

Outlook 2005

Future Developments in the Pulp and Paper Industry

Slide 1 - Title

Future developments in the pulp and paper sector is a topic not easily addressed by simply listing proposed projects. This is because, first, proposals don't equal projects and secondly, projects may not have been publicly announced. My presentation, then, will be a personal view on the future directions of, and challenges for, the sector and how we might work to secure a thriving, high-value adding industry in Australia.

INDUSTRY OVERVIEW

Before moving into the substantive discussion it is worth having a brief look at the industry in Australia and the broader international environment within which it operates.

Slide 2 – Industry statistics and features

The pulp and paper industry is one of the most capital-intensive industries in the world characterised by a lumpy investment profile and long-lived capital assets. One paper making machine, for example, costs around half a billion dollars. Timelines are long. The industry employs about 5,000 people around Australia primarily in rural and regional areas.

Slide 3 – Company logos

The pulp and paper industry in Australia is made up of a few large globalised players, both home grown and international.

Slide 4 – Production and consumption

Collectively they make about 3.2 million tonnes of paper primarily for the domestic market. The value in turnover in the forest and wood products industry is \$18 billion. More than half of this (more than \$9 billion) is in paper and paper products representing just over 2 percent of Australia's GDP. Approximately 40 per cent of Australia's paper demand is met by imports, primarily in printing and writing papers.

The industry also produces about 1.4 million tonnes of pulp but, at present, only for input into our domestic paper manufacturing. We import a further 400,000 tonnes to meet our domestic requirements.

DEMAND

Despite a strong economy the demand for paper and paperboard has increased by only 19 per cent over the past 9 years compared to economic growth of 39 percent for the same period.

Slide 5 – Balance of Trade

Australia's trade deficit in wood and paper products is \$1.75 billion, most of which is attributable to pulp and paper. Probably not surprising to many of you, it is clear that as the value of the product increases, so too does the extent to which imports meet our domestic consumption in wood and paper products.

Slide 6 – Imports by unit value

Australia exports a lot of low value wood products and imports much of its high value wood and paper products.

Slide 7 – Paper consumption by grade

In relation to packaging papers, imports are low at around 154 kt and our exports are solid (704kt). This partly reflects a recent increase in production capacity as a result of the commissioning of Visy's Tumut mill.

Demand for tissue and newsprint is relatively stable, and is mostly met by domestic production although tissue imports are growing steadily.

Slide 8 – Global consumption printing & writing papers

Over the past 10 years, the consumption of printing and writing papers has grown steadily and demand remains solid – the "paper-less office" has never eventuated but there are signs that generational change may be driving a cultural change resulting in a slowing in demand. For example the long-term growth rate in demand is 1.6 per cent compared with the economy's 3.8 percent. Australian production meets about 45 percent of the demand with imports making up the difference.

In terms of pulp production, bleached pulp production is static and imports are increasing at 7.5 percent per annum. It is now generally

recognised that Australia is buying nearly enough pulp to support a world-scale pulp mill.

Slide 9 – Real price of newsprint

In terms of pricing trends, paper – manufacturing is a highly trade-exposed industry where the price tends to be set by the least-cost international producer, many of whom enjoy enormous direct and indirect subsidies. The real price of paper has been declining for many years. On the basis of the existing industrial profile it is likely that Australian consumption will continue to increase but possibly more slowly than in the past and the real price is unlikely to increase substantially.

Slide 10 - Forecast

Future demand for paper products is likely to continue to grow, although possibly at more modest rates than we have seen in the past. Whether this future demand will be met by a strong domestic paper industry or increasing levels of imports is less certain and will depend on a number of variables, some of which the industry has little or no control over.

COMPETITIVENESS

Slide 11 – Competitive advantages

When it comes to supplying the world's demand for paper products, Australia is simply one of numerous options for investment by increasingly globalised players. If Australia is to have a vibrant, innovative and growing pulp and paper sector, then it must exploit its many comparative advantages more effectively. Once we understand what they are and their relationship with the pulp and paper sector we can we work to more effectively protect, increase and celebrate them.

Australia has a great many advantages making investment attractive. These include, but are not limited to:

- fibre supply
- land for expansion
- flexible and well trained work force;
- stable political environment;
- well-developed national infrastructure;
- sensible and balanced environmental protection laws;
- competitive energy costs; and

- the many benefits delivered from a decade of taxation and micro-economic reforms.

Slide 12 - Competitiveness Pressures

Against these, however, are:

- the nature of the Australian industry where most of the machines are more than thirty years old with capacity below world standards;
- the mismatch between the long timelines needed to plan for a capital intensive industry and the very short timeframes adopted by financial analysts and governments, encouraging an inappropriate short term investment focus;
- the high value of the Australian dollar;
- trade negotiations that may inadvertently, fail to reflect adequately the maturity of Australia's industrial base and economic diversity and in doing so risk strengthening Australia as an importer of high value manufactured goods and exporters of high volume, lower value commodities;
- a level of environmental responsibility not shared by our international competitors;
- multiple-level Government regulation;
- uneconomic industry subsidisation in competitor countries; and
- the burgeoning Asian economies.

Industry and governments have little influence over some of these, including the value of the dollar and the growth of the Asian economies but this highlights the imperative for tackling those elements over which we do have some control.

It is worth spending a minute on what many believe to be the most critical factor influencing the longer-term future of the paper industry — Australia's proximity to Asia. Being close to Asia is a mixed blessing. For the growers and exporters of low-value products it represents a tremendous opportunity. For those who process and add further value to these resources in Australia, the situation is more challenging.

Slide 13 — Chinese expansion

To put it in perspective, Australia produces about 3.2 million tonnes of paper and paper board per annum. Today, China produces about 10 times this – 39 million tonnes and imports a further 5 million (*URS*). To make this paper they import about 5 million tonnes of pulp and 6.4 million tonnes of wastepaper (*URS*). The installation of a further 11 million tonnes of Chinese papermaking capacity is confirmed for 2003-2005 and an additional 11 million tonnes is awaiting government

approval (*PPI Asia*). This suggests that within the next 5 years China will be making almost 60 million tonnes of paper and board to Australia's 4.5 million (ish) (ie 13 times).

This could result in fierce competition for fibre – both virgin and recovered paper - and long-term fibre cost increases. Will there be an international fibre shortage? Certainly expansions in the plantation estates around the world will be required, as will a much more concerted effort to get substantially more wastepaper into the paper-making stream.

Although we like to think of China as a developing country, there is nothing 'developing' or 'third-world' about its modern paper industry. Its recent foray into modernising its paper industry has led to investment in the best and most efficient operations that money can buy. Half a million tonnes output is the new standard for a paper mill in a culture where there is no regard for international patterns of supply and demand and where the sole objective is to be the lowest cost producer. Further they are able to exploit the enormous quantities of cheap timber from Russia where there is no regard for sustainable development practices. If paper manufacturing capacity in China and Asia, is out of step with domestic demand, as many predict, it is quite possible that international markets may, on occasions, be flooded with cheap paper.

This situation poses a particular challenge for much older industries in countries with small domestic markets operating in an already fiercely competitive international market and where currency appreciation has contributed to the toughest environment that we have had for many years.

FUTURE INVESTMENT

Those intending to invest in pulp and paper making in Australia need a strong capital base and an understanding that pulp and paper are heavily traded commodities exposed to the vagaries of a highly competitive international market. They also need to be able to plan for the long term.

Despite the challenges and the absence of manufacturing protection or large subsidies, the Australian pulp and paper industry is continuing to invest. As mentioned above, Australia imports almost enough pulp to underpin a world scale pulp mill. This fact, together with the import/export profile outlined above, suggests that most of the investment attention at present would be around increasing Australia's pulping capacity. The most talked about development is Tasmanian

company, Gunns, proposal for a pulp mill producing 500,000 - 1.3 million tonnes of pulp, mostly for the export market.

In addition to the Gunns proposal, the Australian paper manufacturing industry has indicated it will invest \$188 million in capital projects during 2004-05 and approximately \$1.3 billion over the next 5 years (*A3P statistics*). During 2004-05, the industry also invested more than \$14 million in pulp and paper-related research and development (*A3P statistics*). There are a range of other proposals out there at varying stages of development. New greenfields sites and additional paper machines are constantly being considered and international companies regularly put Australia on their itinerary for investigation.

THE FUTURE OF THE PULP AND PAPER SECTOR

This is an industry in for the long haul. So the question is not *whether* Australia will continue to have a pulp and paper sector — the capital investments are too large to strand — rather it is to what extent the full potential of the industry can be realised. How far can the industry go in adding value to Australia's timber and recovered paper resources, substitute domestic production for imports, growing export markets for our most price competitive products, changing the colour of our trade balance from red to black?

Australia must, for good economic, environmental, employment and regional development policy reasons, have the confidence to aspire to be much more than the woodchipper to the north.

Slide 14 - Indicative product prices

It is not an unrealistic expectation that Australia can, and should, add considerably more value to its timber and recovered paper resources than it does at present. Industry, working with government, can turn our trade deficit (which contributes to about 1/12 of Australia's trade deficit) into a trade balance or better. This is a reasonable aspiration but it can only be pursued with an understanding of the implications for Australia of the monumental changes occurring in China and the profundity of the implications for our domestic industries.

The key is for Governments and industry to work in partnership to honestly and transparently assess the competitive position and realistic potential of all parts of the wood and wood products industry; to identify the impediments to, and opportunities for growth; and agree a roadmap that shifts the industry from a trade deficit of almost \$2 billion dollars to a trade surplus.

Slide 15: 2020 back in Balance

2020: BACK IN BALANCE

The industry and Government have recently agreed to do just that. The industry, in concert with the Commonwealth Government, is committed to aggressively pursuing an agenda that exploits and maintains, despite signs of erosion, our many competitive advantages.

The Australian Government, particularly the Minister for Fisheries, Forestry and Conservation, Senator Ian Macdonald, is to be warmly congratulated for initiating and supporting what promises to be the most exciting and important strategic development in the history of the Australian wood and paper manufacturing industry. They should also be congratulated for recognising the value in working with the industry in pursuing a shared vision. It is only when industry and governments work closely that real and practical progress can be made, which is what makes the Government's Industry Partnerships such an innovative and highly valued program.

GHD with Fifth Estate and Abare have been commissioned by the *2020: Back in Balance* Steering Committee to commence the first part of the project which we intend to have finalised by mid-year.

Once complete and accepted by both the industry and Government, *2020: Back in Balance* will provide some policy markers for, amongst other things:

- encouraging the planting of the right trees in the right places at the right time;
- encouraging innovation in product and market development;
- training and educating for the future, including our future industry leaders;
- trade negotiations that take strong account of Australian manufacturing and the need to remove trade distorting subsidies in competitor countries;
- pursuing energy market reform such that long-term reliable supplies of competitively priced energy to large energy users is the driver and delivers real and tangible benefits to end users;
- attracting skilled personnel to regional centres;
- building on the Government's achievements in continuing to improve critical transport and infrastructure; and
- a more informed debate around natural resource management and catchment management planning and the role of plantations.

The future of the industry cannot be guaranteed by governments. They cannot alter the currency appreciation or affect the amount of

capacity going into China but they can, in working with the industry, assist in ameliorating their impacts by focussing on those areas that give Australia its greatest competitive advantage.

Slide 1