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THE URUGUAY ROUND**

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NATURAL RESOURCE-BASED PRODUCTS: TWO-TIER PRICING ISSUE

Submission from the United States

The following submission has been received from the delegation of the United States with the request that it be circulated to members of the Negotiating Group on Natural Resource-Based Products.

Introduction

Trade in natural resources and natural resource-based products is a major component of international trade and is of critical importance to most domestic economies as well. Access to raw materials and energy resources is essential for the industrial sectors of all economies. Resource-rich countries depend on the export of these resources and their derivatives to promote economic growth and development. The total value of trade in natural resources and resource-based products amounts to hundreds of billions of dollars annually.

There are many complex problems affecting resources and natural resource-based products. In this submission, the United States intends to focus principally on one practice -- two-tier pricing of natural resources, particularly energy resources -- and the distorting effect this practice can have on international trade in resource-based products. In previous discussions, we have noted our concerns about other practices (e.g., export restrictions, subsidies, and government ownership practices) affecting trade in this area and we reserve the right to submit additional papers on these practices or other related subjects as the work of this group progresses.

Essential Factors

The resources which are of interest in terms of government practices and their potentially distorting effects on trade include (but are not limited to) petroleum, natural gas, coal, uranium and non-ferrous metal ores. Natural resource-based products affected by government practices include petrochemicals, fertilizers, cement and other construction materials and non-ferrous metal products. Of these products, those most directly affected by two-tier pricing practices are petrochemicals and nitrogen fertilizers.

Background and Issues

The term "dual pricing" is generally taken to refer to any government programs or actions to establish domestic prices for natural resources at some level below the value they would otherwise have if determined by market forces in a situation where there are no impediments to export. There need not be two distinct price levels in the country in question. A single domestic price, kept arbitrarily low by government intervention and restrictions of some sort on exports, or a range of low price levels all determined by such practices would equally fall under

a well-constructed definition of dual pricing. Dual pricing can distort trade by providing an artificial advantage to producers of resource-intensive or derivative products who export their goods in competition with other suppliers that do not benefit from the lowered input costs.

The distortive effects of dual pricing can be exacerbated when the producer of the resource or resource-based product is the government. Such governments seek to maximize the revenue generated by the export of their resources (in natural or derivative form). This is a legitimate and appropriate exercise of sovereignty recognized by the GATT. Unfortunately, governments tend to be less flexible than privately owned enterprises when it comes to adjusting plans to reflect changing market conditions. Thus, their actions may worsen market trends and hinder the self-correcting tendencies of the market.

The problem is well illustrated by the oil market events of 1973 to the present, including developments in oil-based products. The increasing prices stimulated production, particularly after the second shock of 1979-80, while depressing demand. At the same time, plans for refining and petrochemical capacity made in the late 1970's resulted in new supply of these resource-based products in the early to mid-1980's, when the markets for these products were weak.

The existence of high world prices for a resource coupled with weak demand for products based on that resource creates a situation with significant potential for trade distortions. These were typical during the period 1980-85 for trade in oil-based products. Among the practices cited as causing significant trade distortions were two-tier pricing, export restrictions and various other forms of government intervention intended to create artificial advantages for exports of oil-based products. Examples of specific country practices were documented in a U.S. International Trade Commission study (Potential Effects of Foreign Governments' Policies of Pricing Natural Resources, USITC Publication 1696, May 1985), which was undertaken at the request of the U.S. Congress. Trade-distortive practices in the natural resource area also include such importing-country practices as quantitative restrictions and buy-national requirements for coal use, coupled with subsidies for inefficient domestic resource producers, as noted by Australia in its earlier submission to this group.

The United States has also engaged in some of the forms of government intervention cited above in connection with natural resource-based products. U.S. oil and gas price controls in the

1970's obviously created certain advantages for U.S. petrochemical exports. U.S. export controls on oil and other resources may affect industries using these resources as inputs. Over the past eight years we have taken numerous steps to reduce or eliminate many of these practices in our own country, recognizing that in the longer term they run counter to our own interests, in addition to the problems they may cause in international trade. We note that some other countries have also moved away from such interventionist practices in recent years, including our close neighbors Canada and Mexico, with whom we have had trade frictions in these sectors in the past, and we commend them for their efforts in this regard.

It is important in considering strengthening the GATT discipline in the natural resource area to recognize the interdependence of natural resource producers and consumers. Neither can profit over the longer term at the expense of the other's industries. What we need to seek is a "win-win" result, as opposed to a "lose-lose" result from a beggar-thy-neighbor approach to trade problems. Excessive government intervention in natural resource-based product markets distorts market signals and ultimately harms all players in the market.

Relevant GATT Articles

Among the GATT Articles and provisions which have some bearing on the question of trade in natural resource-based products are Article III, Article XI, Article XVII, Article XX, and the Subsidies Code. In addition, some of the new areas also relate to these issues, such as investment. However, present interpretations of the GATT do not address the problem effectively:

1. Dual and controlled pricing do not give rise to a (countervailable) subsidy where the same price is charged to all purchases in the foreign market and they comprise more than a single group of industries; yet for certain natural resource-based products the practices have the same effects as a countervailable subsidy (a cash grant lowering the net cost to the exporter below the world, or market, price). Also, in certain cases, such pricing practices are clearly aimed at stimulating or "subsidizing" exports.

2. GATT Article XI prohibits export restrictions "other than duties, taxes or other charges." Dual or two-tier pricing has not generally been considered as within the scope of Article XI. However, two-tier pricing cannot exist unless there is some form of export restriction on the natural resource. In some cases, this practice is equivalent to a prohibited non-tax export

restriction. In the recently completed trade agreements between Canada and the United States, both countries affirmed that they considered minimum export price requirements as being inconsistent with the obligations of Article XI. The trade-distorting effects of two-tier pricing could be substantially limited by the broad acceptance of this interpretation by other Contracting Parties.

3. GATT Articles I and III proscribe discrimination as to tariffs and internal taxes respectively, but not as to export taxes; yet the protection of production for export through measures giving domestic producers discriminatory access to raw materials has equally harmful effects. Export taxes provide one means of establishing two-tier pricing, thus allowing the trade distortions that may arise in the markets for natural resource-based products.

4. The high degree of government ownership and control in resource-based industries is another factor contributing to trade distortions. Governments may adopt policies of encouraging investment in downstream industries dependent on resource inputs by offering these inputs at low prices, while at the same time promoting high prices for the resource on the world market. Where the government controls both the natural resource and the production of the resource-based product, there is a lack of transparency and a tendency to engage in behavior inconsistent with commercial considerations (providing the resource as an input at significantly less than its alternative opportunity cost sold in world markets). In addition, government-owned enterprises are often less responsive to changes in market and business cycle conditions than their commercial counterparts. Article XVII at present does not address either of these kinds of trade-distorting behavior.