COMMENTS BY THE

GOVERNMENT OF CANADA

TO THE INTERNATIONAL TRADE ADMINISTRATION

U.S. DEPARTMENT OF COMMERCE

REQUEST FOR COMMENT:

CONSTRUCTION OF PIPELINES USING DOMESTIC STEEL AND IRON

U.S. FEDERAL REGISTER 82FR05197

March 16, 2017

Submitted by:

The Canadian Embassy

Washington, D.C.

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INTRODUCTION

The Government of Canada would like to provide the following comments on the Department of Commerce's ("the Department") development of a plan for the domestic sourcing of materials for the construction, retrofitting, repair, and expansion of pipelines inside the United States, further to the notice published in Federal Register volume 82, No. 50 of March 16, 2017 ("the notice").

Canada has serious concerns regarding the plan that the Department has been asked to develop given the negative impact the envisioned restrictions would have on our shared supply chains and the Canada-U.S. trade relationship. Moreover, limiting the commercial decisions of companies engaging in private transactions would set a negative precedent, increase the regulatory burden and be contrary to fundamental World Trade Organization (WTO) and North American Free Trade Agreement (NAFTA) obligations.

BILATERAL RELATIONSHIP IN THE STEEL SECTOR

The U.S. and Canadian steel industries have long been interdependent. They are an integral part of each other's supply chains for finished and semi-finished products, especially in sectors such as automotive, construction and energy. Many steel facilities operating in both countries are subsidiaries of the same parent companies, including ArcelorMittal, Tenaris, Evraz, Harris Steel and others. In addition, most of our steelworkers are represented by the same union, the United Steelworkers (USW).

Steel trade between our two nations has allowed manufacturers in our respective countries to specialize in complementary products that enhance productivity and competitiveness, bringing jobs and benefits to both the United States and Canada. Moreover, according to the U.S. Census Bureau, the United States consistently has a trade surplus with Canada in this sector. In 2016, the U.S. surplus amounted to USD$2.3 billion for steel and articles of iron and steel. Canada is also the number one export destination for U.S. steel products, representing approximately USD$9.7 billion in 2016, which includes over USD$1.3 billion in pipe and tube products.

Canada is an important market for raw materials and purchases a total of USD$2.3 billion yearly in U.S. raw materials such as iron ore, metallurgical coal, flux, non-ferrous metals, and scrap steel. In fact, about 85% of all inputs used by Canadian steelmakers in 2016 were purchased in the United States.

Furthermore, American and Canadian steel producers are an integral part of each other's supply chains for steel products, especially in sectors such as automotive, construction and energy. For example, in North American auto supply chains, a steel coil produced in the U.S. can be transformed several times in cross border shipments with Canada, starting from raw steel, to polished sheet, to form stamping, to chrome plating, to assembly and finally to sales market.

Strong Relationship and Common Goals

Canadian and American steel is traded between our two countries based on shared, open market principles. Our industries do not seek trade remedy measures against each other because our firms operate based on fair trade practices. In fact, our industries and governments consistently work together on issues of common interest and together, tackle challenges faced in both our markets.

In recent years, Canadian and American steel producers have been equally challenged by two global trends: the problem of global excess steel capacity and unfair trading practices (dumped and subsidized imports). These pressures have affected Canadian and American steel companies and are a major factor behind the current financial difficulties of some of them. Our government officials and our industries have been working in close cooperation to address these steel market distortions. In addition to frequent informal discussions on common challenges, collaboration takes place through a number of mechanisms:

- North American Steel Trade Committee (NASTC). Since 2003, the steel industries and the governments of Canada, Mexico and the United States have met twice yearly to discuss the North American marketplace, the import situation, and other issues that may affect the competitiveness of the sector.
- Organisation for Economic Co-operation and Development (OECD) Steel Committee. Canada and the United States have a long tradition of working together to reduce market distortions in the steel sector and promote competitive and open markets for steel.
- G20/OECD Global Forum on Steel Excess Capacity. Cooperation and coordination by our governments led our leaders to push for the creation of the Global Forum in 2016. Canada and the United States continue to work shoulder to shoulder to seek concrete solutions to the global problem of steel overcapacity and production.
- Trilateral Customs Steel Enforcement and Cooperation Dialogue. Announced on June 29, 2016, our governments have stepped up cooperation between our customs agencies to ensure robust trade enforcement, including increased information sharing on high-risk shipments and on broader trends concerning potential circumvention and evasion.

Negative Impacts on the Steel Sector

Given the high integration of the Canadian and American steel industries, as detailed above, a plan that would ban Canadian steel from the construction, retrofitting, repair, and expansion of pipelines inside the United States would have serious negative economic impacts not only for Canada, but for the United States as well.

Affecting the profitability of companies operating in both countries

A number of steel producers operate mills in both Canada and the United States to produce steel for the North American energy sector, including ArcelorMittal, Tenaris and Evraz. The financial health of these companies is dependent on market stability and access for all of their operations. Therefore, their ability to maintain production and employment in the United States and their ability to undertake new investments is contingent on the viability of their Canadian operations, and vice versa. The issuance of the Presidential Memorandum has already caused significant market uncertainty in the energy infrastructure sector. Any negative impact on the profitability of Canadian steel mills could lead to a reconsideration of investment in the United States. This uncertainty extends to the energy sector where Canadian and American oil, gas and pipeline companies own tens of billions of dollars in infrastructure, have production assets on both sides of the border, and employ thousands of people.

Loss of raw materials market

As already mentioned, Canadian steel producers source the majority of their raw materials from the U.S. The loss of this market for Canadian steel producers would certainly result in a reduction in their overall production and, therefore, in a reduction in their purchase of raw materials from their U.S. suppliers.

U.S. states that would be most affected by a drop in sales of raw materials to Canada include Michigan, Minnesota, Utah (the three leading iron ore suppliers), as well as Wyoming, West Virginia, Kentucky, Pennsylvania and Illinois (the leading U.S. coal suppliers).

Benefits to the U.S. from a healthy Canadian steel sector

A ban on Canadian steel for U.S. pipeline projects would have wider repercussions on the Canadian steel sector as a whole. The loss of a significant market in the U.S. would add to the current external challenges faced by Canadian steel producers, such as global excess capacity and unfair trading practices, and may threaten their long-term profitability and viability.

The United States benefits from a healthy Canadian steel sector that provides steel inputs for U.S. manufacturing sectors such as automotive, construction, fabrication and machinery and equipment. Steel is a major export to Canada for Ohio, Pennsylvania, Indiana, Texas, Michigan, Kentucky and Alabama, supporting thousands of U.S. steel workers.

Thanks to the integration and specialization of our steel industries, Canadian steel exports to the United States complement American steel production, providing manufacturers with the specific steel grades and steel products they need to assemble finished products. Consequently, a reduction in steel production in Canada would be disruptive for multiple stages of the manufacturing supply chains across a wide range of sectors in the United States. Losing trusted suppliers would entail costs for U.S. manufacturers related to: project delays; the need to work with new suppliers to develop the specific grades of steel required; the need to factor in new shipping costs, especially for offshore imports; and, the need to renegotiate medium- and long-term contracts. Displaced steel from Canada would not necessarily be replaced by American production. Rather, it would likely lead to increased imports from countries with which the U.S. currently has a trade deficit in steel, including from countries that have an excess steel capacity and/or that use unfair trading practices.

THE OIL AND GAS SECTOR

Canada and the United States share integrated energy systems and infrastructure that support over USD$100 billion of two-way energy trade. This includes not only oil and gas and pipelines but over 30 cross border electricity transmission lines and a strong and thriving collaboration on renewable energy and clean technology, all of which advances U.S. energy security. Canada is the largest energy supplier to the United States and currently supplies 43% of the United States' daily oil imports. These imports power U.S. economic growth and support job creation in the energy sector and beyond. Canada also is the largest export market for U.S. crude, which supplies 30% of Canadian demand, and further contributes to U.S. growth and jobs. This unique relationship is sustained by a network of 70 operating cross border oil, gas and petroleum products pipelines, built over decades by an integrated world-class manufacturing supply chain.

Any disruption to our integrated energy markets, pipeline manufacturing networks, or current and future pipeline projects will place both the Canadian and American industries at a disadvantage. Restrictions on supply would increase prices of essential pipes and tubes products for our oil and gas industries and make energy extraction, transportation and operations more costly and less efficient for energy producers and consumers alike.

Domestic content requirements increase project costs due to decreased competition, capacity and supply constraints, and increased administrative burden on suppliers and the purchasing entity. Increasing the costs of pipeline transportation in the oil and gas sector could make pipelines less attractive and result in more companies relying on rail transportation. Not only would this lead to reduced job creation, but statistics demonstrate that pipelines remain the safest method to transport oil shipments.

In Canada, several pipeline projects that are either in the planning stages or in need of maintenance or retrofit, including those that cross the border, are worth over USD$31 billion. These projects are fully open to U.S. suppliers and inputs.

In order to advance North American energy objectives Canada and the United States should work together to ensure that the infrastructure that is needed to reach our objectives can be developed in a way that reflects the open and integrated nature of our energy markets.

TRADE POLICY CONSIDERATIONS

Pipeline construction in the United States is largely undertaken by private companies as an entirely commercial activity. Imposing requirements on these private companies to favour domestic products over imports would be an unprecedented intrusion into commercial decision making that would increase the regulatory burden within the United States on manufacturers and on the energy and energy infrastructure sectors. Doing so would also violate fundamental provisions of the WTO and NAFTA agreements.

Specifically, a U.S. requirement for the use of domestic steel in private pipeline construction would be inconsistent with WTO and NAFTA provisions in the areas of trade in goods and investment, in particular, GATT Article III (National Treatment), NAFTA Article 301 (National Treatment), as well as the provisions of the WTO Agreement on Trade-Related Investment Measures (TRIMs) and NAFTA Article 1106:1 (Performance Requirements). Canada will continue to protect its interests to preserve these fundamental obligations in the face of any *prima facie* violations.

These trade obligations have served both Canada and the United States well by protecting our exporters from discrimination in third country markets. For example, in 2006 Canada, the United States and the European Union successfully challenged China's imposition of measures that adversely affect exports of automobile parts on the grounds that these restrictions violated, *inter alia*, GATT Article III (WTO DS DS339, 340, 342). In that case, the United States argued that by establishing thresholds on the use of imported auto parts that trigger additional internal charges and burdensome procedural requirements, the measures accord less favorable treatment to imported auto parts than to domestic auto parts. The WTO Appellate Body upheld the Panel's findings that the Chinese measures violated GATT Article III:4 because they accorded imported parts less favourable treatment than like domestic auto parts.

CONCLUSION

Canada believes that private companies should be allowed to operate in accordance with commercial considerations, without regard for nationality. The United States and Canada are natural allies on steel, for which we have a complementary, interdependent and mutually beneficial trading relationship. Both Canada and the United States have a persistent trade deficit in iron and steel products with the world, and our steel producers face similar pressures caused by the global problems of steel overcapacity and dumped and subsidized imports originating from outside of North America. Working together to advance free and fair trade is of paramount importance to ensure a strong future for our steel and energy industries and to create good jobs on both sides of our border.

Any restrictions on Canadian steel or other Canadian inputs into U.S. pipelines would have a negative impact on this mutually beneficial trading relationship. Uncertainty is, in fact, already having a negative impact on construction, orders and jobs in both Canada and the United States.

Canada appreciates the Department's willingness to receive public comments on this matter. We strongly hope that the economic and legal arguments detailed in this submission will contribute to the conclusion that the potential benefits of any pipeline input restrictions would be outweighed by the far more significant and broad negative impacts on the U.S. economy that such restrictions would have. Transition periods or exceptions for materials already purchased would not fundamentally address the significant negative impact that restricting access would have. As such, it is Canada's strong belief that the Department should not proceed with the proposed plan.