PACIA	**Plastics and Chemicals Industries Association**

Submission to the Department of Foreign Affairs & Trade

Feasibility Study on an Australia China Free Trade Agreement.

July, 2004

Introduction

The Plastics and Chemicals Industry Association (PACIA) is the peak national body for the Australian plastics and chemicals sectors.

In 2000-01, turnover in these sectors was $24.63 billion. This was an increase of more than 12 percent on the previous year, and over four years turnover has increased by 21.8 percent. These data are at current prices.

Industry value added in 2000-01 was $6.9 billion. At current prices, this was an increase of only 1.3 percent on the previous year, and overall value added has not increased significantly over four years.

At 30 June 2001, these sectors employed about 81,300 persons. By comparison, employment one year earlier was 77,096 and four years previously was 75,378. Total employment growth over four years was about 7.9 percent. Over the same period, wages and salaries increased by 53 percent, in current price terms, to $3.8 billion.

The chemicals and plastics (C&P) sectors represented about 9 to 10 percent of total manufacturing activity, as the following figures show:

Indicator	**C&P as % Mfg**
Turnover	9.78
Industry Value Added	9.57
No Employed	8.60
Wages and Salaries	9.76

Employees in the chemicals and plastic sectors are, comparatively, highly skilled and educated. Wages and salaries in these sectors are about 114 percent of the average for manufacturing.

In 2003, exports to all destinations by the C&P sectors were $3,312 million. This was 5.6 percent down on 2002 export values, but 20 percent above the value, in current price terms, of exports in 1999. Imports in 2003 were $9,426 million, a 25 percent decline on the previous year. Over the four years to 2003, imports fell by 12.6 percent in current price terms.

The International Council of Chemical Associations (ICCA) estimates that world chemical industry production exceeds $US1.7 trillion annually, and that nearly one third of this production is traded internationally. Australian production represents less than one percent of world production.

Chemicals and Plastics – Australia's Trade with China

Australia has a substantial trade deficit with China. In 2003, exports were $293 million, compared to imports of $690 million. Details of trade for broad industry sectors are set out in Table 1 below.

Table 1: Australia's Trade with China - Chemicals & Plastics Sectors

Industry Sector	**Exports 2003 ($m.)**	**Imports 2003 ($m)**
253 Basic Chemicals	197.7	221.8
254 Other Chemicals	30.7	98.3
255 Rubber Products	6.3	76.0
256 Plastic Products	57.9	293.7
Total	***292.8***	***689.8***

In 2003 China replaced the US as Australia's second largest export market for C&P, with China representing about 9 percent of total exports[*]. In that year China was the third biggest supplier of C&P imports after the US and Japan, and represented over seven percent of total imports*.

Australia's exports of C&P products to China have increased rapidly in recent years, from a $116 million in 1999 to $293 million in 2003, an increase of more than 150 percent. The comparable increase in exports to all countries was 21 percent. The increase in export trade to China has been spread across many sectors, as Table 2 indicates.

[*] Figures should be treated with some care – due to confidentiality requirements, there are no country details for one quarter of exports, and 9 percent of imports.

Table 2: Australia’s Exports to China - Key Chemicals & Plastics areas

Industry Group	Value, 2003 ($m.)	Increase 1999 – 2003 (%)
Inorganic Industrial Chemicals	152.2	153.9
Synthetic Resins	30.1	125.1
Plastic Extruded Products	26.7	144.9
Plastic Injection Moulded Products	25.2	281.2
Paints	17.0	350.1
Organic Industrial Chemicals	15.4	146.3
Total	***292.8***	***152.4***

Australia's imports of C&P products from China has also increased over the past four years; despite a fall of 23 percent in 2003, imports in that year were some 31 percent above the 1999 figure. The increase of 31percent over four years in imports from China compares with an overall decline in imports of C&P of 12.6 percent over four years 1999 to 2003. Table 3 provides details of imports for major product areas.

Table 3: Australia’s Imports from China - Key Chemicals & Plastics areas

Industry Group	Value 2003 ($m.)	increase 1999 – 2003 (%)
Plastic Injection Moulded Products	220.9	18.4
Organic Industrial Chemicals	137.0	43.4
Plastic Bags & Film	59.9	6.5
Inorganic Industrial Chemicals	59.5	11.6
Total	***689.9***	***31.4***

More complete details of trade with China in the chemicals and plastics sectors are contained in Attachment 1.

Survey of PACIA members

PACIA forwarded a questionnaire to all domestic manufacturing and importer members of the Association as part of preparing a submission to the Feasibility Study. The format of the questionnaire generally followed the format suggested by the DFAT at the time that submissions were called for in early April.

Nine members of the Association - seven who identified as manufacturers (one as a manufacturer/importer), and two importers - replied. A summary of these replies is Attachment 2.

Overall, there was little support for an FTA. No respondents saw the benefits as outweighing costs, and most saw a substantially negative impact.

The replies to the questionnaire clearly indicate that the C&P sectors have a range of concerns about access to the Chinese market which must be addressed if an FTA is to deliver benefits to export markets. These include:

- tariff rates which are currently above 10 percent for a range of products
- bureaucratic processes imposed on foreign enterprises of differently to those applicable to local firms
- differences in supply costs of inputs as between locally based and overseas and enterprises
- concern about collusion and market manipulation, with the apparent objective of influencing world market prices
- lack of Intellectual Property protection; and
- inconsistencies of application of administrative requirements

Eight of the respondents indicated that they would like to be contacted further by DFAT concerning their responses; details of company contacts for these respondents are set out in the response to Question 27 of the survey.

The Chemicals and Plastics Sectors, and the Regional Context

The C&P sectors in the Asia region have experienced significant growth in over the past few decades, and this growth is expected to continue as the countries in the region expand and develop their industrial bases.

China will be a major part of this development, it is the largest economy in the region and is expected that its recent rapid growth will continue for many years.

Developments in technology has seen the size of many plants in the chemicals and petrochemical areas increase - in some cases to operating capacities that are several times larger than the plants of only 10 and 20 years ago.

While this new technology offers potential for reducing costs, it creates some significant issues for the Australian industry. In many cases, the size of modern plants is larger - significantly larger - than Australia's domestic market, and the development of plants in Australia could only be contemplated on the basis of some confidence that export markets can represent a substantial proportion of output. However, freight costs and a range of tariff and non tariff barriers applied by countries in the region - often reflecting their own industrial development aspirations - preclude Australia from these markets. Also, Australian producers typically face higher costs for capital developments, safety, environmental and social requirements than other suppliers in the region, and this too limits export potential.

The C&P sectors have, in the context of the Chemicals and Plastics Action Agenda (CPAA), developed proposals for substantial, export oriented petrochemical developments in North Western Australia based on the availability of hydrocarbons, and has asked that the Government sponsor a study, which builds upon the work already undertaken with the support of the Western Australian Government. There remain, however, many hurdles if this or any other major projects is to progress, including higher establishment and operational costs than those of Asian competitors.

There are, and will continue to be, product areas where Australian plastics and chemicals sectors can compete internationally, and even remain a significant and technically advanced influence in world markets. However, for the major part of these industry sectors, the outlook is that it will remain essentially an import replacement capacity focused on the domestic market and centred in 'brown fields' developments in or near capital cities.

Markets and prices for major chemicals and feedstock are volatile, with both prices and supply volumes fluctuating significantly due to economic cycles and market influences. Markets are also influenced by the large-scale and high fixed cost structures of these sectors - at times of surplus capacity, producers will sell any excess production at marginal cost as it is typically cheaper to do this than scale back plants. As new plants are commissioned they represent a significant part of world supply, and each new plant can lead to surpluses and significant price reductions. This phenomenon can have a particularly acute impact in international spot markets where the new production capacity is in a developing country which is protected by tariffs and other measures and has a substantial part of the output committed for local consumption, with output above this demand sold at whatever price can be obtained.

Australia, as a comparatively small, open and competitive market is particularly susceptible to the market volatility described above. In many cases, local producers have no alternative but to seek to match the 'spot' prices, as they too do not have the capacity to scale back production and maintain profitability.

Notwithstanding the limits to their capacity to utilise latest technology and expand, and the inherent volatility of the market, the C&P sectors believe they can continue to serve the domestic market at very low or zero rates of import duty. Presence in the market, access to low-cost energy and feedstock sources, the opportunity and time to adjust and improve productivity of existing plant and the capacity to survive the slumps of a volatile market are, however, all crucial to survival.

Tariff Assistance to the Australian Industry

General Rate duties in the C&P area (Chapters 28 to 40 of the Australian Harmonised Tariff) are, with a few exceptions relating to parts for motor vehicles and plastic or rubber garments, at either 5 percent or free.

PACIA's attitude to FTAs has been based on a recognition that the trend in border assistance is toward free rates of duty, and that, in time, the Australian industry must compete without tariff assistance. In the light of this, PACIA considers that there are three essential issues that should be addressed in relation to tariff and tariff related measures; these are:

a) Phased tariff reductions; and
b) Effective Rules of Origin.
c) Removal of the 3% Revenue Tariff on Certain Tariff Concession Orders

(a) Phased Tariff Reductions

PACIA's position in relation to the phased tariff reductions recognises that while that the existing tariffs of 5 percent may be minimal from a broader economic policy point of view, many Australian chemical and plastic producers have received significant benefit from the 5 percent tariff, and this level of assistance is factored into their business and investment decisions and pricing strategies. Importantly, it is vital to profitability, which is often less than the price margin afforded by the 5 percent duty.

This position recognises also that the C&P sectors are, essentially, import replacement industries and thus price takers, and that they are also relatively capital intensive industries with plant and equipment amortised over a long periods. As a consequence, the requirement to improve productivity to maintain competitiveness with overseas suppliers is an ongoing challenge, and a significant, discrete reduction in prices as a result of a tariff reduction does have a substantial adverse effect on the ongoing efforts of the industry to implement the change necessary to achieve productivity improvement over time.

PACIA seeks the phasing down of the current 5 percent General Rate on a range of C&P produced domestically. This range is not extensive – in the context of the Australia US FTA, the list was less than 70 tariff items. PACIA will review this list to ensure it accurately reflects the current industry structure and capacity, and provide it for the Feasibility Study.

In the Australia Singapore FTA phasing down of duties was not achieved. Phasing was achieved in the Australia Thai FTA, but not so in the US Agreement (with one, minor, exception).

A consequence of the Singapore FTA outcome was that Australian plastic/polymer and chemical producers report that, where Singapore is a significant supplier to the Australian market, the need to match Singapore's prices has effectively denied the Australian industry the price margin that General Tariff rates would provide were the FTA not in place.

If, or perhaps when, the US agreement is finalised, it would seem likely there will be a similar impact, but affecting an even broader range of products.

The concern of the C&P sectors is that an FTA with China will have an impact on a broad range of both intermediate goods and final products (including, importantly, inputs into industries such as the auto, white goods and food industries), to the extent that the General rate has little relevance to the assistance of the sectors receive from tariffs

Against this background, PACIA's attitude will continue to be that the phased introduction of tariff reductions is, and will continue to be, important to significant sectors which can and will compete at free rates, but need time to make the investment and other structural adjustment necessary to survive.

China is recognised as a very low-cost supplier, and has the capacity to rapidly expanded its production and output in most manufacturing activities. Phasing of duties will be an important transition feature of an FTA if Australia is to have the capacity to restructure to the change to market circumstances that the free trade agreement will involve

(b) Effective Rules of Origin (RoOs)

Effective RoOs are vital in any FTA if the FTA is to ensure that third countries do not derive a benefit from the FTA by means of transhipment, minor final processing activity or the misrepresentation of origin. In this context, PACIA has supported an approach to RoOs based on a requirement for substantial transformation, as evidenced by a change of tariff classification, or CTC. A key advantage of this approach is its simplicity (compared to other approaches) and consistency of operation, and the ability of third parties to identify avoidance or evasion of its provisions.

PACIA considers that the criteria for RoOs established for the Australia United States FTA provides a sound model and requests that the same model be adopted in relation to a possible FTA with China.

(c) Removal of the 3% Revenue Tariff on Certain Tariff Concession Orders (TCOs)

The decision by the government in 1996 to impose a 3 percent duty on manufacturing inputs eligible for a TCO continues to be a significant impost on local manufacturers, as many of the products subject to this duty are essential inputs to local activity - for example, catalysts and additives used in the manufacture and compounding of plastics, particularly higher performance plastics.

This 3 percent duty on TCO imports was introduced as a Budget measure. On many occasions, and over several years, the Government has acknowledged that the 3 percent duty on TCOs is an imposition which adversely affects the competitiveness of Australian industry, and has indicated that is committed to its removal as soon it is as it is fiscally responsible to do so. Yet despite substantial budget surpluses, and a range of measures to reduce tax and return surplus to the economy, the three percent tariff on TCOs has not been withdrawn.

The duty on TCOs becomes a particular irritant, and acts to reduce assistance levels to local producers, when it applies to inputs to a process where the downstream products with which the industry must compete are imported duty free.

PACIA considers that the continuation of the 3 percent duty on TCOs reduces the ability of the manufacturing industries to adjust to change brought about by the competitive pressures associated with the introduction of FTAs, and requests that the government address this issue as a matter of urgency in order that industry can best address the impact and benefits of free trade agreements. PACIA considers that, given the impact of FTAs on domestic prices (and assistance levels generally), it is appropriate and timely to address the 3 percent duty on TCOs, before the full impact of current and prospective FTAs is felt.

Anti-Dumping and Countervailing Duties

In the context of negotiations for all previous FTAs, PACIA has argued strongly that these Agreements should maintain and preserve the rights of Australian industry in relation to safeguards, particularly, the capacity to take anti-dumping and/or countervailing action in accordance with the existing rights under World Trade Organisation Agreements.

The FTAs that Australia has entered to date, and the US FTA, do have adequate provisions in relation to anti-dumping and countervailing activity.

The position in relation to China is, however, complicated by the fact that in many respects China is not a market economy, and thus there are complex issues in establishing that dumping has occurred, and an appropriate dumping margin. This complexity is compounded by –

- legislation to address the 'Economies in Transition' issue which was recently passed by Parliament, and
- provisions within the Australia China Trade and the Economic Framework which also specifically address be 'market economy' status of China.

PACIA notes and that China FTA Study Task Force placed a document entitled 'China: Market Economy Status' on the DFAT website in late June 2004. A separate submission in relation to the anti dumping issue, including matters raised in the DFAT paper will be forwarded shortly.

Safeguards other than Anti-Dumping

The supply and market situation of the C&P sectors in the Asian region outlined above provides some explanation for the interest of the Australian chemicals and polymers sectors in anti-dumping action. Similar industry structures and market influences would seem to prevail in relation to other industry sectors where anti-dumping action has been sought and achieved in recent times than -- paper, glass and steel products are, perhaps, other examples.

PACIA and the C&P sectors are concerned that anti-dumping action is an inadequate remedy to the market situation described. In can often be the case that depressed prices due to surplus capacity relates to factory inputs and feedstocks, and where this depresses prices and increases supply of downstream products anti-dumping action is not available in relation to those downstream products. Apart from the expense of bringing in anti-dumping action, the time taken for an investigation to be completed means that the injury experienced by the industry is not addressed in sufficient time.

This concern has a particular relevance in the case of China, where it can be reasonably expected that industrial development in the C&P sectors will be based on the latest technology involving very large plants and based on expectations of ongoing and significant increases in domestic demand - a situation where the commissioning of these plants may lead to surplus capacity (at least in the short term), and market volatility.

PACIA considers that the Feasibility Study should explore whether there are safeguard actions available other than anti-dumping which might better serve Australian industry in order that it can survive the inherent volatility of growth in the Asia region, and China in particular. It would seem especially important that there is a clear direction in this regard if, as would seem to be the case, an outcome of an FTA with China is a lessening of the capacity to take effect anti-dumping action in a situation where government influence on the prices and output remains a reality.

Conclusion

The C&P sectors are encouraged by trade statistics which have indicated strong growth in exports in recent times (albeit from a comparatively low base in terms of local activity and international trade volumes). While these sectors note that there continues to the the potential for growth in trade in intermediate goods with China, it remains concerned that practical limits on domestic capacity, freight and other domestic infrastructural costs will mean that there are limits to the extent to which export potential provides significant opportunities for these sectors.

Tariff and non tariff barriers remained important impediments to the potential markets for C&P products in China. PACIA supports the view that it is imperative that these barriers be addressed in any FTA developed with China.

The C&P sectors consider that it is appropriate that, for import competing goods produced in Australia, tariffs of 5% should be phased to zero over time as part of any FTA with China. The necessity for the industry to address structural adjustment issues and improve productivity in order that it can compete at free rates of duty involve careful consideration of capital improvements and market strategies, and these sectors consider is appropriate that they be given time for decisions in these areas to be implemented. Effective Rules of Origin are vital part of any ongoing tariff assistance regime.

The C&P sectors have raised the issue of nuisance tariffs with the government for many years. These sectors consider is imperative that the Government acknowledge that its concern is in this area are relevant to its capacity to effectively address the challenges of bilateral FTAs (and reducing border assistance levels generally), and that this issue should be resolved before Australia commits itself to FTA with the largest economy in the region.

PACIA will make a further submission to the feasibility study on Anti-Dumping issues.

PACIA considers that the Government, as part of the Feasibility Study, should address the issue of effective safeguards generally, so that the available safeguards are attuned to the market conditions that are likely to prevail in the region in the future, particularly the market volatility that is apparently inevitable as the region expands and develops its infrastructure in industry sectors such as C&P.

PACIA understands that there will be ongoing dialogue during the Study and that there will be further opportunity to represent the views of the C&P sectors is. Any feedback from this submission, and on other issues of concern in relation to trade with China, would be welcome.

Plastics and Chemicals Industry Association
July, 2004