Kaal Australia Pty. Limited

2nd Submission to the

Productivity Commission

Review of Australia's General Tariff Arrangements

June, 2000

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Introduction

The Productivity Commission has released its draft report into Australia's General Tariff Arrangements. The report recommends the removal of Australia's remaining tariffs on manufactured goods and provides four options for the timing of the removal.

Kaal Australia rejects the Commission's recommendation and seeks to reinforce the message presented in its first submission to the Inquiry – that is, further unilateral reductions in aluminium sheet tariffs would exacerbate the disadvantage Kaal Australia faces compared with its competitors.

The company's long-term viability may be put at risk by the options presented in the draft report.

Kaal Australia is already at a major disadvantage to other producers in competing countries following the Australian government's decision to remove the tariff on aluminium cansheet, the company's major product line. That decision in combination with this current Productivity Commission inquiry has already forced Kaal Australia and its owners to reassess its capital expenditure program in Australia.

In addition, a number of significant developments in the aluminium rolled products industry since Kaal Australia made its first submission demonstrate the importance of maintaining tariffs at globally competitive levels.

Kaal Australia has been informed that Korea, formally a significant market for the company, is considering the removal of concessional arrangement for imports of cansheet following the announcement of major new investment in the Korean rolled products industry.

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Executive Summary

Kaal Australia made a submission to the Productivity Commission Review of Australia's General Tariff Arrangements in January 2000 and presented at the public hearing in Sydney on 28 January.

Kaal Australia presents this 2nd submission as a supplement to its first and points out that the issues raised in the first submission remain current.

Kaal Australia believes the Commission's draft report does not pay sufficient regard to the detrimental effect of unilateral tariff reductions on Australian manufacturers.

In particular, Kaal rejects the assertion by the Commission that the costs of adjusting to unilateral tariff removal would be slight. This assertion ignores a significant body of evidence put to the Commission by manufacturers including Kaal Australia that the costs to these businesses will be high.

The Commission sets out four options for removing Australia's remaining general tariffs. None addresses the key concern raised by Kaal Australia in its first submission - without reciprocity in tariff removal , Kaal Australia is at a major disadvantage to our competitors and our long-term viability is at risk.

Kaal Australia also rejects a key argument made by the Productivity Commission that depreciation of the Australian currency in the last decade has offset reductions made to tariffs. Kaal Australia's major input – aluminium – is denominated in US dollars (USD), substantially negating any benefit from a depreciating currency.

In addition a number of significant developments in the aluminium rolled products industry since Kaal Australia made its initial submission should be noted by the Commission:

- Australia's largest general sheet and foil manufacturer has notified the closure of its operations, with the loss of 200 jobs.
- A major global competitor to Kaal Australia has acquired and announced expansion plans for two large aluminium rolling facilities in Korea and is negotiating with the Korean Government for the removal of concessional arrangements on importation of aluminium cansheet.

Kaal Australia notes the recommendation made by the Commission that if removal of tariffs for selected industries – including aluminium fabrication – are to occur, a period of notice should be given and introduction phased. Kaal Australia reiterates that it can only continue to compete if reductions in tariffs are harmonised with the rest of the world.

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Kaal Australia's Position on Further Tariff Reductions

Kaal Australia is a leading producer of aluminium flat rolled products, supplying both domestic and export markets. Kaal Australia's operations are efficient with a skilled and flexible workforce and in the past three years the company has grown its exports by around 50%. Between 1997 and 1999 Kaal Australia has generated $854 million in export revenue.

Australia's stance on aluminium rolled products tariffs is unique. The Federal Government removed the 5% tariff on aluminium canstock during 1999. All other countries with aluminium rolling facilities, have tariff protection. As a result these producers can import to Australia free of tariff whilst Kaal Australia is denied a reciprocal benefit. This imbalance has resulted in substantial loss of potential export business.

Kaal Australia 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 and that a harmonised approach to tariff reduction is required. Australia's competitors 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.

South Africa has announced such an arrangement, and Kaal Australia understands that Korea is considering similar arrangements. Both countries can ship cansheet into Australia duty free.

Since these announcements were made Kaal Australia has lost sales of 20,000 tonnes per year to South Africa and around 4000 tonnes to Korea. This represents around 15% of Kaal's total sales.

In response to this loss of export business Kaal Australia 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.

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

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Developments in the Australian Aluminium Rolled Products Industry
In early may, Capral Aluminium, Australia's largest manufacturer of general aluminium sheet and foil announced that it would rationalise its business by closing its rolling mills. The announcement indicated there would be consequent job losses of 200 people

The Commission should note that this decision has been made within the existing tariff environment for general sheet and foil. The competitive conditions which forced Capral to make this decision continue to apply to Kaal Australia's operations.

With the closure of Capral's rolling operations, Kaal Australia will become Australia's sole manufacturer of aluminium sheet products.

Given the fierce competition from imports within the sheet market, Kaal Australia believes that the loss in Australian manufacturing capacity will be largely replaced by imports.

Impact of Currency Depreciation on Kaal Australia's Business
The following assertion was made by the Productivity Commission in its media release of 25 May 2000 that:

"The costs faced by manufacturers in adjusting to tariff removal would be slight, especially when viewed against the background of the improvement in competitiveness brought about by the decline in Australia's exchange rate over the past decade."

This assertion does not hold for the aluminium fabrication industry which operates in a global market.

Kaal Australia, like other fabricators, sources its aluminium denominated in USD. Other raw materials such as lacquers and freight are also denominated in USD.

Metal makes up a significant proportion of the company's costs (for example, the metal component of cansheet can represent up to 75% of total revenue). This substantially negates any benefit the company receives from the historical decline in the AUD/USD exchange rate.

A large part of the company's capital expenditure is also on items denominated in USD. The depreciation of the Australian dollar has increased the cost of undertaking capital expenditure by the company.

In addition, volatility in the exchange rate has introduced a further risk to Kaal Australia's business that must be managed, with associated costs.

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Consequences of Tariff Reductions on Regional Australia

In the overview of its draft report the Commission states:

"The Commission's analysis shows some possible adverse effects from tariff reductions on the industries singled out by participants. Increases in real value added are estimated in all the regions identified, however, and, for two of the regions, the estimated employment gains in the mining and services sectors more than offset the losses in manufacturing. In general, the estimated magnitude of the effects is small and much less than predicted by participants."

Kaal Australia is a major employer in Geelong in Victoria and Yennora in Western Sydney. The company also supports a considerable number of service industries in those regions.

Kaal Australia's payroll expenditure alone in these regions is in excess of $60 million.

As previously stated, between 1997 and 1999 Kaal Australia generated export revenue of $854 million. For every $10 of export revenue generated only $1 goes back overseas, adding significant value to the Australian economy.

Should Kaal Australia's business become unprofitable in Australia, the company's assets are demountable and could be relocated. Any capital that could be salvaged is unlikely to be reinvested in Australia.

The global nature of the Aluminium industry ensures that it locates in regions where most value can be added.

It is difficult to see how forcing Kaal Australia to become unprofitable by unilateral tariff reductions by Australia could provide a net benefit to the economy.

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Reciprocity is the Key to retaining competitiveness in the Aluminium Rolled Products Business

Kaal Australia 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.

Current tariff rates for major rolled products producing countries include:

India		27.5%
Taiwan		10%
China		12%
South Africa		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.

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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 Government's in competing countries, the Australian Government 's decision has serious negative implications for Kaal Australia's business.

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

Until recently Kaal Australia supplied 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 Aluminium project comes on line. In its previous submission Kaal Australia advised that its shipments to South Africa would cease by year-end. Shipments have now ceased.

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

Kaal Australia also previously advised that Alcan Aluminium, a major multinational canstock producer, had acquired and was expanding two aluminium rolling facilities in Korea.

Since its previous submission to the Commission, Kaal Australia's exports to Korea have reduced from around 12,000 tpy to 8000 tpy. Kaal Australia currently faces a 6% tariff on cansheet entering Korea. We understand that the Korean Government is considering the removal of concessions, which would increase this to 8%. Alcan Aluminium's Korean operations will be able to export competing product to Australia with no tariff or non-tariff barrier.

Combined, these developments will result in loss of business to Kaal Australia of 30,000 tpy. With both the Hulett Aluminium plant in final stages of commissioning and the Alcan Aluminium plants undergoing expansion, we expect to see a strong increase in the flow of imports into the Australian market from these countries in the near future.

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Impact of further tariff reductions on product diversification strategy

The reduction of Kaal Australia'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 with investment in additional processing technology has been identified to manufacture aluminium sheet suitable for Australia's flourishing shipbuilding and transport equipment industries.

Kaal Australia's decision to enter these markets remains on hold pending the outcome of this inquiry and response to the inquiry by Government. Australia's industry policy environment is and remains a critical factor in both the ongoing viability of Kaal Australia and its future growth.

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Kaal Australia – Company Profile

OWNERSHIP	Alcoa Inc. 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
1999 REVENUE	$546 million
1999 EXPORTS	$293 million
MARKETS	Aluminium product manufacturers – Australia, New Zealand, Asia and South Africa.

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