Review of Australia's General Tariff Arrangements

SUBMISSION NO: 35

SUPPLEMENTARY TO:

SUBMISSION BY :

HUNTSMAN CHEMICAL COMPANY AUSTRALIA PTY LIMITED AND HUNTSMAN CORPORATION AUSTRALIA PTY LTD

Date of Submission: 12 January 2000

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HUNTSMAN SUBMISSION TO THE PRODUCTIVITY COMMISSION ON TARIFF RATES

Executive Summary

Huntsman is an international chemical manufacturing company with two significant chemical manufacturing businesses operating in Australia.

Huntsman Chemical Company Australia Pty Limited is an integrated producer of styrene and phenol based chemicals and plastics located at West Footscray, Victoria.

Huntsman Corporation Australia Pty Ltd is an integrated producer of ethylene oxide and derivative chemicals with its major manufacturing facility located at Botany, NSW.

Other business characteristics include:

- Large employers with a highly skilled workforce
- Add value to Australian natural resources
- The only Australian manufacturer for the majority of their products
- Supply to a broad cross section of Australian industry
- Have established export markets
- Compete with large scale overseas manufacturers
- Depend on the existing 5% tariff level in pricing products in the Australian market

The consequences of eliminating import tariffs are significant for Huntsman. It will reduce profitability and reduce investment in manufacturing capacity and productivity improvement. This will threaten the viability of chemical manufacturing plants at West Footscray and Botany chemical sites. Each site is highly integrated. The closure of an individual plant on an integrated site will threaten other plants by weakening the site economies of scale.

Elimination of import tariffs is also likely to cause abandonment of existing R&D activity presently focussed on developing higher value specialty chemicals for Australian and export markets.

Huntsman's position on Australia's General Tariff Arrangements is as follows:

1. Tariff levels on chemicals and plastic products manufactured in Australia are low by comparison with competitors in other countries. These Australian tariff levels should be retained at 5% of FOB value to maintain the viability of the chemicals and plastics sector of Australian manufacturing industry.

2. Tariffs on products and equipment not manufactured in Australia should be eliminated immediately. These tariffs are a government cost input disadvantaging an industry which is a price taker competing against overseas manufacturers.

More detailed submissions from each Huntsman operating company are attached together with an appendix facts summary.

Huntsman Chemical Company Australia Pty Limited

Business Description

Huntsman Chemical Company Australia (HCCA) is a significant Australian manufacturer of chemicals and plastics materials supplying customers in Australia, New Zealand and Asia. The company's major product lines are styrene monomer and derivative polymers of styrene, phenol and derivatives of phenol. These products are manufactured at an integrated chemical site at West Footscray. The site employs 440 people.

See the business statistics summary appendix.

Ownership History

The business was founded by Monsanto. Manufacturing commenced in 1942.

In 1987 Monsanto sold out to Consolidated Press. The business name was changed to Chemplex Australia Limited.

Huntsman Chemicals, a large privately owned US based chemical manufacturing company, bought a 50% share in 1993 and changed the company name to Huntsman Chemical Company Australia.

The business has undergone significant restructuring through the 1980's and 1990's to adapt to changes within the Australian and global manufacturing sectors.

Products

Huntsman is the only Australian manufacturer of styrene monomer, polystyrene, expandable polystyrene, phenol and acetone. Competitive product is supplied from imported sources.

Huntsman also manufactures unsaturated polyester resins and phenolic resin products. Competitors for these products are importers and the local producers: Nuplex Industries, Valspar Corporation, Orica and Adhesives and Borden Chemicals.

Value to the Australian Economy

The products manufactured by Huntsman add significant value to indigenous raw materials. Feedstocks include ethane and natural gas from Bass Strait, propylene refined from local crude oil and BTX extracted from coke ovens off-gas from BHP's Port Kembla steel works. Value added to raw materials and energy inputs in 2000 is forecast to be A$108 million.

Huntsman is a large employer in Melbourne's Western suburbs. Direct employment is 440 with significant indirect employment through outsourced services including transport, distribution, maintenance, engineering, site services, IT etc.

Huntsman's manufacturing plant is a capital intensive, technically sophisticated facility requiring highly trained, skilled employees and contractors. In particular, the level of training provided by Huntsman to maintain a productive, skilled workforce is higher than most other areas of manufacturing industry.

As the alternative source to HCCA for most products is imported product, the majority of the value added by HCCA directly contributes to Australia's balance of trade.

Market Characteristics

Markets for Huntsman products are highly competitive and price sensitive.

The majority of HCCA products are commodity chemicals and plastics. Non-tariff barriers are non existent for competing imports. High quality substitutable products are available from multiple Asian, US and European sources. Because of its proximity, most competitive product is imported from manufacturers located in Asia. Countries with well developed chemical and plastics industries are Japan, Taiwan, Korea, Singapore, Malaysia, Thailand and Indonesia.

The level of competition is broad. For example in Asia there are 31 styrene monomer producers and 75 polystyrene/expandable polystyrene producers. Most are capable of supplying acceptable quality product into the Australian market. Additionally these products are widely marketed through trading houses specialising in export markets.

Pricing Mechanisms

Prices in Australia follow world prices, particularly Asian prices. The landed price of imported products from Asia normally sets the price for Australian consumers of HCCA products. In some cases the export price from the country of origin is marginally costed because chronic over capacity exists in the product markets in which Huntsman operates.

Business Conditions in Australia

HCCA has been unprofitable through the 1990's with the exception of 1995. During 1995 a transient world shortage led to high prices and margins for styrene monomer. HCCA's poor profitability has been caused by low prices due to world overcapacity, low import barriers combined with a challenging cost structure associated with scale disadvantages, high raw material costs and a high wage/low productivity legacy of the 1970's and 1980's.

Significant productivity advances have been achieved by HCCA during the 1990's to improve profitability. These include:

- Intense scrutiny and reduction of all input costs
- Restructuring of the workforce from 800 in 1990 to a forecast of 370 by the end of 2000. This has been achieved in a co-operative manner with involvement of unions and staff

- Rationalising production facilities amongst local producers of polystyrene, expandable polystyrene, ABS and SBR Latex
- Over $30 million investment in business, plant and equipment at West Footscray since 1993

Value of 5% Tariff

At the prices prevailing in Q4 1999, the 5% import duty had a revenue effect of $5.7 million and a profit effect of $5.4 million to HCCA.

Prices for all HCCA manufactured chemicals and plastics reflected the 5% FOB import duty applicable to imported product from competitors. Import duty on imported raw materials is low because most are duty free. Some raw material items attract the 3% taxation duty because they have been formerly manufactured in Australia. The duty paid on imported raw material inputs is estimated at $300,000/year.

Consequences of Elimination of 5% Import Duty on Locally Produced Chemicals and Plastics

Reduction is Profitability

Profitability will be reduced by $5.4 million/year before any sales volume loss due to plant closures by customers. This is the net effect of revenue reduction on goods sold in Australia less cost reduction on the duty component of inputs.

Competitors would not suffer the same profit effect because they produce in other countries, most of whom have higher tariff levels than Australia. Obviously their domestic prices would be unchanged.

Possibility of Plant Closure

Reduced profitability could easily result in the closure of the phenol/acetone and phenolic resin businesses at West Footscray, and possibly the whole site. The phenol and phenolic resin business have low profitability and suffer from poor economy of scale. However their closure would threaten the viability of the entire integrated site because site fixed costs would not be reduced proportionally. Such decisions are obviously significant for business owners and are not made without long term consideration. However Australian chemical manufacturing industry is also facing other financial challenges that would contribute to a business becoming non viable. These include – possible greenhouse gas regulations, changes to anti dumping law, the high cost of environmental safety regulatory compliance, changes to the Australian oil refining industry and the world price and margin outlook for our commodity products.

Closure would lead to job losses of over 90% of West Footscray employees. Alternative high quality jobs are not readily available in other industries.

Reduced Investment

Huntsman plans to invest over $33 million between 2000 and 2003 on the West Footscray site. Much of this is discretionary and would be at risk in a deteriorating profit environment caused by elimination of import tariffs.

Two significant examples of projects under threat are a $5 million productivity investment in instrumentation on Huntsman's Styrene Monomer plant and a $5 million capacity expansion of Huntsman's Expandable Polystyrene plant. The latter project will replace $25 million/year of imported plastic material for manufacturing insulation products for the building industry and for packaging materials in the fish, fruit and vegetable industries.

Discouraging this investment will threaten the long term viability of the industry.

Reduced Customer Viability

Most of HCCA's Australian customers businesses are operated in highly competitive markets where prices are influenced by import duty. Some of these may be forced to close if the duty on competitive products were eliminated. In particular production of synthetic rubber, downstream polystyrene, synthetic emulsions and ABS polymers are at risk. If these downstream industries close, Huntsman's entire West Footscray site would become non-viable.

Reduced Customer Competitiveness

If elimination of import duty caused the closure of Huntsman's West Footscray plant, many customers would be detrimentally affected by being forced to rely on imported sources of raw materials. They would incur additional costs of higher working capital due to increased inventory and forward cover, higher processing costs and increased waste through standardised products as opposed to customised local products. Other impacts are loss of price support for exports and special projects, and loss of local technical expertise and assistance.

Loss of Skills

Plant closure as a result of elimination of import duty would cause a permanent loss of skills to Australian manufacturing industry. Huntsman's workforce is highly skilled and productive. However alternate employment options within the chemical industry are rare. The community would bear the cost of retraining displaced employees.

Tariffs Required for Competitiveness

The current business environment for the Chemical Industry is inappropriate for a reduction in import tariffs. Profitability is low and the Australian Chemical Industry already has low effective tariff rates compared with other Australian industry and when compared with other countries.

Huntsman's competitors are mostly producing in Korea, Malaysia, Indonesia, Thailand, Taiwan and Singapore. The 1998 Asian financial crisis has reduced the A$ exchange rate for many competitors, reducing their relative costs. Over supply prevails in all HCCA products. As a result profitability is low. It is not a suitable time to reduce tariff levels.

Additionally, local industry faces higher costs than competitors, much as a result of Australian government policies. In particular high labour costs, due to the industrial relations system, high infrastructure costs and high transport costs.

Other industries receive subsidies such as the diesel fuel rebate. Huntsman does not benefit from such measures. In fact the Productivity Commission report Trade and Assistance Review 1998-9 viewed the Chemical Industry as having a low effective tariff rate of 3%.

International tariff rate comparisons put the Huntsman businesses at a significant disadvantage compared with many competitors, in particular Indonesia, Malaysia and Korea. It would be unfair and unwise to further reduce tariff levels on chemicals produced in Australia.

Tariffs on Goods Not Manufactured in Australia

Tariffs should be removed on goods and equipment not manufactured in Australia. These tariffs are an unnecessary input cost whose only benefit is to raise government revenue. The annual cost to HCCA is $300,000.

Products include:

ABS resin
Phthalic anhydride
Isophthalic acid
Epoxy resin

Huntsman Corporation Australia Pty Ltd

January 2000

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Business Description:

Huntsman Corporation Australia Pty. Limited (HCA) is an Australian manufacturer and marketer of surface active agents (surfactants) and chemicals derived from ethylene oxide. The major product lines are ethylene oxide, ethylene glycols, glycol ethers, hydraulic brake fluid, automotive coolant, triethanolamine and nonionic surfactants. The products are manufactured at two sites; Botany in New South Wales, and Deer Park in Victoria. The Botany site employs 114 people and a further 10 are employed at Deer Park. HCA also operates a commercial and technical centre at Ascot Vale, Victoria where 67 people are based.

Ownership History:

Manufacture of ethylene oxide derivatives at Botany commenced in 1965, and these products have been produced continuously since then. However Orica (formerly ICI Australia) sold the asset, along with the Business, to Huntsman Corporation at the end of 1998. Orica continues to operate the plant at Deer Park and provide a small quantity of product (2KT pa) to Huntsman under a long term toll arrangement.

Products:

Huntsman Corporation is the only manufacturer of ethylene oxide and ethylene oxide derivatives in Australia (with the exception of Dow Chemicals who use HCA's ethylene oxide in the manufacture of flexible polyols). However, competitive product is manufactured in many Asian countries, including Indonesia, Singapore, Korea, Taiwan, Japan and China. Importers are active in sourcing product from Asia as well as from Europe and South America and selling in competition to Huntsman in Australia and elsewhere in the Region.

Value to the Australian Economy:

By far the largest raw material used by Huntsman Corporation is ethylene, which is purchased from Qenos and delivered by pipeline. Qenos convert Cooper Basin ethane to ethylene at Botany. Ethylene is a commodity, which is freely traded within the Asian Region. Qenos have the capability of exporting ethylene into the Region; however they prefer supplying to Huntsman because the returns are significantly higher. As well as ethylene, Huntsman utilises a range of other imported raw materials. Value added to raw materials by Huntsman Corporation in 2000 will be AUD85.0M.

Huntsman Corporation is a significant employer of highly trained and skilled employees. Of the total direct staff of 183, 42% are tertiary qualified, including 10 with PhDs. The Company is involved in a number of co-operative R&D projects with tertiary institutions.

Huntsman Corporation exports 16% (by value) of its output, mainly to New Zealand and Asia. Export growth has averaged over 15%p.a. over the last two years and is forecast to continue to grow at around 8% p.a. into the future. By contrast, growth in domestic sales is forecast at around 4.5-5% p.a. Huntsman Corporation has been able to sustain this high level of export growth through an aggressive product development programme which targets the more specialised offshore markets. However, the cost of maintaining a 35 person technical facility in Melbourne is high, and can only be sustained because of the current level of profitability of products sold into the domestic market.

Market Characteristics:

Manufacture of ethylene oxide and derivatives is capital intensive and potentially hazardous. In order to minimise safety risks and keep production costs down, most global manufacturers operate large plants on integrated petrochemical complexes. Within Asia, such manufacturing sites exist in Indonesia, Singapore, Malaysia, Korea, Japan, Taiwan and China. Most of the large regional ethylene oxide plants are upstream of large ethylene glycol plants, the output of which is used to produce synthetic fibre for the local textile industry. The situation in Australia is anomalous in that there is practically no local synthetic fibre production. Australia therefore cannot sustain a large ethylene oxide/glycol complex unless most of the output is exported; fierce competition and disadvantageous ocean freight rates make this unattractive.

HCA therefore operates a small (by world standards) ethylene oxide and derivatives plant and has attempted to fill this capacity by maximising its share of the domestic market. This has meant developing a broad range of products, both commodities and specialties. It is estimated that around 70% of Huntsman product sold into the Australian market is subject to direct competitor attack from Asian and other global producers. If Huntsman were to lose a significant proportion of this domestic non-differentiated market to offshore competitors, it would be unable to place the freed-up capacity quickly into differentiated markets. This is because differentiated market opportunities tend to be small, geographically and industry-wise scattered, and introduction times are long.

Tariffs:

The tariff level on ethylene oxide derivates in Australia is currently 5% of the FOB value. Preferential tariffs of 3% apply in some cases. In 1986, the general tariff on these products was 30% of FOB, with Developing Country preferential rates set at 0-5%. However, following the 1986 Federal Government review of the Chemicals and Plastics Industry, a phased reduction of general tariffs was implemented; at the same time, Developing Country preferences were also phased out. The current 5% level became effective 1 July, 1996.

The tariff rates for ethylene oxide derivatives in those countries whose manufacturers can supply production into Australia are given below:-

Material	China	India	Korea	Taiwan	Indonesia	Singapore
Ethylene Glycol	-	-	8%	1-2.5%	0%	0%
Brake Fluids	10%	30%	8%	5%	5%	0%
Ethoxylates	10%	30%	8%	5%	10%	0%

*These are based on CIF value.

It can be seen that Australian tariffs are already low in comparison with out Regional competitors.

Within the ASEAN countries, a 90% reduction on tariff for selected products is currently available to approved ASEAN producers (AIJV scheme). This is scheduled to be phased out by 2003. A new scheme (AICO – ASEAN Industrial Co-operation Scheme) was introduced for ASEAN countries in 1996. This allows eligible companies in participating countries within ASEAN to enjoy preferential tariffs in the range of 0-5%.

Competitiveness Issues:

Because Australia has practically no local polyester fibre production, the scale of ethylene oxide and derivative plants necessary to service the domestic market is small by world standards. Small plants such as the HCA Botany operation tend to have higher fixed costs than large world-scale plants.

However, the competitiveness of an investment is also a function of the investment environment, construction costs and operating costs. Favourable investment incentives and accelerated depreciation rates apply in most Asian countries where products, which compete with HCA, are manufactured. In addition, construction costs in Australia for new plant are 10-15% higher than in Asia. Plant operator remuneration in Australia can be 3-4 times higher than in Singapore, Malaysia or Taiwan.

Significant productivity increases have been made by HCA since 1998. Volume output this year is forecast to be 15% up on 1998 performance. Fixed cost, in real terms, will decrease by 13% over the same period. HCA has instigated a programme aimed at accelerating the process for productivity improvement.

Pricing Mechanisms:

Approximately 70% of HCA product are subject to direct competitor threat from imports. Pricing of these products is therefore dictated by Asian Regional prices.

Approximately 30% of HCA products are differentiated from competitor products. Pricing of these products, mostly surfactants, is set at a level which ensures that the customer maintains

his competitiveness, and also which ensures that the customer does not seek to substitute the product with cheaper alternatives.
Because the sale of a surfactant involves the sale of an effect, it is technically feasible to substitute most ethoxylated surfactants with other more freely available non-ethoxylated surfactants. This has the overall effect of keeping down the unit price of ethoxylates.

Australian Business Conditions:

HCA has enjoyed a reasonable level of profitability over the last year. The EBITDA/Sales ratio is about the global average for this industry; but well down on the world market leaders.

HCA could improve profitability short term, by reducing fixed costs. This could be achieved by ...

(a) Ceasing to manufacture some product lines, and acting as a trader of imported goods. Savings would be made through reduced factory manpower and services.

(b) Reducing the level of TS&D expenditure by shedding technical staff.

These measures would reduce fixed costs, but long term would damage the future of the Business, particularly in its ability to innovate and grow market share in Asia.

Value of 5% Tariff:

The current import duty has a positive profit impact of AUD4.9M to HCA.

Consequences of Elimination of 5% Tariff on Ethylene Oxide Derivatives:

(a) HCA's profitability would be reduced by around AUD5.0M p.a. Because HCA is largely debt-financed, HCA would be forced to cut costs by shedding 10-15% of its workforce. A drastic reduction in technical staff would severely limit the ability of HCA to grow market share in Asia. HCA would retreat to a position whereby predominantly Australian customers only were being serviced.

(b) Prices to Australian domestic customers would initially fall by around 3%. Since ethylene oxide derivatives are used either as process aids in agriculture, mining, textiles, etc. at very low concentrations, or are minor cost contributors to manufactured goods such as automobiles and paint, the competitiveness of Australian customers will not change significantly.

HCA therefore operates a small (by world standards) ethylene oxide and derivatives plant and has attempted to fill this capacity by maximising its share of the domestic market. This has meant developing a broad range of products, both commodities and specialties. It is estimated that around 70% of Huntsman product sold into the Australian market are subject to direct competitor attack from Asian and other global producers. If Huntsman were to lose a significant proportion of this domestic non-differentiated market to offshore competitors, it would be unable to place the freed-up capacity quickly into differentiated markets. This is because differentiated market opportunities tend to be small, geographically and industry-wise scattered, and introduction times are long.

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Material	Japan	China	India	Korea	Taiwan	Indonesia	Singapore
Ethylene Glycol						0%	
Brake Fluids							
Ethoxylates		10%	30%			10%	0%

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APPENDIX

BUSINESS STATISTICS SUMMARY

BUSINESS	HUNTSMAN CHEMICAL COMPANY AUSTRALIA PTY LIMITED	HUNTSMAN CORPORATION AUSTRALIA PTY LIMITED
Turnover Domestic Export	AUD240 Million 83% 17%	AUD160 Million 82% 18%
Employees	440	185
Products & Harmonised Tariff Code	Styrene Monomer 2902500015 Polystyrene 3903190013 Expandable Polystyrene 3903110012 Phenol 2907110008 Acetone 2914110019 SAN 3903200028 ABS 3903300015 Polyester Resins 3907910033/2 Phenolic Resins 3909400033/4	Ethylene Glycol 2905.31.00 Diethylene Glycol 2909.41.00 Butyl Glysolv 2909.43.00 Methyl Glysolv 2909.42.00 Triethanolamine 2922.13.00 Hydraulic Brake Fluid 3819.00.00 Automotive Coolant 3820.00.00 Nonionic Surface Active Agents 3402.13.00
Markets	Plastics Conversion Chemical Manufacture Adhesives Manufacture Rubber Manufacture Paint Manufacture Building Products Construction Products Packaging Materials Appliances Automotive Mining Equipment Leisure	Agricultural Chemicals Automotive Brake Fluid/Coolant Household & Industrial Detergents Woolscouring Mineral Processing Paint & Resin Manufacture Chemical Manufacture Rubber Latex Processing Oil/Gas Production Construction Chemicals
Value added in Australia	AUD108 Million	AUD85.0 Million
Manufacturing Plant	West Footscray, Victoria	Botany, New South Wales
Ownership	50% Huntsman Corp USA 50% Consolidated Press	80% Huntsman 20% Consolidated Press

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