

UNITED STATES INTERNATIONAL TRADE COMMISSION

WHEAT GLUTEN
Investigation No. TA-204-2

EXECUTIVE SUMMARY AND VIEWS OF THE COMMISSION
(USITC Publication No. 3258, December 1999)

EXECUTIVE SUMMARY

On June 1, 1998, following a unanimous affirmative injury determination by the Commission under Section 201 of the Trade Act of 1974, the President imposed quantitative restrictions on imports of wheat gluten. Wheat gluten, the natural protein portion of wheat that is extracted after wheat is milled into flour, was defined for purposes of the Commission's investigation as including basic (or "vital") wheat gluten and those types of modified wheat gluten that are used for the same functionality and purposes as vital wheat gluten. The most common use for wheat gluten consumed in the United States is in the production of bakery products, while a smaller percentage of consumption is in nonbakery uses such as pet foods and seafood analogs. The President applied the quota to wheat gluten imports from the European Union, Australia, and all other countries with the exception of Canada, Mexico, Israel, beneficiary countries under the Caribbean Basin Economic Recovery Act and the Andean Trade Preference Act, and developing countries that have accounted for a minor share of wheat gluten imports. Upon the announcement of the relief, the U.S. wheat gluten industry embarked on implementing its adjustment plan of improving efficiency and developing new products.

The Presidential proclamation provided for a three year quota running from June 1 to May 31 of each year. Quantity restrictions by country are as follows:

June 1, 1998-May 31, 1999:

Australia	28,315,000 kg (62.4 million pounds)
European Union	24,513,000 kg (54.0 million pounds)
Other countries	4,693,000 kg (10.3 million pounds)

June 1, 1999-May 31, 2000:

Australia	30,014,000 kg (66.2 million pounds)
European Union	25,983,000 kg (57.3 million pounds)
Other countries	4,975,000 kg (11.0 million pounds)

June 1, 2000-May 31, 2001:

Australia	31,814,000 kg (70.1 million pounds)
European Union	27,543,000 kg (60.7 million pounds)
Other countries	5,273,000 kg (11.6 million pounds)

Implementation of the quota in its first year was not smooth. Improper identification of some wheat gluten caused imports from the EU to surpass their total allotment for the first quota year by the sixth month. At the close of the first quota year the President, recognizing that imports from the EU had exceeded their allotment by 5,402,000 kg (11.9 million pounds), acted to remedy the quota overage by reducing the EU's second year (1999/2000) quota allotment by the amount of the overage in the first year. During the second quota year, the European Union exhausted its entire allotment in the first month of the year.

The Commission's monitoring investigation collected data for the years ending June 30, 1998 and 1999, a 2-year continuation of the data series collected during the original section 201 investigation. The first year of the 2-year period corresponds roughly to the year before the quota was implemented and the second year corresponds roughly to the first quota year. Despite the imposition of the quota, imports from the European Union, Australia, Canada, and other sources, whether or not subject to the quota, all increased in quantity and value during this period. Unit values from each of these sources also increased.

The United States, Australia, and the European Union continued to account for the largest share of the U.S. wheat gluten market in the years ending June 30, 1998 and 1999. However, during that period,

shipments from the United States and the European Union lost market share in the United States, while imports from Australia and from other countries subject to the quota gained market share by quantity. Imports from Canada, not restricted by the quota, showed the biggest increase, and the market share of imports from Poland, a developing country that is exempt from the quota restriction, grew rapidly as well.

Petitioner alleges that, in addition to the overage, several forms of quota circumvention limited the anticipated positive effects of the relief to the U.S. industry in its first year. Specifically, there have been substantial imports of a blend of 90 percent vital wheat gluten and 10 percent of either soy protein or dried meat by-product for use in pet food applications. The U.S. Customs Service recently classified this “pre-mix” product under HTS subheading 2309.90.10. Such blended product, which according to petitioner maintains the essential characteristics of vital wheat gluten, is entering the United States quota-free and is being sold to former customers in the pet food business who subsequently canceled contracts with U.S. wheat gluten producers.

Petitioner also cites increased imports of wheat gluten from Poland as evidence that a European producer is transshipping wheat gluten from the European Union through a subsidiary in Poland to the United States. Official U.S. Department of Commerce import statistics report no imports of wheat gluten from Poland during calendar years 1994-97 and only 440,000 pounds in the 12 months prior to the imposition of the quota. During the first quota year, however, imports from Poland grew to 5,004,000 pounds. In the first five months of 1999, imports from Poland accounted for 6.9 percent of total imports of wheat gluten into the United States.

The domestic industry saw improvement in its financial condition following the imposition of the quota. The quantity of domestic shipments in the year ending June 30, 1999, exceeded the levels of the previous six years and the value of those shipments reached a high not seen since 1994. The quantity and value of export shipments were the highest they had been in six years. Unit values of both domestic and export shipments also showed favorable increases. Each of the producers had increased sales and increased operating income between the two years examined; two firms rebounded from operating losses experienced in 1998. Increased prices were the primary factor in the increase in profitability.

U.S. prices rebounded from a 7-year low established in September 1997 and generally rose through June 1999. Quarterly sales quantities rebounded after January-March 1996 and finished in April-June 1999 at a 7-year peak. The majority of quarterly delivered selling price comparisons between the domestic and imported vital wheat gluten showed underselling by the products from the European Union and from all other countries; the majority of comparisons for products from Australia and Canada showed overselling.

The petitioner believes that quota circumvention in the first year limited the increase in U.S. selling prices and quantities. The petitioner expected U.S. producers' vital wheat gluten selling prices to average about \$0.10 more per pound and domestic sales quantities to total about 30 million pounds more than actually occurred. As a result, the U.S. industry's revenue from its domestic sales of vital wheat gluten during this period fell short of its expectations, and, in its view, negatively affected its efforts to implement its adjustment plan.

In January 1998, as part of the section 201 injury investigation of wheat gluten, the U.S. wheat gluten industry submitted to the Commission its proposal for competitive adjustment under import relief. Noting that U.S. producers were already using the most modern equipment available to produce wheat gluten in the most cost effective manner possible, the adjustment plan, while committing the industry to continue to improve efficiency and productivity, focused on the continuing development and marketing of new products made from modified wheat gluten and modified wheat starch which sell for higher prices and yield more profit than the unmodified products. U.S. producers expected relief to bring sustained profitability which would enable the necessary investment to develop and market modified products. Greater diversification, in turn, would provide the industry with the ability to withstand an increase in imports that could occur at the end of the relief period.

As early as the late 1980s, the domestic industry invested in the research and development of new products based on the physical, chemical, and enzymatic modification of wheat gluten and its co-product, wheat starch. As wheat gluten imports increased during the 1990s, however, U.S. firms dedicated even more time, and millions of dollars, to getting their new modified products to the market more quickly. This process accelerated during the relief period, as small- and full-scale plants were planned and constructed to produce modified products. An entire research division was added at one firm headed by food chemists and other scientists devoted to developing applications for new wheat technology for products already on the market. Promotional campaigns were launched and additional salespeople were hired with the technical expertise to show potential customers how these modified products could improve the quality of their goods.

Bolstered by consumer interest in natural-based cosmetics, products made from non-genetically modified organisms, and environmentally friendly biodegradable products, the U.S. wheat gluten industry is on the leading edge of world-wide research on new functional applications of wheat gluten and wheat starch. Industry-wide, U.S. firms continue their goals of building long-term relationships with customers while shifting from product-driven to market-driven strategies in order to supply product needs to customers. Many of the industry's decisions to dedicate funds to the construction of full-scale plants, as opposed to the small-scale plants that are currently in operation, are scheduled to be made in the next several months and reportedly depend significantly on the profitability of their wheat gluten operations as a whole.

SEPARATE AND ADDITIONAL VIEWS OF CHAIRMAN LYNN M. BRAGG

Wheat Gluten *Inv. No. TA-204-2*

I join my colleagues in approving the attached report as the Commission's midterm monitoring report required under section 204(a)(2) of the Trade Act of 1974. As discussed below, however, I believe that certain developments since the imposition of import relief in this case have significantly undermined the effectiveness of that relief. Specifically, the following developments, in my view, have combined to suppress domestic prices and limit domestic shipments in the U.S. market, thereby significantly diminishing the effectiveness of the quota relief intended to assist the domestic industry to make a positive adjustment to import competition.

-Developments

First, notwithstanding the imposition of quantitative restrictions by the President, wheat gluten imports reached record levels during the first year of quota relief (*i.e.* from June 1, 1998 through May 31, 1999), due in part to an overage of imports from the European Union. Although the President has responded by reducing the second year quota allotted to the European Union by the amount of the first year overage,¹ the first year overage was one of several factors that contributed significantly to lower than anticipated domestic price and shipment levels in the U.S. market following imposition of the quota relief.²

Second, imports of vital wheat gluten from Poland, which are not currently covered by the quota remedy, increased dramatically since the President imposed import relief—from 660,000 pounds in crop year 1998 to over 5.5 million pounds in crop year 1999, a more than seven fold increase.³ Prior to crop year 1998 there had been no imports from Poland since at least January 1992.⁴ This dramatic and unexpected rise in exports from Poland to the United States corresponds to a sharp decline in Polish home market shipments and exports to third country markets other than the European Union.⁵

The record reflects that increased imports from Poland into the United States were facilitated by significant exports of wheat gluten from the European Union to Poland. During the period January-May 1999, wheat gluten exports from Poland to the United States totaled 2.9 million pounds, while exports of wheat gluten from the European Union to Poland totaled 700,000 pounds.⁶ Thus, by virtue of the apparent displacement, exports from the European Union to Poland appear to have allowed for the exportation of at least an additional 700,000 pounds of wheat gluten from Poland to the United States during the first year of import relief.⁷

¹ 64 Fed. Reg. 29,773-74 (June 2, 1999).

² See Report at II-5 and V-24 (average U.S. price during the first year of quota relief was substantially lower than that anticipated by the petitioner, notwithstanding a 16.5 percent increase in apparent U.S. consumption between the 1998 and 1999 crop years). In addition to an overage of imports from the European Union, I note that there were greater than anticipated import volumes from both Canada and Poland, discussed *infra*. See Report at V-25.

³ Table II-1, Report at II-5. Crop years run from July 1 through June 30 of the following calendar year; thus, the final month of crop year 1999 (*i.e.* June 1999) is also the first month of the second quota year. Report at II-4, n.7.

⁴ Report at V-26, n.36.

⁵ Report at IV-6.

⁶ Report at II-12.

⁷ I note in this regard that Cargill B.V., a producer of wheat gluten located in the Netherlands, has a subsidiary known as Cargill Polska, which operates a wheat gluten production facility located in Wroclaw, Poland. Report at II-11 and II-12. Cargill Polska accounted for the great majority of wheat gluten imports into the United States from Poland during crop year 1999. Report at IV-6.

Notably, Poland accounted for only 0.4 percent of total imports into the United States in crop year 1998, and 2.6 percent of total imports in crop year 1999.⁸ For the first five months of 1999, however, imports from Poland accounted for a significant 6.9 percent of total imports of wheat gluten into the United States.⁹

The information developed in this midterm review demonstrates that the quota relief imposed by the President is being undermined by means of significantly increased off-quota imports into the United States from Poland, which are facilitated by wheat gluten exports from the European Union to Poland. Moreover, aside from such circumvention concerns, the President may wish to consider expanding the quota regime to include Poland based upon the significantly increasing share of total imports held by Poland during the first quota year.

Third, since the imposition of quota relief, Canada has been the source of a blended product which is comprised of 90 percent wheat gluten and 10 percent of either soy protein or dried meat by-product. The wheat gluten incorporated into this blend, however, was imported from the European Union and thus would have been subject to the EU quota if it were exported directly to the United States as vital wheat gluten.¹⁰

In October 1998, the U.S. Customs Service ruled that this 90/10 blended wheat gluten product is properly classified under HTS subheading 2309.90.10, which covers mixed feed ingredients used in animal feedings.¹¹ Apparently because Customs administers the quota regime imposed by the President on the basis of whether an import is classified under either HTS subheadings 1109.00.10 or 1109.00.90, Customs did not count the 90/10 blended product imported from Canada toward any quota limitation.

The record in this midterm review indicates that there is a significant degree of interchangeability between the 90/10 blended wheat gluten product imported from Canada and 100 percent vital wheat gluten, as at least one domestic pet food producer suspended its contract with a domestic supplier of wheat gluten in favor of the 90/10 blended product from Canada, and more than one domestic wheat gluten producer reported the suspension and/or cancellation of a contract due to the availability of the imported 90/10 blended product in the United States.¹² Moreover, the Canadian exporter has indicated that it sees potential in the U.S. market for more sales of the 90/10 blended product.¹³ The actual and potential adverse impact on the domestic industry from imports of the blended product is thus clearly evident, and there is every indication that this impact will continue to mount if current conditions remain unchecked.¹⁴

I find this prospect particularly troublesome because I believe the 90/10 blended wheat gluten product falls within the scope of both the Commission's original 201 investigation and the Commission's unanimous recommendation for relief submitted to the President.

Specifically, I note that the Commission unanimously recommended a quantitative restriction on "imports of wheat gluten *that are the subject of this investigation.*"¹⁵ The petitioner's description of the scope, which was the basis for the Commission's scope definition, emphasized that "[a]lthough the HTS subheadings are provided for convenience and customs purposes, the written description of the scope of this investigation is dispositive."¹⁶

⁸ See Table II-1, Report at II-5.

⁹ Report at II-12.

¹⁰ Report at V-26.

¹¹ Report at II-10.

¹² Report at II-11.

¹³ *Id.*

¹⁴ The record in this midterm review confirms that a substantial volume of the 90/10 blended wheat gluten product has been imported into the United States from Canada in 1999. Report at II-11.

¹⁵ *Wheat Gluten*, Inv. No. TA-201-67, USITC Pub. 3088 (March 1998), at I-3 (emphasis added).

¹⁶ Letter from Randolph J. Stayin (Barnes & Thornburg) to Donna R. Koehnke (Secretary, U.S. International Trade Commission), December 31, 1997.

The Commission, in defining a single domestic like product, found that “domestically produced wheat gluten is ‘like’ imported wheat gluten and . . . the domestic industry consists of the domestic producers of *all forms of vital wheat gluten, including modified wheat gluten that is used in the baking and pet foods industries.*”¹⁷ The Commission expressly highlighted the fact that “wheat gluten has no substitutes that have the functional properties of ‘vitality’ that are needed in the baking and pet food applications in which it is used.”¹⁸

Although the Commission in its original report acknowledged the classification of imported wheat gluten under HTS subheadings 1109.00.10 and 1109.00.90, such references simply reflected the fact that all then-known imports of vital wheat gluten were classified under those two subheadings. Thus, the imported 90/10 blended product now at issue was not specifically considered by the Commission precisely because it did not exist at the time the Commission rendered its recommendation; nonetheless, I am satisfied that all forms of wheat gluten having the functional properties of “vitality” required for baking or pet food applications, including the 90/10 blended product now at issue, are encompassed by the scope of both the Commission’s investigation and recommendation to the President, without limitation to particular subheadings under the HTS, and that import relief should be administered accordingly. In my view, to the extent that wheat gluten from the European Union enters the United States off-quota in the form of the 90/10 blended product from Canada, the quota relief imposed by the President is significantly undermined.

Moreover, aside from such circumvention concerns, the President may wish to consider expanding the quota regime to include Canada based upon the significantly increasing share of total imports held by Canada since the imposition of quota relief.¹⁹ Specifically, I note that in crop year 1998 wheat gluten imports from Canada constituted 8.0 percent of total imports, while in crop year 1999 this level increased to 13.6 percent, with the absolute volume of such imports more than doubling.²⁰ In addition, I believe that the import data for crop year 1999 are somewhat understated because they do not account for the 90/10 blended wheat gluten product imported from Canada.

Fourth, I note that the adjusted second-year quota allotted to the European Union was filled almost in its entirety within the first month of the second year of quota relief, *i.e.* June 1999.²¹ This behavior is reminiscent of the surge in wheat gluten imports from the European Union which occurred after the Commission rendered its affirmative injury vote in January 1998 but prior to the beginning of the quota regime on June 1, 1998.²² The petitioner has argued that the pre-relief period import surge created an inventory overhang in the United States which undermined the effectiveness of the first year of import relief.²³ Apparently, the large volume of wheat gluten imports from the European Union entered in June 1999 has again resulted in substantial inventories.²⁴

Based upon the domestic industry’s experience with the quota relief to date, I believe that circumstances may warrant amendment of the quota regime to incorporate a provision which would

¹⁷ *Wheat Gluten*, Inv. No. TA-201-67, USITC Pub. 3088 (March 1998), at I-9 (emphasis added). Indeed, the Commission expressly noted that the pet food industry accounted for 15-20 percent of the wheat gluten consumed in the United States. *Id.* at I-6.

¹⁸ *Id.* at I-9.

¹⁹ I note in this regard that section 312(c) of the NAFTA Implementation Act provides that the President may subsequently include a NAFTA country that was initially excluded from import relief, if the President determines that a surge in imports from that NAFTA country is undermining the effectiveness of such import relief. 19 U.S.C. § 3372(c).

²⁰ See Table II-1, Report at II-5.

²¹ Report at II-8 and V-25, n.35.

²² Report at V-24, n.29.

²³ See *Id.*

²⁴ See Report at II-4, n.7.

preclude entry of the maximum annual allotment within a relatively short period of time in order to avoid disruptive inventory overhangs in the U.S. market. Thus, the President may wish consider amending the proclamation in order to administer the quota for the third year on a quarterly basis, and to limit the amount of annual quota that may be entered in any one quarter to no more than a specified percentage of the full year quota.

–Conclusion

I note that the domestic industry has made substantial progress in achieving the goals set out in its adjustment plan, as detailed in the Commission’s midterm monitoring report.²⁵ However, the foregoing developments have operated to significantly undermine the effectiveness of the import relief by suppressing domestic prices and limiting domestic shipment levels in the U.S. market.²⁶ As a result, revenues which would otherwise have been achieved by the domestic industry have not been realized, thereby hindering the efforts of the domestic industry to make a positive adjustment to import competition within the relief period imposed by the President.

Accordingly, the President may wish to consider amending the quota relief in order to address the significant increase in imports from Canada and Poland (both in absolute terms and as a percentage of total imports), as well as circumvention of the quota on imports from the European Union via displacement of the Polish product and incorporation of wheat gluten from the European Union into the 90/10 blended wheat gluten product imported from Canada (discussed above). The President may also wish to consider amending the quota relief in order to alleviate the potential for disruptive inventory overhangs resulting from surges in within-quota imports.

In my view, such steps comport with the safeguard statute and are consistent with the records developed in both the Commission’s underlying 201 investigation and this midterm review. I further believe that such steps are necessary to allow the domestic industry to benefit fully from the import relief imposed by the President and thereby make the best possible adjustment to import competition by the end of the relief period.

²⁵ See Report, Part VI (Adjustment Efforts), at VI-1 to VI-8.

²⁶ See Report at V-24 to V-26.