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"STRENGTH AND VULNERABILITIES OF THE FREE MARKET IN EUROPE WITH PARTICULAR REFERENCE TO CHEMICALS"

The very recent GATT negotiations, with respect to the chemical sector in the United States and in Europe, have shown quite distinctly where our respective strengths and weaknesses lie.

In Petrochemicals and Fertilizers the European Community has been on the defensive whereas in the organic intermediates and the more sophisticated chemicals and products it was the United States which was on the defensive. This was particularly so for dyestuffs, pharmaceuticals and cosmetics excepted.

It is our feeling that on smaller volumes intermediate and finished organic chemicals we are well diversified and efficient in Europe.

It is probable that in general the trade distribution systems of our chemical Companies are more developped abroad than those of US Companies. Even for the US market US companies seem to be relatively less interested in small volume business for fine chemicals and intermediates. To an increasing extent they leave that part of the home market to their European competitors. (This is shown by the evolution of benzenoïd imports into the US, where for 1978 imports exceeded US output).

On the reverse, we cannot say that we have no problems with petrochemicals. Generally speaking, we are more vulnerable where we depend substantially or entirely on raw materials supplies from outside the Community as is the case with crude and with rock phosphate.

More precisely I should say that this is an area where we either are or could become vulnerable and where our attention should be focussed first on a sober analytical approach, and then eventually through action to solve the problems.

The European Community is concerned by :

- the petrochemical industry development of the Arab world, particularly in the Gulf region (a potential problem in the late eighties).

- the petrochemical industry development of Eastern European countries (a potential problem in the eighties).

- the gas and crude price controls related to petrochemical cost advantages in the US (a real problem).

I will go along these problem areas in detail.

But I should nevertheless make one general aspect very clear before :

When speaking about problems linked to the Arab region, to Eastern Europe and to the United States this doesn't mean in any case that all our problems are imported. In view of the over-capacities existing in Europe, it is fair to say : part of the problem was home made.

But one must also admit that before 73 it was extremely difficult to believe that the fabulous growth rates for petrochemicals demand could ever dive to the levels where they are now. It was on overwhelming temptation for industry to invest with (nearly) closed eyes, and all the more easily the more Governments, tempted too by attractive job creation potentials for regional developments took over generous parts of (virtually not existing) financial risk by granting public funds.

This is one reason for a certain part of the over-capacities still existing in the Community.

Another reason lies in the fact that for the investment expenditures and for the Community as a whole the pre 1973 trend continued unbroken up to 1975 included ! It was not before 1976 that on an overall Community basis the petroleum crisis impact on petrochemical investment behaviour became apparent. It took two years in Europe to realize the full impact of the petroleum crisis and to influence investment decisions. This is all the more astonishing if one looks at the investment behaviour of the refinery industries of the European Community :

This sector, apparently, realized much quicker than the petrochmical industry the real importance of the 73 crude price rise and drastically diminished investment expenditures already in 1974.
So a good deal of our petrochemical overcapacity was home made because for at least over two years the petroleum crisis was underestimated.

Capacity utilization is improving now in Europe but it had been down to very preoccupying levels. Over the recent two quarters business cycles evolved more positively.

In spite of this serious situation in the past <u>our chemical markets remained essentially open</u>.

This has been shown by <u>GATT negotiations</u> in the framework of the Tokyo Round where we made, initially, a full formula offer and we only withdrew afterwards and in part a series of concessions because the concessions of our trade partners didn't seem to be satisfactory.

But the preponderantly open state of our chemical market is also reflected in the activities of the Commission on a commercial defense line :

To illustrate this I would like to state that out of 79 cases of commercial defense since 1970 20 involved chemicals, 5 of which in the fiber sector, 3 cases involved the US. In only one of the chemical cases, an antidumping duty was established, but not far long, as our trading partner preferred to adapt his price.

8 cases were brought to an end by voluntary undertakings, 6 as a result of the developments, one was rejected and only 4 cases are still pending.

By the way, most of these chemical cases were directed against imports from Eastern European countries.

Our commercial defense system is thus very critical but not at all protectionist.

For the future we would like very much to maintain such a dynamic and open trade policy provided that trade competition is fair on our market.

In other words : we will be very critical of unfair competition. We wish fair competition and this holds for all the problem areas which I am now going to discuss.

Two of our problem areas

- the petrochemical development of the Arab region and

- the petrochemical development of Eastern Europe,

are of more medium or longer term impact on the economic behaviour of our chemical industry but nevertheless they have caused a lot of ink to flow and generate much hot air.

<u>Petrochemical developments in the Arab world</u>

We have studied trade relations with the Arab world, as well as the market for turnkey projects, as part of the Euro-Arab dialogue.

So far as trade agreements are concerned, we have

- the Lomé-Agreement to 4 (Djibouti, Mauretania, Somalia, Sudan)

- the Maghreb Agreements to Algeria, Morocco and Tunisia

- the Machrak Agreements to Egypt, Jordan, Lebanon and Syria.

But by far the most important feature is the Generalised System of Preferences, since it applies to all Arab countries.

When looking at our trade in chemicals, we see that our exports are well diversified over the Arab world. As to our imports from those countries, we note steady increases but not yet on an alarming scale :

- ammonia has been coming into the Community for quite a number of years with a surge in 1978;

- some ethylene started to flow in 1978, some methanol since 1976, with an upsurge since 1978;

- there are consistent imports of phosphate fertilizers from Egypt, Lebanon, Morocco and Tunisia with an upsurge for Morocco since 1977 and for Tunisia particularly since 1976. Some urea is beginning to flow too.

However, when we look at the technology and turnkey project market in the Arab world, a disquieting picture emerges. Arab countries have embarked on a vigorous and rather narrowly-based development programme in the last two years. The capacities launched correspond roughly to one-half of the present capacity of the whole Community for products such as ethanol (49 %), methanol (60 %), ammonia (58 %) and phosphoric acid (43 %); while for urea, their projects will surpass Community capacity (104 %).

The desire of the Arab region to upgrade their natural resources is entirely legitimate and natural.

It is economical to the extent that -

- it is in this type of activity that the valuation of the other factors (capital/labour) can be the best in that region (classical theory of comparative advantages);

- the rhythm with which the new productions develop do not wreck the world market of the products concerned, because, then, the first condition can't be fulfilled.

The risk to wreck a market is not an illusion : to the extent to which the operation of new production units override the rhythm of the growth of consumption and the rhythm of the replacement of obsolete units by new and more efficient plants, the price level of the products considered will tend to go down to the level of variable costs of marginal units in other words, to a price level which will cover only very partially the fixed costs of most modern units (and the less the more the marginal units are modern).

And prices could stay at such levels as long as unused modern capacities are kept in a stand-by position.

This situation could be changed only if the producers of the rest of the world would abandon fighting on prices in order to maintain their volume of production. This is conceivable only if they may be assured that their competitors from raw material producing countries will restrict themselves to a certain market share for the products considered and they will enter into new productions at a reasonable rhythm and aiming at a reasonable market share, in other words if their behaviour is rigorously economical .

Such a development would correspond as much to the general interest than to the interest of the companies.

General interest is here touched upon in the largest sense of the notion : not only of the countries in which the production of chemicals is actually situated but also the interest of countries producing raw materials, if one considers that they could not reasonably hope to recover losses which they have to face when imposing themselves on the markets for downstream products by receiving - at a later stage - of a monopoly rent on those same products.

Let us hope then that what will happen on the world market in the future will comply strictly with good economic logic.

And it is the role of politics to make sure that things happen that way.

Petrochemical developments in Eastern Europe

Our studies of chemical compensation agreements with East European countries over the last three or four years tend to show that the volumes involved until now give no cause for us to expect an alarming increase in market penetration into the European Community. There may be some question marks about urea, methanol, and caprolactam, but for some 20 other products we see no problem. Indeed, the most recent figures seem to indicate a decline in deals of this nature.

On the other hand, we have been more worried in studying the chemical pricing policy of these countries for their exports to our markets.

We have examined unit prices (that is to say value divided by volume of product) and think we have detected consistent under-pricing, particularly for soda ash and most of the termoplastics, involved in non buy-back arrangements.

One possible explanation of those low prices could be that it is very difficult to enter our market at higher prices because the producers already present on the market fight to maintain their output. Excessive imports either from Eastern European or from Arab countries tend to bring the prices at the level of the variable costs of the marginal producers. At such prices, the number of cases in which Eastern countries have a real economic interest in building new plants essentially for export is probably limited; they can only make a profit in selling marginal quantities from plants whose production goes mainly to their home market.

Those economic constraints have perhaps not always been clearly felt, especially in the first buy back deals but the learning process seems to be on the move. I hope in the interest of all concerned parties that it will bear its fruits before we get into major trouble.

The advantages to the US petrochemical industry derived from price controls on gas and crude oil

We in the Community have made some interesting calculations of the cost advantages available to petrochemical producers on this side of the Atlantic as a result of price controls on gas and crude oil. The picture is complicated since the effect appears twice : both in the form of cheaper raw meterial, and cheaper energy in the various conversion processes. The picture is further complicated by other technical or natural advantages enjoyed by some US producers. Suffice it to say that US producers seem to be able to produce basic petrochemicals at two-thirds of the European costs; and about half or more of the US advantage is derived from raw material costs.

Oil and gas price-controls are to be phased out, but some will last until 1985. So long as they exist, they can be said to constitute an indirect subsidy to US petrochemicals :

a subsidy which distorts international competition and although for most of those products the exports from the US to Europe did not raise considerably, this does not mean that the impact of the cost differencials is not already deeply felt.

Even if most of the American petrochemical compagnies did not and were not to try to export more, offers from commercial intermediaries are enough to oblige producers of some sensible products to keep their prices at a level where they sell with a loss.

I do believe that price controls were not intended to have this subsidizing effect in international trade when they were adopted by the American government, and I am quite sure that the U.S. realise that

- they have no real interest in exporting under the form of petrochemicals their natural resources in petrol and gas at prices below their present value on the world market

- they have neither interest, doing so, to put european producers in trouble : their real interest is more to have fair competition ensuring that all over the free world the industry will transform scarse raw materials at the lowest costs.

So I expect to find a large measure of understanding when we tackle this issue in Washington, tomorrow and I hope that here also we will be able to prevent going on a collision course.