 21, 2000 (65 F.R. 80455). The hearing was held in Washington, DC, on February 27, 2001, and all persons who requested the opportunity were permitted to appear in person or by counsel.

Views of the Commission

I. Summary of determination and recommendations

Pursuant to section 204(c) of the Trade Act of 1974 (Trade Act) (19 U.S.C. § 2254(c)), we make an affirmative determination in this investigation. Specifically, we determine that action under section 203 of the Trade Act with respect to imports of wheat gluten continues to be necessary to prevent or remedy serious injury and that there is evidence that the domestic wheat gluten industry is making a positive adjustment to import competition.

Having made an affirmative determination, we recommend that the President take the following action –

- (1) extend the action for an additional 2 years, and expand the import quota by an additional 6 percent in each of those 2 years (based on the level in the third year of the original action);
- (2) continue to administer the annual quota on a quarterly basis, with an overall annual limit as well;
- (3) undertake international negotiations to address the underlying cause of the increase in imports, including negotiations that would lead to a significant reduction by the European Union of its rate of duty on imports of wheat gluten and wheat starch; and
- (4) include wheat gluten mixes that retain the essential vitality of wheat gluten within the scope of the remedy action, based on the Commission's conclusion, described below, that such mixes are covered by the description of the scope of the product at issue in the Commission's original determination.¹

II. Background

This is the first investigation that the Commission has conducted under section 204(c) of the Trade Act. We instituted the investigation effective November 30, 2000, following receipt of a petition from the Wheat Gluten Industry Council.² The petitioner asserts that the wheat gluten safeguard action continues to be necessary to prevent or remedy serious injury to the domestic wheat gluten industry and that there is evidence that the domestic wheat gluten industry is making a positive adjustment to import competition. In addition, the petitioner asks that we recommend to the President that he extend the relief for an additional 2 years at the current level or, if the law requires that the action continue to be phased down, that it be phased down at the rate of 1 percent per year. The petitioner also asks that we “reconfirm” that the intended scope of the quota includes all vital wheat gluten, including certain wheat gluten mixes, and that we urge the

¹ With respect to this issue, Commissioner Bragg refers to her mid-term monitoring report views. *See* Separate and Additional Views of Chairman Lynn. M. Bragg, Investigation No. TA-204-2, *Wheat Gluten*, USITC Pub. 3258, app. A (December 1999).

² The Wheat Gluten Industry Council consists of three domestic producers, ADM Arkaday (ADM), Manildra Milling Corporation (Manildra), and Midwest Grain Products (Midwest). ADM supported the petition when it was filed, but on January 6, 2001, ADM advised the Commission that it no longer supported the petition. Report to the President on Investigation No. TA-204-4, *Wheat Gluten*, at I-1 (hereinafter “Report”).

President to engage in WTO negotiations to require the EU to reduce its rates of duty on wheat gluten and wheat starch to the same levels as the U.S. levels.³ The Government of Australia and Australian producer Shoalhaven Pty., Ltd.⁴ appeared in the investigation in support of the request for continuation of relief, whereas the European Commission, the Association des Amidonneries de Cereales de L'UE (ACC – the EU association that includes wheat gluten producers),⁵ and the Corn Refiners Association appeared in opposition to the request for continuation of relief.

The action currently in effect is the result of a proclamation issued by the President in May 1998,⁶ following a unanimous determination by the Commission that increased imports were a substantial cause of serious injury to the domestic wheat gluten industry. The original proclamation was modified by two additional proclamations issued in May 1999 and May 2000.⁷ In Proclamation 7103 of May 30, 1998, the President imposed an annual a quota of 126.8 million pounds on imports of wheat gluten for a period of 3 years and 1 day, with the annual quota amounts to increase by 6 percent in each of the second and third years. He excluded imports from Canada, Mexico, beneficiary countries under the Caribbean Basin Economic Recovery Act and Andean Trade Preference Act, and other developing countries that accounted for a minor share of wheat gluten imports. The President established quota shares for Australia and the EU, and a share for all other non-exempt countries. In Proclamation 7202 of May 28, 1999, the President modified the quota for the second year to reduce the European Community's allotment for that year by the amount of EU wheat gluten that entered during the first quota year in excess of the EU's full year quota share. In Proclamation 7314 of May 26, 2000, the President modified the quota for the third year to include imports from Poland⁸ and to allocate the quota on a quarterly basis.

As required by section 204(a)(1) of the Trade Act, the Commission has monitored developments with respect to the domestic industry since the action first took effect. As part of this effort, the Commission monitored the progress and specific efforts made by workers and firms in the domestic industry to make a positive adjustment to import competition. As required by section 204(a)(2) of the

³ Petition at 4-5; petitioner's prehearing brief at 6.

⁴ Australian producer Shoalhaven and U.S. producer Manildra are both owned by the Manildra Group of Australia. Report at II-1.

⁵ The AAC has asserted that an extension of the action is not warranted in light of the decision of the Appellate Body of the World Trade Organization (WTO) concluding that certain aspects of the U.S. safeguard action with respect to wheat gluten were inconsistent with U.S. obligations under the WTO Agreement on Safeguards. AAC prehearing brief at 3-9. We note that there is a separate procedure under U.S. law for addressing instances in which actions under U.S. safeguard law have been found to be inconsistent with WTO obligations. See section 129 of the Uruguay Round Agreements Acts (URAA) (19 U.S.C. § 3538). Under that procedure, the USTR, on March 15, 2001, requested that the Commission issue an advisory report on whether title II of the Trade Act of 1974 permits the Commission to take steps in connection with its action in Investigation No. TA-201-67, *Wheat Gluten*, that would render its action in that proceeding not inconsistent with the findings of the WTO Appellate Body in its report dated December 22, 2000, entitled "United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities," AB-2000-10. In a letter dated March 22, 2001, the Commission reported to the USTR that title II of the Trade Act permits it to take such steps. As April 2, 2001, the Commission had not received a request from the USTR for a determination under section 129 of the URAA.

⁶ Proclamation No. 7103, May 30, 1998, 63 Fed. Reg. 30,359 (June 3, 1998).

⁷ Proclamation No. 7202, May 28, 1999, 64 Fed. Reg. 29,773 (June 2, 1999); and Proclamation No. 7314, May 26, 2000, 65 Fed. Reg. 34,899 (May 31, 2000).

⁸ Such imports initially accounted for a minor share of total imports and were excluded on the basis that Poland is a developing country; imports from Poland increased significantly, however, after the relief action went into effect in 1998.

Trade Act, the Commission submitted a report to the President and the Congress on the results of its monitoring in December 1999, the mid-point of the relief period.⁹

The product at issue in this investigation is vital wheat gluten (hereinafter “wheat gluten”). Wheat gluten is produced from wheat flour. The manufacturing process for wheat gluten always results in two products: one part gluten and approximately five parts starch.¹⁰ Wheat gluten is about 75 percent protein.¹¹ About 80 percent of the wheat gluten consumed in the United States serves as an input for the baking industry to supplement the gluten in flours used to make baked goods; wheat gluten is a necessary ingredient in the production of high-fiber and multi-grain breads. The protein content of the wheat crop affects the demand for wheat gluten: when the protein content is low, demand for wheat gluten increases, and vice versa.¹² The pet food industry accounts for most of the remaining 15-20 percent of consumption.¹³

III. Statutory framework

Section 204(c)(1) of the Trade Act provides that the Commission, upon the request of the President or the concerned industry, is to “investigate to determine” –

whether action under section 203 continues to be necessary to prevent or remedy serious injury and whether there is evidence that the industry is making a positive adjustment to import competition.

Thus, in order to make an affirmative determination, section 203(c)(1) requires that the Commission make two affirmative findings – (1) whether the relief action continues to be necessary to prevent or remedy serious injury, and (2) whether there is evidence that the industry is making a positive adjustment to import competition. Neither the statute nor the legislative history of the URAA further describes the nature of the determination the Commission must make under section 204(c), or sets out factors to be considered in making that determination.

However, the term “positive adjustment” is defined in section 201(b) of the Trade Act. A positive adjustment to import competition is considered to have occurred when

- (A) the domestic industry –
 - (i) is able to compete successfully with imports after actions taken under section 204 terminate, or
 - (ii) the domestic industry experiences an orderly transfer of resources to other productive pursuits; and
- (B) dislocated workers in the industry experience an orderly transition to productive pursuits.¹⁴

⁹ Investigation No. TA-204-2, *Wheat Gluten*, USITC Pub. 3258 (December 1999).

¹⁰ Report at I-4.

¹¹ Report at I-4.

¹² Report at I-4.

¹³ Report at I-4.

¹⁴ Section 201(b)(1).

The statute further provides that the domestic industry may be considered to have made a positive adjustment “even though the industry is not of the same size and composition” as the industry at the time the investigation was instituted under section 202(b).¹⁵

IV. Basis for affirmative determination

In making our affirmative determination, we reviewed the evidence in the investigation record relating to the present condition of the industry and the factors affecting competition, as well as the evidence in the record concerning whether the domestic industry is making a positive adjustment to import competition. We also reviewed the basis for the Commission’s affirmative injury determination in 1998, the adjustment plan submitted by the domestic industry in 1998, and the extent to which the industry has been able to carry out the terms of the adjustment plan.

On the basis of our review of that evidence, we find that both elements of the statutory test for making an affirmative determination in this investigation are satisfied. Specifically, we find that the import relief action for wheat gluten continues to be necessary to prevent or remedy serious injury, and that there is evidence that the domestic industry is making a positive adjustment to import competition.

A. The Commission’s injury determination.

In the original investigation in 1998, the Commission found that wheat gluten was being imported in such increased quantities as to be a substantial cause of serious injury to the domestic wheat gluten industry.¹⁶ The Commission found that imports had increased from 128 million pounds in 1993 to 177 million pounds in 1997, and that nearly all of this increase occurred during 1996 and 1997.¹⁷ It found that by the end of the period of investigation virtually all of the factors relevant to industry performance were negative. Industry capacity utilization had declined significantly, production and shipments had declined, end-of-period inventories more than doubled, the industry had gone from being profitable to operating at a loss, the average unit value of the industry’s wheat gluten sales had declined and were at their lowest level in 1997 at the same time that unit costs were rising, hourly wages were relatively flat, worker productivity had declined due to the decline in capacity utilization, and unit labor costs had almost doubled.¹⁸

The Commission found that the increase in imports was both an important cause and not less than any other cause of the serious injury. It found that the surge in imports in 1996 and 1997 coincided with the sharp downturn in industry performance in those 2 years. The Commission found that the prices of imports from the EU, which accounted for most of the increase in imports, were consistently below prices of domestic wheat gluten.

The Commission also considered whether the downturn in industry performance might have resulted from other possible causes, such as changes in the wheat starch market as alleged by the European respondents. However, the Commission found none of those other causes to be a more important cause of the serious injury than increased imports. In fact, as the analysis showed, the Commission found none of

¹⁵ Section 201(b)(2).

¹⁶ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998). All three members of the Commission, Commissioners Miller, Bragg, and Crawford, voted in the affirmative; there were three vacancies on the Commission at that time. Commissioners Koplan, Okun, Hillman, and Devaney were not members of the Commission at that time, and Commissioner Crawford’s term expired in June 1999.

¹⁷ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-10.

¹⁸ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-14.

these other causes to be significant.¹⁹ The facts and analysis from the original investigation form the background for our consideration of the current petition for the extension of relief.

B. The industry's 1998 adjustment plan.

We also examined the adjustment plan presented by the domestic industry in the course of the 1998 investigation. In that plan the members of the domestic industry stated that they would focus the bulk of their adjustment efforts on developing and marketing new products made from modified wheat gluten²⁰ and modified wheat starch, while continuing to enhance their efforts to improve efficiency and productivity in the production of wheat gluten.²¹ These modified products would be expected to sell at higher prices and yield higher profit margins than unmodified wheat gluten and wheat starch.

Midwest, Manildra, and Heartland indicated that they planned to spend a combined *** to develop modified wheat gluten and modified wheat starch products, construct production facilities in which to produce them, and develop markets for these products.²² The plan detailed new product development efforts that Midwest, the largest domestic producer, already had underway, some of which were protected by patents or involved secret production processes. These new products included meat- or milk-protein replacers, coatings, films, cosmetics, and biodegradable serviceware. Midwest stated that its 5-year goal was to produce *** percent of its wheat gluten as modified wheat gluten products. Manildra indicated it would construct a plant in Hamburg, Iowa, costing about \$***, to produce modified wheat gluten and wheat starch, particularly wheat protein isolates to be used in non-dairy cream products and as a meat extender.²³ Heartland proposed to develop biodegradable/edible feed containers for livestock. ADM proposed to upgrade its use for producing Gypset B, a modified wheat starch product used as a core binder for gypsum wallboard.

C. Whether action continues to be necessary to prevent or remedy serious injury.

After considering the views of the parties, we found it appropriate in this investigation to consider the following factors in making our finding on whether action continues to be necessary to prevent or remedy serious injury: the level and prices of imports since the action was taken; the current condition of the domestic industry and changes in the various indicators of the industry's health since the action was taken including changes related to industry adjustment efforts; and developments in foreign industries and markets, including production, capacity, and prices. Based on our evaluation, we find that action continues to be necessary to prevent or remedy serious injury to the domestic wheat gluten industry.

¹⁹ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-16-17.

²⁰ The term "modified wheat gluten" typically refers to vital wheat gluten that has been altered physically, chemically, or enzymatically. Report at I-5, note 19.

²¹ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-25. For example, Midwest indicated it planned to spend at least \$*** during the relief period to continue to improve its efficiency and reduce costs in producing wheat gluten. *Id.* at note 123.

²² Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-25.

²³ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. 3088 (March 1998), at I-25, notes 123, 125.

1. Imports under the quota

As described above, the President allocated portions of the annual quotas to the EU, Australia, and “other” countries, and administered the quotas during the first 2 years on an annual basis. First year quota shares were 54.0 million pounds for the EU, 62.4 million pounds for Australia, and 10.3 million pounds for other countries. In the first quota year, the EU overfilled its quota allotment by 11.9 million pounds, or by 22.0 percent, and the EU quota was closed in the sixth month of the quota year (November 1998).²⁴ To offset the over-quota shipments, the EU’s quota allotment for the second year was adjusted downward by the amount of the excess. In the second quota year, the EU exhausted its entire reduced quota allotment in the first month of the quota period, June 1999.²⁵ To prevent a repetition of the front loading of the quota in the third year, the President directed that the quota for the third year be administered on a quarterly basis. In the third year, the EU filled virtually all of its quarterly quota allotments on the first day of each quarter.²⁶

Poland was exempt from the original quota as a developing country that accounted for a minor share of U.S. imports. However, imports from Poland, which were 660,000 pounds in 1998 (July 1, 1997 to June 30, 1998),²⁷ prior to relief, then soared to 5.0 million pounds in the first quota year, and 13.8 million pounds in the second quota year.²⁸ To address the surge in imports from Poland, the President included Poland in the “other countries” category for the third quota year.

Australia, the other major supplier, filled its quota allotments in each year as well, including its quarterly allotments in the third year, albeit at a slower pace, with imports spaced relatively evenly throughout the quota year or quarter. The “other countries” category was only partially filled during the first 2 quota years. In the third quota year, this category was filled in each of the first 2 quarters.

In sum, for the two main sources of exports to the United States, the EU and Australia, the quotas have been “binding” in the sense they have been filled, and in the case of the EU, filled quickly. This suggests that the termination or significant expansion of the quotas will lead to a significant increase in imports in the near term, particularly from the EU. Moreover, the effectiveness of the quota in the first 2 quota years was weakened by over-quota EU imports during the first year, the filling of the entire EU second-year allotment in a single quarter, and the unexpected surge in imports from Poland during the first 2 years of the quota.²⁹

We also examined the prices of imports over the period of relief. The weighted average pricing data for EU wheat gluten show a consistent pattern of continued underselling, as compared to prices for

²⁴ Report at II-7-11.

²⁵ Report at II-7-11.

²⁶ Preliminary import data from the Census Bureau indicated substantial over-quota imports from the EU in the third quota year. However, corrected Census data indicate no excess. See INV-Y-053.

²⁷ Report at II-5. Data for the period include data for June 1998, the first month of the quota.

²⁸ Report at II-8.

²⁹ We note that the effectiveness of the relief may have also been affected by quota-exempt imports from Canada, which increased substantially during the first quota year and remained at higher levels for the remainder of the period we examined. We note, however, that Canadian imports did not generally undersell domestic wheat gluten, in contrast to imports from the EU or from “all other countries,” a category that includes Poland. See Report at Figure V-2. We also note that the effectiveness of the order may have also been affected by imports from Canada of wheat gluten mixtures that contain 90 percent wheat gluten and 10 percent soy protein or animal by-product. The mixtures retain the vitality of wheat gluten but have been exempt from the quota. This issue is discussed below in the Recommendations section.

U.S. wheat gluten, even with the quotas in place. EU wheat gluten undersold domestic wheat gluten in all but one of the 10 calendar quarters (through December 2000) since the action became effective. Except in January-March 1999, when EU wheat gluten sold at a 3.1 percent premium to domestic wheat gluten, EU wheat gluten has undersold domestic wheat gluten by margins ranging from 2.1 percent to 19.2 percent.³⁰ Australian wheat gluten, on the other hand, has sold at a slight premium throughout the remedy period, ranging from *** percent in April-June 2000 to *** percent in October-December 2000.³¹ Imports in the category that includes all other non-exempt countries, like EU imports, were usually priced lower than domestic wheat gluten, in some cases by substantial margins.³²

In the original investigation, the Commission found that the low prices of imported wheat gluten – particularly from the EU – helped to cause serious injury to the domestic industry. We find that recent price information – particularly with respect to EU wheat gluten – further supports the conclusion that continued relief is necessary.

2. Developments with respect to the domestic industry's condition

We also examined the various indicators of the industry's performance over the period of relief to determine whether continued relief is necessary. These data generally show improvement in the condition of the industry during the first 2 years of the quota action, but a substantial deterioration in the most recent interim period. The domestic industry does not currently exhibit the level of performance which indicates relief is no longer necessary.

We note initially that domestic wheat gluten consumption has increased since the action took effect. Consumption rose from 313.0 million pounds in 1998 to 364.8 million pounds in 1999, and then fell to 321.2 million pounds in 2000. Consumption increased from 149.3 million pounds in interim 1999 to 171.1 million pounds in interim 2000.³³

U.S. producers' domestic shipments rose modestly in the first 2 years of the quota period,³⁴ from 144.4 million pounds in 1998 to 151.7 million pounds in 1999 and 174.8 million pounds in 2000, but then declined to 77.5 million pounds in interim 2000 (July-December) from 88.1 million pounds in interim 1999.³⁵ Domestic production followed a similar trend.³⁶ Domestic capacity has declined slightly since 1998, from 275.2 million pounds in 1998 and 1999, to 274.5 million pounds in 2000; capacity was

³⁰ Report at V-5.

³¹ Report at V-5.

³² Imports from Canada (which are quota-exempt) generally sold for prices slightly higher than domestic wheat gluten.

³³ Report at II-4. Full year data for 1998-2000 are for years ending June 30. The irregular trend in consumption over the period may be due in large part to the entry of the EU's entire second-year quota allotment in June 1999, and the inclusion of those imports in the consumption figures for 1999 (July 1998-June 1999). However, it is likely that much of this import volume was actually consumed in later months. If imports are measured on a quota year basis (June-May) rather than July-June (effectively moving the June 1999 imports into consumption for 2000), then consumption showed a steady increase over the three full years of the period investigated: 308.6 million pounds in 1998, 322.8 million pounds in 1999, 345.1 million pounds in 2000. Consumption would be 201.3 million pounds in interim 1999 and 172.2 million pounds in interim 2000.

³⁴ Data approximate the quota year – data are for years ending June 30, as compared to the year ending May 31 for the quota year.

³⁵ Report at II-4.

³⁶ Report at III-1.

unchanged between interim 1999 and interim 2000.³⁷ Capacity utilization initially increased from 54.3 percent in 1998 to 61.4 percent in 1999 and 64.1 percent in 2000, but it fell in interim 2000 to 65.0 percent compared to 68.4 percent in interim 1999.³⁸ The ratio of U.S. producers' inventories to shipments rose and fell erratically, and was lowest in the year ending June 30, 2000, and highest at the end of the period in July-December 2000.³⁹ Employment, hours worked, wages paid, and hourly wages all trended slightly upwards, but unit labor costs (per pound) remained unchanged.⁴⁰ Labor productivity rose between 1998 and 2000, and reached its highest level (608.4 pounds per hour) in interim 1999, but fell in interim 2000 (to 534.2 pounds per hour).⁴¹

Industry financial data show a similar pattern of gains followed by more recent declines. The Commission received usable financial data from three of the four domestic producers on their domestic wheat gluten operations. In 1998, two of the three reporting firms operated at a loss, but in 1999, 2000, and interim 1999 all three operated at a profit. However, in interim 2000, two of the three reporting firms, including the ***, operated at a loss, and this loss (as measured in cents per pound) was larger than the loss reported in 1998.⁴² The third reporting firm was ***.⁴³

As described further below, the industry has made progress on its efforts to develop, produce, and sell more modified wheat gluten and wheat starch products. Its sales of modified wheat gluten products increased by more than *** percent between 1999 and 2000.⁴⁴ Its sales of modified wheat starch products increased by about *** percent from 1999 to 2000, but remained below levels achieved in 1995 to 1997. Although the industry has increased its sales of modified products, its revenues from sales of those products in 2000 were only about *** the value of the industry's revenues from sales of (unmodified) wheat gluten.⁴⁵ Thus, the industry continues to rely mainly on its sales of wheat gluten.

The industry's inability to increase its sales of modified products more quickly may have been due, at least in part, to lower-than-anticipated revenues from wheat gluten sales that could be available for investment in modified products.⁴⁶ The reduced revenues, in turn, may have been due in part to the

³⁷ Report at III-1.

³⁸ Report at III-1.

³⁹ Report at III-3.

⁴⁰ Report at III-3.

⁴¹ Report at III-3.

⁴² Report at III-5-6. The operating loss in interim 2000 was largely due to declining wheat gluten prices, lower sales volume, and higher factory overhead costs resulting principally from higher energy and labor costs (Report at III-7). The operating loss was not due to costs associated with implementation of the adjustment plan. Depreciation and other operating expenses, including SG&A, which would have reflected capital expenditures and other operating costs related to implementation of the plan, did not increase in interim 2000. Expectations of lower prices upon termination of the relief in June 2001 may have had an impact on current prices. *See* Report at V-7.

⁴³ Report at III-6.

⁴⁴ Report at VI-3.

⁴⁵ Report at Tables III-5, VI-2. Revenues from modified wheat gluten and starch products were less than *** percent of the industry's combined wheat gluten and wheat starch revenues in 2000. *See* Report at Table D-1.

⁴⁶ For example, Midwest and Manildra reduced or delayed certain investments as a result of these lower revenues. Petitioner's Posthearing Brief at 64; Report at VI-2.

difficulties experienced under the quota with the over-quota EU imports and increased imports from Poland.⁴⁷

In sum, the most recent data show that the domestic industry continues to experience difficulties, particularly financial difficulties, even with the import quotas in place. Moreover, its production and sale of modified wheat gluten and wheat starch products, while increasing, have reached only modest levels to date in the context of the industry's overall wheat gluten operations. These facts lend further support for the need for continued relief to help enable the industry to continue its adjustment efforts.

3. Foreign industry developments

As noted above, imports surged during the period examined in the original investigation, causing significant declines in industry profitability and other performance indicators. We have examined the record in this investigation to determine whether relief no longer continues to be necessary, or whether, instead, present circumstances with respect to the foreign industries and markets are sufficiently different such that relief no longer continues to be necessary.

The EU in 2000 had by far the largest wheat gluten capacity in the world (722.4 million pounds) and was the largest producer (687.4 million pounds), and its capacity and production continue to increase. EU capacity increased between 1998 and 2000 by 2.5 percent, and capacity in place in interim 2000 was nearly 10 percent above capacity in interim 1999. Production increased by 14.9 percent between 1998 and 2000, and by 8.4 percent in interim 2000 as compared to interim 1999.⁴⁸ The EU maintained excess capacity of over 27 million pounds in interim 2000 alone, an amount equal to over 15 percent of U.S. apparent consumption during that period. The EU exported over 25 percent of its production to countries outside the EU.⁴⁹ Prices for wheat gluten in the EU have fallen recently,⁵⁰ further increasing the incentive of EU producers to export to higher-priced markets such as the United States. Moreover, the EU respondents have identified no developments with respect to the EU market or industry that would suggest that import relief was no longer necessary.⁵¹

Capacity and production have also increased in Australia and Poland, which are significant exporters to the U.S. market. Although only a fraction of EU capacity and production, Australian capacity (***) pounds) and production (***) pounds) increased by almost *** percent during the period.⁵² Polish capacity and production increased by an even larger percentage, by more than *** percent during the period, to *** pounds in 2000, and continued to increase rapidly in interim 2000.⁵³

⁴⁷ For example, Midwest ramped up production in 1998 in anticipation of reduced import supply as a result of the quota. When this reduction did not materialize, the company was left with the cost of holding inventories *** above previous year levels. Report at III-1.

⁴⁸ Report at IV-3.

⁴⁹ Report at IV-3 (Table IV-3).

⁵⁰ Report at V-9.

⁵¹ We are aware of no reductions in the substantial tariffs maintained by the EU on imports of wheat gluten and wheat starch. The petitioner asserts that the EU import tariff on wheat gluten is 10 times higher than the U.S. tariff on wheat gluten, and that the EU import tariff on wheat starch is 40 times higher than the U.S. tariff on wheat starch. Petitioner's prehearing brief at 6-7.

⁵² Report at IV-1, IV-4.

⁵³ Report at IV-4. Canadian capacity and production also increased significantly during the period, by almost *** percent, to *** pounds and *** pounds, respectively, in 2000. Report at IV-2. Canadian exports to the United States *** during the first year that the quota was in place. However, they *** in the second year and *** in

In sum, capacity and production of other major wheat gluten producing countries have increased during the remedy period, and the EU in particular maintains substantial excess capacity.⁵⁴ Therefore, there is reason to believe that much of the increase in world production will be directed towards the U.S. market in the absence of continuation of the action, in view of the fact that the quotas have been filled, by some suppliers very quickly, and there is excess foreign production capacity, particularly in the EU.

In view of the above, we believe that action continues to be necessary to prevent or remedy serious injury.

D. Evidence the industry is making a positive adjustment to import competition.

The domestic industry is making progress in its efforts to make a positive adjustment to import competition. Over the period of relief, Midwest has invested nearly \$*** in the development, marketing, and production of new modified wheat gluten and modified wheat starch products. The modified wheat gluten products include Wheatex, a proprietary texturized gluten used as a meat extender or replacer; the FP Series, which provides film-forming properties for a wide range of food products; Aqua-Pro II, a proprietary hydrolyzed wheat protein in liquid form used in cosmetics products; and biodegradable resins used for food serviceware and in coating films. Midwest's modified starch products enhance the ***.⁵⁵

The record also indicates that Midwest had planned to construct a new plant for the production of ***.⁵⁶

Manildra secured a ***. Manildra is also currently testing modified wheat gluten for use ***.⁵⁷ ADM increased its sales of ***.⁵⁸

Heartland has focused its efforts on new product development. Since 1998, it has spent \$***.⁵⁹

Thus, the record shows that during the nearly 3 years that the remedy action has been in place the domestic industry has made substantial new investments in the plant and equipment and product development and marketing areas proposed in its adjustment plan. As a result of these efforts, domestic shipments of modified wheat gluten and starch products have increased, although, as described above, the industry remains dependent mainly on its revenues from the sale of wheat gluten rather than modified products. We discuss below in the remedy section the additional time for continued relief that we have found to be necessary.

Recommendations

Duration of extension. After considering the information on the record of this investigation, and the arguments of the parties, we recommend that the President extend the relief action for 2 additional years. We believe that this is the minimum amount of additional time that the domestic industry needs to remedy serious injury and make a positive adjustment to import competition.

interim 2000 as compared to interim 1999. Report at IV-2. Data are for years ending June 30. Canada is excluded from the quota.

⁵⁴ Report at IV-1-4. Data for 2000 are for the year ending June 30.

⁵⁵ Report at VI-2.

⁵⁶ Report at VI-2.

⁵⁷ Report at VI-2.

⁵⁸ Report at VI-2.

⁵⁹ Report at VI-2.

While the industry has developed and begun to produce a number of modified wheat gluten and wheat starch products, and its sales of those products have grown over the period, its overall sales of modified products have not yet reached levels necessary to enable the industry to withstand the resumption of heightened competition that will occur upon termination of the action.

Midwest has set the goal of \$*** in sales of modified and specialty wheat gluten products and \$*** in sales of premium, modified and specialized wheat starch products by the year 2003.⁶⁰ It has indicated that this level of sales will position the company so that it is no longer vulnerable to injury by imported wheat gluten. To achieve these goals it will need additional revenues to secure funding for increases in capacity, and will need to invest further in stepped up marketing efforts.⁶¹

Manildra Milling has indicated that it will need to sell *** pounds of a starch pre-gel product and *** pounds of modified starch to enable it to survive termination of relief. It has indicated that further time and resources are necessary to market these products, and has set a target of ***, under optimum conditions, to achieve its sales goals.⁶² It has also indicated that 2 more years of relief were necessary for its parent company in Australia to further develop, test, and market modified wheat gluten products for ultimate production and sale in the United States.⁶³

We are persuaded that two years of continued relief (until mid-2003) would provide the domestic industry with the additional time and additional revenues from sales of wheat gluten such that it would be able to complete its efforts at a positive adjustment to import competition. In the absence of continued relief, it is our view that a substantial increase in imports at low prices would cause a significant decline in the industry's performance and would thwart the industry's efforts to invest in the capital and resources necessary to bring its adjustment plans to fruition.

Amount of relief. We recommend that the President continue to progressively liberalize the action by expanding the quota by 6 percent in both of the additional 2 years. This rate of increase would be the same as during the first 3 years of the quota. It would also generally reflect the recent rate of increase in domestic consumption. Finally, it will encourage the industry to continue to adjust and thus help prepare it for the time when the action terminates – since safeguard actions are temporary in nature and cannot be extended indefinitely.

We also recommend that the President continue to administer the annual quotas on a quarterly basis, to reduce the likelihood of disruptive surges. We further recommend that the President provide an overall annual limit to address the situation in which quota shares are exceeded in any quarter.

International negotiations. We believe that the most effective long-term solution to the import problems faced by the domestic wheat gluten industry is a reduction in the high EU import barriers to trade in wheat gluten and wheat starch. As in our original investigation report, we again recommend that the President include the reduction of such EU barriers as one of his goals in any new round of bilateral or multilateral negotiations that includes agricultural products.

Scope of relief action. We recommend that the quota on wheat gluten be revised to include wheat gluten mixtures that retain the vitality of wheat gluten. The petitioner specifically referred to a blended

⁶⁰ Tr. at 120 (Mr. Seaberg); Petitioners posthearing brief at 64. The initial adjustment plan did not set target sales goals, but did indicate that sales of Wheatex, a texturized wheat protein, had the potential to reach an annual sales level of *** pounds. See Adjustment Plan at p. 8, Report at Appendix F.

⁶¹ Midwest has set out in detail its specific needs for additional production capacity and for additional staff and resources for marketing in relation to the following products: ***. Petitioners posthearing brief at 41-58.

⁶² Tr. at 160 (Mr. Piester). Manildra Milling set a goal in the initial adjustment plan of *** pounds of sales of modified wheat starch products.

⁶³ Tr. at 183-184 (Mr. Piester).

product consisting of 90 percent vital wheat gluten and 10 percent soy protein or dried meat by products that is used in making dog food. Petitioner alleged that this blended product is being made in Canada using wheat gluten from the EU and then exported to the United States. Petitioner argued that the blended product is entering the United States under tariff provisions that are not covered by the quota,⁶⁴ and from a quota-exempt source (Canada), but is being sold to former customers in the pet food business who subsequently canceled contracts with U.S. wheat gluten producers.⁶⁵

The Commission investigated petitioner's allegation and confirmed that a significant quantity of such imports have entered the United States from Canada during the relief period.⁶⁶ The service of blending wheat gluten is a relatively new commercial activity for the Canadian firm, only having begun the venture in late 1998 for sales in the United States.

Because the 90/10 blended product was not imported or produced domestically at the time of the Commission's original investigation, the Commission did not consider whether it fell within the scope of its determination.⁶⁷ In the original 201 injury determination, the Commission determined that "the imported article covered by this investigation is wheat gluten, the natural protein portion of wheat that is extracted after wheat is milled into flour."⁶⁸ In describing the domestic product that is "like" the imported wheat gluten subject to investigation, the Commission stated that it included "all forms of" basic or "vital" wheat gluten as well as those forms of "modified" wheat gluten that are used by the baking and pet food industries to add "vitality" to their products.⁶⁹

We find that the blended product retains the vitality of the subject wheat gluten product.⁷⁰ We thus find that the product is covered by the Commission's description of the scope of the product at issue in the Commission's original determination. The potential exists for significant imports of this product in the future if the action is extended. Such imports could undermine the effectiveness of the action.

Accordingly, we recommend that the President include the blended product described above within the scope of the remedy action to eliminate the potential for circumvention.

⁶⁴ In an Oct. 23, 1998 ruling, Customs classified the 90/10 mixture under HTS subheading 2309.90.10, which put the product outside the HTS subheadings listed in the President's relief proclamation. On June 25, 1999, Customs denied the request of the Wheat Gluten Industry Council to revoke the October 1998 classification ruling. See petitioner's posthearing brief at exhibits 11, 13.

⁶⁵ This issue was also raised by the domestic industry in the course of the Commission's mid-point review and included in our monitoring report sent to the President in December 1999. In the view of Commissioner Bragg, if the 90/10 product is confirmed to be within the scope, then such merchandise is within the quota.

⁶⁶ The 90/10 product is a blend of either soy protein or an animal by-product manufactured by ***. *** in Canada imported *** pounds of wheat gluten between December 1998 and June 2000 from European sources ***. Report at I-6. Interview with ***. EU exports to Canada of wheat gluten coincidentally increased, rising from 2.9 million pounds for June 1997 – May 1998 to 9.8 million pounds for June 1998 – May 1999 and further to 11.9 million pounds for June 1999 to May 2000. Report at I-6. According to Eurostat statistics, posthearing brief of Association des Amidonneries de Cereales de L'UE (AAC), app. B.

⁶⁷ Report at I-6.

⁶⁸ Investigation No. TA-201-67, *Wheat Gluten*, USITC Pub. No. 3088, March 1998, at I-3, note 1.

⁶⁹ Report at I-6.

⁷⁰ We note that no party disputed petitioner's allegation regarding the product's vitality.