Plastics and Chemicals Industries Association

Submission to the Department of Foreign Affairs & Trade

Australia - Malaysia Free Trade Agreement Scoping Study

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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 Malaysia

Australia has a substantial trade deficit with Malaysia. In 2003, exports were $77 million, compared to imports of $271 million. Details of trade for broad industry sectors are set out in Table 1 below.

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

Industry Sector	**Exports 2003 ($m.)**	**Imports 2003 ($m)**
253 Basic Chemicals	45.0	81.7
254 Other Chemicals	21.5	35.1
255 Rubber Products	2.2	84.0
256 Plastic Products	8.6	70.2
Total	***77.4***	***271.0***

In 2003 Malaysia was Australia's 12th largest export market for C&P, representing about 2.3 percent of total exports*. Malaysia was the 11th biggest supplier of C&P imports, and represented 2.9 percent of total imports*.

Australia's exports of C&P products to Malaysia have declined in recent years, from a high of $88 million in 2001 to $77 million in 2003. This decline of 12 percent compares to a decline in total exports over this period of 25 percent.

Australia's imports of C&P products from Malaysia have increased over the past four years; despite a fall of 28 percent in 2003, imports in that year were 13 percent above the 1999 figure. The increase in imports from Malaysia has been particularly evident in a few product areas, 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 Imports from Malaysia - Chemicals & Plastics

Industry Group	Value 2003 ($m.)	increase 1999 – 2003 (%)
Plastic Bags & Film	54.2	39.8
Organic Industrial Chemicals	27.9	92.2
Rubber Tyres	27.9	48.1
Synthetic Resins	18.5	110.9

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

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.

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 to 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 are 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 they 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 and protected by tariffs and other measures, and output above local consumption demand is demand sold on export markets 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.

Access to the Malaysian Market

As the trade data above indicate, the C&P sectors do not have a substantial market in Malaysia. However, the tariffs of 30 percent applied to many import competing chemicals and plastic products, and this severely limits the capacity of any potential importer to compete, and develop markets.

PACIA does not have any information about non tariff barriers, and other restrictions on investment, immigration, banking, etc which can limit market access, either generally or in relation specifically to the chemicals and plastics sectors. However, it is recognised that an important benefit from bilateral trade agreements is the capacity to identify and remove (or at least reduce) non tariff and other restrictions. PACIA therefore supports efforts in this regard.

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 in any FTA proposal there are three essential issues that should be addressed in relation to tariff and tariff related measures; these are:

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

<u>(a) Phased Tariff Reductions</u>

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 price takers where world prices are transparent and volatile; 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 Scoping 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).

Australian plastic/polymer and chemical producers report that a consequence of the Singapore FTA outcome, where Singapore is a significant supplier to the Australian market, was that the need to match Singapore's prices effectively denied the Australian industry the price margin that General Tariff rates had provided before the FTA.

The concern of the C&P sectors is that when the US agreement is finalised, and if an FTA with China is consummated, it would seem likely that the price margin afforded by General tariff rates will be eroded for a broad range of import competing industries' products (including, importantly, inputs into industries such as the auto, white goods and food industries).

An FTA with Malaysia will continue and extend this erosion.

Against this background, PACIA's considers that, within particular industry sectors, it is appropriate that the first step in the changes to tariff rates within a bilateral agreement is to align the rates of both parties, and that the phasing of rates to zero should provide industry sectors with the time to make the investment and other structural adjustment necessary to realise the opportunities available from larger, but very different, markets.

PACIA's attitude will continue to be that the phased introduction of tariff reductions is, and will continue to be, important to significant parts of the C&P sectors which can and will compete at free rates in the longer term.

(b) Effective Rules of Origin (RoOs)

Effective RoOs are vital in any FTA if it 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 Malaysia.

(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 the surplus to the economy, the 3 percent tariff on TCOs has not been withdrawn.

The duty on TCOs becomes a particular irritant, and delivers negative effective assistance to local producers, when it applies to inputs to a process where the downstream products of the industry must compete with goods that are imported duty free.

PACIA considers that the continuation of the 3 percent duty on TCOs reduces the ability of manufacturing industries to take the opportunities and adjust to 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.

Safeguards

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, of considerable concern to the C&P sectors. Along with other industry associations, these sectors consider the terms the Australian Government agreed for the commencement of a feasibility study, and for the commencement of FTA negotiations, represent a significant erosion of rights, provided for by WTO Agreements and included in Australian legislation.

PACIA considers that it should be a basic and non-negotiable element of any FTA with Malaysia that anti-dumping and countervailing rights and obligations set out in WTO Agreements (and provided for in Part XVB of the Customs Act) are maintained.

Safeguards other than Anti-Dumping

The industry and market situation of the C&P sectors in the Asian region outlined above (ie, high fixed costs, volatile world markets,) provides some explanation for the interest of the Australian C&P 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. 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 to avoid injury and market share losses to the domestic industry.

In can often be the case that depressed prices due to surplus capacity relate to factory inputs and feedstocks. Where this depresses prices and increases supply of downstream products, anti-dumping action is not available in relation to those downstream products. In this situation, (sometimes described as 'input dumping')WTO anti-dumping provisions provide no remedy for predatory and destabilising actions that are typical of the cyclical trough.

In the current (and ongoing) growth climate in Asia, concern about the impact of market supply and price volatility, has a particular relevance. It can be reasonably expected that industrial development in Asia will be based on the latest technology involving very large plants and based on expectations of ongoing and significant increases in domestic demand – but where surplus capacity will, at least in the short term, cause market volatility and sales at marginal cost or less to maintain factory throughput.

PACIA considers that the Scoping 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.

Conclusion

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

The C&P sectors consider that it is appropriate in any FTA that, for import competing industries, tariffs applied by both parties should first be aligned, and then phased to zero over time. 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 require 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 FTAs covering substantial parts of the region, and our largest trading partners.

PACIA considers that an FTA with Malaysia should maintain and preserve the rights of Australian industry to take anti-dumping and/or countervailing action in accordance with the existing rights under World Trade Organisation Agreements.

PACIA considers that the Government, as part of the Scoping 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 Malaysia, would be welcome.

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