Kaal Australia

Submission to the

Productivity Commission

Review of Australia's General Tariff Arrangements

January 12, 2000

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January 11, 2000

Frontispiece

The attached submission to the Productivity Commission Review of Australia's General Tariff Arrangements sets out Kaal Australia's reasons for the retention of the 5% tariff on aluminium general sheet and foil.

Kaal Australia rejects the assertion by Industry Minister Senator Minchin in his statement of July 1, 1999, that the existing 5% tariff is a "nuisance tariff".

Rather than improving competitiveness, the removal of the tariff will signal to Kaal's global competitors that reciprocity in market access is no longer required.

Kaal supports Australia's initiatives in the development of free markets, but these must be matched by its trading partners if we are to see genuine global competition.

Tariffs, which promote these principles, are not "nuisance tariffs" but important and essential strategic tools, which will enhance rather than diminish the policy objectives of globally competitive markets.

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Background

The Australian Government has announced its intention to review Australia's General Tariff Arrangements. The Productivity Commission is conducting this review to make recommendations consistent with:

- Improving the overall efficiency of the Australian economy
- Encouraging the development of sustainable, prosperous and international competitive industries in Australia; and
- Promoting the provision of high quality competitively priced goods and services to Australian businesses and consumers.
- Supporting the social, environmental and regional policy objectives, including employment objectives, of Australian Governments.

Specifically, the Productivity Commission intends to make recommendations on the following:

- What general tariff rate or rates should apply post 2000?
- Should tariff changes be made across the board? Are exceptions justified for particular commodities or industry groups, on what grounds?
- When should tariff changes be made and why?

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Executive Summary

Kaal Australia is a leading producer of aluminium flat rolled products, supplying both domestic and export markets. Kaal's costs are globally competitive and in the last 3 years the company has grown its exports by around 50%.

In 1998 Kaal Australia generated $350 million in export revenue.

Kaal Australia's business has been seriously impacted by the Federal Government's decision to remove a 5% tariff on aluminium canstock, Kaal's primary product.

Australia's stance on aluminium canstock tariffs is unique. All other countries, which have aluminium rolling mills, have tariff protection. As a direct result of the removal of the tariff, Kaal Australia's margin on its domestic bodystock business has been reduced to break-even (bodystock is a specific canstock product that accounts for 70% of Kaal's output of canstock by volume).

Kaal supports the principle of free trade and believes that it is an appropriate policy objective for Australian Governments. However, the company believes that Australia has moved too far ahead of its competitors in reducing its domestic tariffs. Australia's competitors will have no incentive to keep pace with Australia while they enjoy unrestricted access to our markets and lock out competition from their own markets.

Kaal Australia has seen no indication that any other country has seriously moved to reduce tariffs on aluminium rolled products to levels approaching those of Australia. In fact, new global-scale aluminium rolling plants are currently being established overseas with government commitments to freeze domestic tariffs on aluminium sheet products over the payback period.

In response to the Australian Government's decision to remove the canstock tariff and the subsequent loss of margin, Kaal is assessing its options to grow its capacity in other product areas. Further reductions in Australia's general tariff rate from 5% would make this strategy unattractive.

Margins in the aluminium rolled products business are typically in the order of 2-5%. Uncertainty relating to Australia's future tariff rates has created an extremely volatile climate for investment decisions.

The announcement of the Review of Australia's General Tariff Arrangements has caused Kaal Australia to put all capital expenditure plans - including proposed capital expenditure in a new process for specialised transport sheet production - on hold, pending the outcome of this Productivity Commission Review, and the Government's subsequent response.

The Australian Aluminium Rolled Products Industry

Australia has two domestic producers of rolled aluminium products – Kaal Australia and Capral aluminium. Kaal is Australia's sole producer of aluminium canstock used in the manufacture of aluminium beverage cans.

Australian Aluminium Rolled Products Production (tpy)

	1998		1997	
	Domestic	Export	Domestic	Export
Canstock	51792	73730	49824	56160
General Sheet	26673	27991	26138	29499
Foil	8264	589	7795	670
Total	**86729**	**102310**	**83757**	**86275**

The domestic canstock market is a mature market and has remained relatively static in recent years. Aluminium is under intense pressure from competing packaging materials such as plastics and glass.

By contrast, the Asian canstock market has experienced considerable growth. Kaal Australia has built a significant business exporting aluminium canstock into Asia.

The Australian market for general sheet has seen rapid growth in the last three years, primarily serviced by imports. The growth has been driven by increased use of aluminium in transport and shipbuilding applications.

Rolled Products Imports (tpy)

	1998	1997	1996
General Sheet	22353	23419	14438
Foil	9251	10345	8852
Total	**31604**	**33764**	**23290**

Asian Aluminium Rolled Products Industry

The aluminium rolled products business is capital intensive. A typical 200,000-tpy plant requires an investment in the order of US$400-$500 million.

Success in the aluminium rolling business requires optimum utilisation rates of all capital equipment.

Semi-fabricated manufactures are generally low-margin businesses. This is particularly the case in the aluminium rolling industry, as the cost of raw aluminium comprises a large proportion of total production costs.

Margins for many of the industry's high-volume products are typically in the order of 1-2%. A 5% tariff can mean the difference between an adequate return and a loss.

Asia's major rolled products producing countries have considerably larger domestic markets than Australia. All rolled aluminium-producing countries focus primarily on servicing their domestic markets. Exports are then priced incrementally to maximise capacity utilisation.

Australia's small market has dictated that Kaal build its business on export markets. ***Two thirds of Kaal's products are exported.***

Globally competitive prices within the Australian domestic market underpin Kaal's ability to supply more than 50% of its product into the volatile Asian market. Domestic tariffs play a key role in creating price stability within domestic markets.

Aluminium rolled product prices in Asia are extremely volatile, particularly in the highly competitive aluminium canstock market. Prices vary widely from periods of scarcity and higher than average global prices through to periods of low demand when global producers' use Asian markets (and potentially Australian markets) to dump product.

Global Tariff Rates for Aluminium Rolled Products

Should the Commission recommend removal of the "nuisance tariff" Australia will have the lowest tariffs on aluminium sheet products of any producing nation. Australia is the only country in the world to have a zero tariff on aluminium canstock.

Current tariff rates for major rolled products producing countries include:

India		27.5%
Taiwan		10%
China		12%
South Africa		14% reducing to 10%
Korea		8%
EU		7.5%
US		3%
Bahrain		12%
Malaysia		30%
Indonesia	Canstock	5%
	General sheet and foil	20%
Australia	**Canstock**	**0%**
	General sheet and foil	**5%**

*Source: DFAT Trade Negotiations Analysis System May 1999. **Many countries also have significant non-tariff barriers.

As Tim Colebatch, economics editor of the Age newspaper put it earlier this year *"a decade of rapid tariff cuts has made Australia the most open market for imports in the Western World, while other countries have largely stood their ground".*

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Impact of November 1999 tariff removal on Aluminium Canstock

In response to a recommendation made by the Industry Commission in its 1996 "Packaging and Labelling Inquiry", the Federal Government removed the 5% tariff on aluminium canstock - effective 1 November 1999.

The Australian Government's policy position requires Kaal Australia to compete against significantly larger canstock producers with significantly larger domestic markets on an uneven playing field.

Without similar tariff reductions from competing producers and suppliers of canstock products, the Australian Government 's decision has serious negative implications for Kaal Australia's business.

An immediate market response to the decision has reduced to break even margins for aluminium bodystock.

Since the Australian Government decision was announced in March 1999, Hulett of South Africa has commissioned a US$450 million major expansion of its aluminium rolling business, raising its capacity to 150,000 tpy.

Kaal currently supplies the South African market with 20,000 tonnes of canstock per year. South Africa has indicated that it will maintain a tariff of 10% on canstock once the Hulett project comes on line. Accordingly Kaal Australia's shipments to South Africa will reduce to 7000 tonnes in 2000 with shipments ceasing by year-end.

As a result of Australian Government policy, Hulett will be able to supply the Australian canstock market free of the tariff barriers, which protect its own domestic market.

Alcan, a major multinational canstock producer, announced in June the acquisition of Taihan Electric Wire Co Ltd and the commitment to expand to a 300,000 tpy canstock rolling facility in Korea.

Kaal currently exports between 10,000 and 12,000 tpy to Korea. Kaal will continue to face an 8% tariff on product entering Korea when Alcan's Korean operations begin exporting competing product to Australia with no tariff or non-tariff barrier.

Combined, these developments will result in loss of business to Kaal of 30,000 tpy. The impact on the Australian domestic market from imports from these countries is as yet unknown.

Impact of further tariff reductions on product diversification strategy

The reduction of Kaal's margins in canstock products has made it necessary for the company to identify other markets to maintain profitability and offset the potential loss of domestic canstock business to imports.

A significant import replacement and export opportunity has been identified through the introduction of capital intensive technology to manufacture aluminium sheet suitable for Australia's flourishing shipbuilding and transport equipment industries.

Australian imports of aluminium sheet are worth about $110 million a year. Potential also exists for Australia to become a leading exporter of high-quality aluminium sheet products as well as the technology required to produce them.

Kaal believes that by investing approximately $20 million in best practice technology it can compete with imports of these products on both price and quality. Kaal Australia is currently considering an initial expenditure of $3 million in 2000/01 to achieve this objective.

The margin in general sheet products is approximately 2 - 5%.

Kaal's assessment is based on the current 5% tariff on general sheet products providing sufficient price stability within the domestic market. A reduction in the general tariff rate from the current level without similar reductions in other aluminium sheet producing countries would prejudice the prospect of this project proceeding.

Kaal Australia has put its capital expenditure program on hold pending the outcome of this inquiry and response to the inquiry by Government.

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Kaal Australia – Company Profile

OWNERSHIP	Alcoa Kobe Steel Ltd.
ASSET BASE	$250 million
OPERATIONS	Aluminium rolling facilities at: • Yennora, Sydney, New South Wales • Point Henry, Geelong , Victoria
CAPACITY	180,000 tonnes per year
PRODUCT PROFILE	Value-added manufacturing of semi-fabricated aluminium.
PRODUCTS	Can sheet Coil coated end stock Tab stock Foil General sheet
EMPLOYEES:	800
1998 REVENUE	$650 million
1998 EXPORTS	$350 million
MARKETS	Aluminium product manufacturers – Australia, New Zealand, Asia and South Africa.