HUNTSMAN

Huntsman Response to the Productivity Commission Draft Report on Australia's General Tariff Arrangements

June, 2000

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Summary

Huntsman Corporation is an international chemical company with a number of manufacturing units in Australia. Major manufacturing plants are located at Botany, N.S.W. and West Footscray, Victoria.

Huntsman does not agree with Draft Recommendation 1 of the Productivity Commission Report, namely that the general tariff rate be reduced to free, preferably on 1 July 2001.

Huntsman would like to make the following observations and suggestions:-

- Tariff levels on the products we manufacture in Australia are already lower in general, than in most of our competitors' countries. Further uni-lateral reduction in Australia's tariffs is unlikely to be of benefit in forthcoming trade negotiations.

- The effective rate of assistance afforded by the current tariff regime (outputs minus inputs) to Huntsman is $10 million on sales of $400 million. This is a significant contribution to the profit earned in Australia by Huntsman.

- Huntsman requires an adequate return on capital to justify expenditure on new plant and technology. We favour maintenance of the existing general tariff rate, until a multi-lateral WTO agreement is in place. A rapid elimination of the general tariff in line with the Commission's Draft Recommendation 1, could result in reduced investment in plant and technology, plant closures, and job losses at Huntsman.

- The 3% Tariff Concession Scheme should be reduced to 0%. However, the benefit to Huntsman in Australia of this change is less than $0.5 million.

- Huntsman supports PACIA's recommendations to the Productivity Commission as detailed in PACIA's response to the Draft Report.

Adjustment Costs

We believe the Productivity Commission has under-estimated the negative consequences of reducing tariffs to zero.

Both Huntsman Chemical Company Australia (HCCA) and Huntsman Corporation Australia (HCA) rely heavily on the sale of commodity plastics and petro-chemical derivatives within Australia to remain profitable. Since the acquisition of the West Footscray and Botany assets by Huntsman in 1993 and 1998 respectively, considerable effort has been made to increase productivity.

In the case of HCCA, this has been achieved by investment in new plant and equipment and an overhaul of work practices. In the case of HCA, this has been through a targeted approach to increasing sales of specialty chemicals in both Australian and export markets.

Initiatives like these are time consuming and require dedicated and highly skilled staff to implement. If, because of poor profitability caused by rapid elimination of tariff, Huntsman is forced to retrench staff and curtail its specialty chemicals strategy, the cost to the community would be large. In addition, the highly trained technologists and engineers displaced could have difficulty in finding appropriate work within the Australian Chemical Industry and may be lost to offshore enterprises.

HCA has increased sales value of exports by 50% over the last two years. They now constitute over 20% of our sales. Encouraging Australian manufacturers to continue to develop innovative products, by continuing the current level of tariff support, is consistent with the Government's objective.

Tariffs and the Floating Exchange Rate

The Commission concludes that the influence on competitiveness of Australian Industry of the existing 5% tariff is small relative to the change in competitiveness brought about by exchange rate changes. The Australian dollar/US dollar rate has fallen from 0.78 in 1996 to 0.65 in 1999, and is claimed to have driven improvements in industry competitiveness of 18%.

This generalisation does not apply to HCA. The Profit Contribution Margin the Business earns on the sale of its manufactured goods is a relatively small percentage of sales value. Since raw material feedstock prices are always delineated in US dollar terms, only fixed costs, which are small, fall in US dollar terms as the Australian dollar weakens.

In addition, a falling Australian dollar means that finished goods, sold in Australia, increase in price, but as DFAT points out, often some of this increase is absorbed by importers.

Under these conditions, manufacturers such as HCA lose margin.

Tariffs Levels and Investment

The Productivity Commission argues that "it is difficult to see that sufficient market failure exists in the practical sense such that outcomes would be improved by tariffs". We suggest that the Commission looks at the decline in importance of the Australian Chemical Industry (as a percentage of GDP) over the period 1965-2000, a decline which correlates well with a reduction in tariff from about 40% to 5%.

During this period employment in the Australian Chemical Industry also declined by over 25,000.

The Petro-Chemical and Derivative Industry is capital intensive, not labour intensive. Contribution Margins (Selling Price —Raw Material Cost) are low relative to another manufacturing industry. A small level of tariff protection can significantly aid profitability.

In order to attract significant capital expenditure in new chemical ventures, our Asian neighbours offer a platform of incentives. These include tax holidays (Thailand, Philippines), investment assistance (Singapore) and infrastructure support. For example, the Singapore Government has brought US$12 billion of capital to the Jurong Island Petro-Chemical Complex by creating an economic environment that is attractive to investors.

Although microeconomic reform has gathered pace over the last 10 years in Australia, we still lag behind many overseas countries in offering attractive investment support. The result has been that new investment in the Australian Chemical Industry is very low.

In addition, to investment support, Asian countries use tariff support. For example, the Philippine Petro-Chemical Industry (currently 15% tariff) has been excluded from the tariff reduction schedule of AFTA, and Malaysia has extended its 15% tariff on PE/PP to allow its industry more time to get established.

It is in this climate, with tariffs in competing countries at a much higher rate than in Australia, that it is difficult to understand how the Commission's recommendation of rapid uni-lateral elimination of tariffs will do anything other than move the balance of trade more in favour of our competitors within Asia.

The Huntsman family has an impressive record of investing and developing chemical manufacturing businesses in many countries, including Australia. The elimination of tariffs would clearly reduce the attractiveness of further manufacturing investment in Australia compared with other countries.

Exports

The Commission argues that tariff supported pricing by manufacturers of primary chemicals such as Huntsman is disadvantageous to the competitiveness of export oriented domestic customers who use our products as raw material inputs.

This generalisation is not supported by evidence. In fact, supporting customers who export makes sound business sense. The 5% tariff level is much less significant than other cost disadvantages, such as high freight costs, endured by exporters. In Huntsman's case we endeavour to assist downstream customers who export their products through flexible pricing policies.