China’s Forest Products Industrial Policy and its International Implications

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Summary

China is moving aggressively to develop its domestic pulp, paper, and wood products industries, with measures including:

- Subsidies;
- Preferential loan and tax policies;
- Fast track approval for pulp and paper projects;
- Increased use of trade policy measures, particularly in the paper industry.

However, China’s fibre deficit will continue to increase in coming years;

Increased investment has resulted in rapid capacity building, and in many sectors, overcapacity;

Despite increased competitive pressure not only within China, but also from China-based production in Asian export markets and the US/Europe, there are still sales and investment opportunities for international companies.
China Fibre Resources and Forestry Industry
China’s Forestry Resources

- Total forest area = 263 million ha
- Plantation area = 47 million ha
  - Much of forest area for shelterbelts and environmental protection, not commercial production;
  - Officially announced annual planting = 7.5 million ha (2002)
    4.7 million ha (2001)

- Announced plans to raise forest cover from 16.6% currently to 20% of total land area by 2010, and then again to 28% by 2050;

- Even as the economy has grown, logging bans and harvesting restrictions have reduced domestic log supply 12-15 million m3/yr since 1997;
China’s Annual Consumption of Wood Resources

Annual Consumption:

- **320-330cbm**
- **Industrial Roundwood (44.2%)**
  - 140-146 million cbm
- **Agricultural logs (23.5%)**
  - 75-78 million cbm
- **Fuel Wood (28.8%)**
  - 92-95 million cbm
- **Natural Loss/Other (3.5%)**
  - 11-12 million cbm
Paper Production and Consumption Has Increased Dramatically

Per capita consumption of paper products is still only 37kg/year, compared to over 320 in the US. Demand is expected to continue to grow at 6.8% annually, while production will grow at 4.8%
The Fibre Supply/Demand Gap for Paper and Wood Processing Will Continue to Increase

AF&PA Forest Trends 2004
Fibre Imports Have Risen Rapidly Since the Late 1990s

<table>
<thead>
<tr>
<th>Wood</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USD Billion</td>
<td>2.92</td>
<td>3.71</td>
<td>3.46</td>
<td>4.19</td>
<td>4.64</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pulp</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mmt</td>
<td>3.09</td>
<td>3.34</td>
<td>4.90</td>
<td>5.26</td>
<td>6.03</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
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</tr>
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<tbody>
<tr>
<td>Year</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mmt</td>
<td>3.09</td>
<td>3.34</td>
<td>4.90</td>
<td>5.26</td>
<td>9.38</td>
</tr>
</tbody>
</table>

China’s impact on global markets is considerable; its surging production and consumption is only one reason for volatility and rising world raw material prices.
China Has Announced Aggressive Development Policies to Combat its Increasing Reliance on Imported Fibre and Paper

**Fiber Resources:** Development of 13.33 million hectares of fast-growth-high-yield (FGHY) plantations between 2001 and 2015 requiring an estimated investment of US$8.65 billion.

**Paper/pulp:** Increases in paper/pulp production capacity; 14 million tons of paper and 1.5 million tons of pulp by 2005.

**Wood Processing:** Ten major wood processing projects planned for completion by 2005, representing a total capacity increase of 2.72 million cubic meters of wood products.
The Budget Requirements for These Forestry Investments are Substantial

- Chinese looking for RMB250 billion in industry investment, relying heavily on foreign capital, to reach its industry development objectives;
- Recent announcements claim forestry budgets will total US$100b over next 7 years;
- Government budgeting RMB 105.75 billion (US$ 13bn) to finance forestry development for 2002-2020 (US$720 million per year);
  - Research shows that much of this funding is not going to planting trees, rather as protective cover, welfare, and other transfer payments;

Experience suggests that limited capital and other constraints mean China will continue to rely heavily on imported fibre sources.
Industry Development Policies
Measures Being Used to Fuel China’s Development in These Segments

- Subsidies
- Tax and Investment Incentives
- Trade Policy Measures
- Finance and Investment Incentives
Subsidies

- US$1.67 billion loan interest subsidies for technology renovations and capacity installments at twenty-one State-owned paper-processing projects between 1998 and 2002;  
- US$1.73 billion budgeted for loan interest subsidies for FGHY plantation development through 2015;
Tax Policy

- Tax holidays and reduced taxation rates for companies investing in selected areas;
  - Investment in Western China – ‘Three Free, Two Half’;
  - More preferential terms – not governed by national laws - can be negotiated with local governments;

- Preferential border tax provisions;
  - Vast increase in Russian wood imports and wood processing investments – over 100 – in border region;

- Reduction or elimination of many agricultural fees and taxes for companies developing forestry resources;
  - Agricultural taxes can comprise up to 70% of fiber cost

- Reduced value-added tax (VAT) for enterprises utilizing recycled or wastepaper;
  - Proposals under consideration to exempt pulp and wastepaper imports from any VAT payments

- Lower import tariffs for high-grade paper manufacturing machinery
Trade Policy

- Increased use of Anti-Dumping investigations
  - Protect less competitive State owned producers (newsprint, linerboard);
  - Promote domestic investment – by international players – in higher value paper products by effectively blocking imports;
  - Manipulation by some domestic companies to gain strategic advantage and market share

- Continued tariffs on higher value wood and paper products
Finance and Investment Policy

- Lower than market interest loans;
- Extended loan repayment terms;
- Government financed forestry and related infrastructure investments

Policy banks, the China Development Bank and the Agricultural Bank of China, are the primary vehicles for these preferential lending policies.
These Policy Steps Pose a Significant Competitive Challenge to International Producers

- Likelihood of additional anti-dumping and trade policy measures against imported products;
- Increased domestic and international competition in Chinese markets, and competition from China-based production;
  - All major international forestry products companies are active in China, with growing investment
- Processing investment approval to also require significant investments in plantation resources;
Industry Impact
Growing Production in China’s Wood Processing Industries

**Furniture:** US$7.3bn in Chinese exports last year, up 35% over 2002

**Panels:** Plywood production to reach 15m m³ by 2005 (up from 11.35m m³ in 2002); exports exceeded 2m m³ in 2003, up 13% from 2002;

**Fibreboard:** Will double to 15m m³ by 2005

While processed wood production has grown, timber and sawnwood production has dropped

<table>
<thead>
<tr>
<th>M cu/m</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timber</td>
<td>59.6</td>
<td>52.3</td>
<td>47.2</td>
<td>45.5</td>
<td>44.3</td>
</tr>
<tr>
<td>Sawn Lumber</td>
<td>17.8</td>
<td>15.9</td>
<td>6.3</td>
<td>7.6</td>
<td>8.5</td>
</tr>
</tbody>
</table>
Various Paper Segments Have Seen Similar Growth

<table>
<thead>
<tr>
<th>Product</th>
<th>1997 Production</th>
<th>2002 Production</th>
<th>Average Growth</th>
<th>Consumption Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newsprint</td>
<td>730,000</td>
<td>1,850,000</td>
<td>20.44%</td>
<td>13%</td>
</tr>
<tr>
<td>Wood Free</td>
<td>140,000</td>
<td>1,600,000</td>
<td>62.78%</td>
<td>17%</td>
</tr>
<tr>
<td>Linerboard</td>
<td>1,100,000</td>
<td>2,900,000</td>
<td>21.40%</td>
<td>10%</td>
</tr>
<tr>
<td>White Board</td>
<td>850,000</td>
<td>4,600,000</td>
<td>38.30%</td>
<td>31%</td>
</tr>
</tbody>
</table>

This consistent growth in domestic capacity, combined with Chinese trade policy measures, has resulted in reduced imports in all of these segments.
More Investment Is in the Works

Local Governments have Increasing Power to Approve Foreign Investment

<table>
<thead>
<tr>
<th>Location</th>
<th>Investment Type</th>
<th>Project</th>
<th>Product</th>
<th>Capacity (MT)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ningbo, Zhejiang</td>
<td>Joint Venture</td>
<td>APP Zhonghua</td>
<td>White board</td>
<td>1 million</td>
</tr>
<tr>
<td>Hainan</td>
<td>Joint Venture</td>
<td>APP</td>
<td>Chemical pulp</td>
<td>700,000</td>
</tr>
<tr>
<td>Suzhou, Jiangsu</td>
<td>Joint Venture</td>
<td>Stora-Enso</td>
<td>Wood free paper</td>
<td>400,000</td>
</tr>
<tr>
<td>Changsu, Jiangsu</td>
<td>Joint Venture</td>
<td>UPM</td>
<td>Uncoated wood free paper</td>
<td>350,000</td>
</tr>
<tr>
<td>Nantong, Jiangsu</td>
<td>Joint Venture</td>
<td>Oji</td>
<td>Wood free paper</td>
<td>1.2 million</td>
</tr>
<tr>
<td>Taicang, Jiangsu</td>
<td>Joint Venture</td>
<td>Nine Dragon</td>
<td>Liner board</td>
<td>3 million</td>
</tr>
<tr>
<td>Changsu, Jiangsu</td>
<td>Joint Venture</td>
<td>Lee &amp; Man</td>
<td>Packaging board</td>
<td>1.3 million</td>
</tr>
<tr>
<td>Shijiazhuang, Hebei</td>
<td>Joint Venture</td>
<td>Pan-Asia</td>
<td>Newsprint</td>
<td>300,000</td>
</tr>
<tr>
<td>Shanghai</td>
<td>Joint Venture</td>
<td>Pan-Asia</td>
<td>Newsprint</td>
<td>200,000</td>
</tr>
</tbody>
</table>

AF&PA Forest Trends 2004
**Capacity Growth is Expected to Remain Strong**

<table>
<thead>
<tr>
<th>Product</th>
<th>Production 2002</th>
<th>Projected Capacity 2005</th>
<th>Projected Demand 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newsprint</td>
<td>1.7mmt</td>
<td>2.9mmt</td>
<td>2.5mmt</td>
</tr>
<tr>
<td>Linerboard</td>
<td>2.9mmt</td>
<td>7.4mmt</td>
<td>4.9mmt</td>
</tr>
<tr>
<td>Coated Wood Free</td>
<td>1.6mmt</td>
<td>3.0mmt</td>
<td>3.0mmt</td>
</tr>
<tr>
<td>White Paperboard</td>
<td>4.6mmt</td>
<td>7.75mmt</td>
<td>6.5mmt</td>
</tr>
</tbody>
</table>
As a Result, Significant *Overinvestment and Overcapacity*

- **Newsprint**
  - Industry overcapacity approximately 30%, with 2.9mmt domestic capacity and 2.2mmt demand;

- **Flooring**
  - Over 1,000 producers, capacity expected to grow 30% in 2003

- **Containerboard**
  - Domestic capacity approximately 6 Mmt/annually, additional 1.6 Mmt coming on line in 2003/4

- **LWC**
  - Capacity 700-800,000 mt/annually, but domestic production only 240,000 mt – primarily a result of poor product quality
Challenges to China’s Fibre Expansion Plans

- High cost of Chinese produced fibre;
  - High agricultural taxes and inefficient domestic transportation network raise production and delivery costs;
- Land availability and tenure security;
- Securing adequate plantation land base to support large-scale mills;
  - Competing cash crops in prime growing areas;
- Attracting required investment from foreign banks and companies;
  - Ability to fund investment requirements domestically is doubtful;
- Continuing restrictions on investment and ownership models
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