



New EPI study says China's paper industry subsidies boost overcapacity and 'meteoric' increase in exports

SAN FRANCISCO, July 2, 2010 (PPI Pulp & Paper Week) - China's paper industry owes its rapid growth to government subsidies that give its exporters an unfair global advantage, an academic study published this week stated.

The study by the Economic Policy Institute (EPI), a think tank with the stated aim of "broadening public debate about strategies to achieve a prosperous and fair economy," says the rapid rise in China's paper industry is not due to advantages in natural resources, economies of scale, new technology, or lower cost of production.

Instead, the growth resulted from at least \$33.1 billion in various Chinese government subsidies paid to the country's paper industry between 2002 and 2009, according to the EPI Briefing Paper: *No Paper Tiger: Subsidies to China's Paper Industry from 2002-2009*.

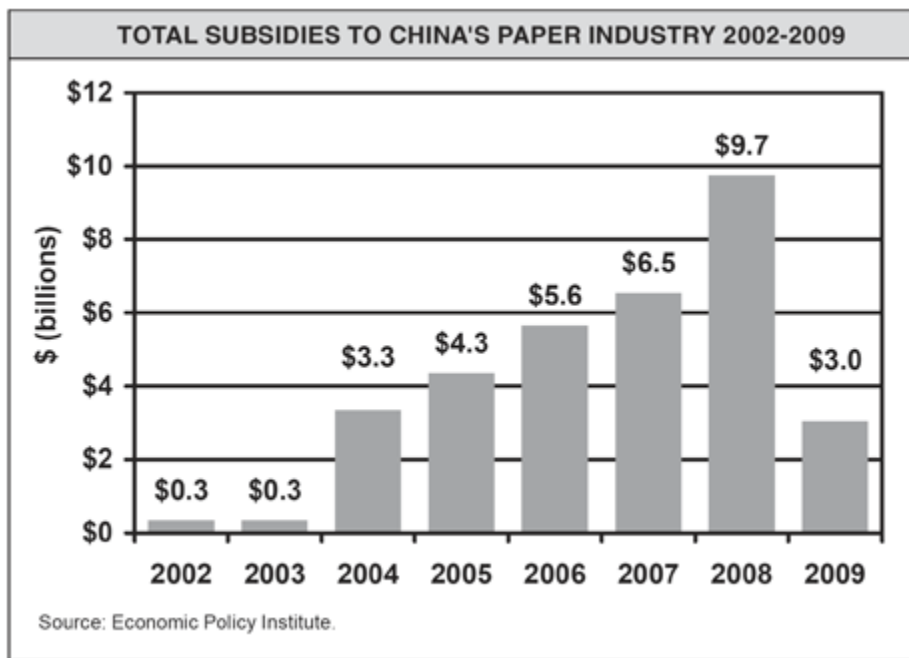
It states that since 2000 China has tripled its paper production, and in 2008 overtook the US to become the world's largest producer of paper and board products.

In 2009, China produced more than 17% of the world's total output and consolidated its place as one of the world's largest exporters.

"The United States is a net importer of paper and [board] products, and imports from China are rising faster than those from any other country. Over the past decade, US paper mills have shrunk with drops in output, employment, revenues, and the number of domestic companies, while Chinese imports have risen rapidly," wrote report author Usha Haley, a professor of international business at Massey University in Auckland, New Zealand.

"Unless the US government acts to offset unfair and illegal subsidies to Chinese paper exports, US paper production will continue to erode, leading to further job losses and widespread mill closures," she said.

Since 2007, US papermakers filed three complaints seeking duties on imports of Chinese coated printing and writing papers and thermal paper. The US International Trade Commission rejected duties for Chinese coated freesheet paper and enacted duties on Chinese lightweight thermal paper. A case for coated printing and writing sheet paper continues to move ahead in the USA, vs Chinese paper producers.



AF&PA agrees. The EPI report reached similar conclusions to American Forest & Paper Assn's (AF&PA) own studies, and confirmed that the Chinese government employed direct and indirect subsidies to support state-owned enterprises and build massive new production capacity, AF&PA pres/CEO Donna Harman said.

The EPI study was commended by Appleton Coated, NewPage, and Sappi Fine Paper North America, which along with the Steelworkers Union had petitioned the US Dept of Commerce last year to impose penalty tariffs on Chinese imports of the coated sheet paper.

"This study shows that Chinese subsidies are pervasive and have fueled the development of their industry. Their policies have damaged production here in the US, and cost jobs," said Appleton Coated CEO Sandra Van Ert in a joint statement.

"China is a non-market economy that simply doesn't play by the rules," stated NewPage Sr VP of marketing and strategy Mike Marziale, while Sappi pres/CEO Mark Gardner noted "until something is done about China's overall predatory policies, we and other industries will continue to have to pursue such trade cases."

But APP Americas acting pres Terry Hunley, who along with Asia Pulp & Paper and Sinar Mas has vigorously opposed the case for penalty tariffs, said the study was not relevant to the trade case.

"According to the US International Trade Commission's investigation, imports of this paper from China actually declined from 2006 to 2008 and the US producers' domestic market share increased during that period. These numbers clearly show that US paper makers are not being harmed by Chinese producers," he said.

Credibility gap? Hunley also cast doubt on the study's credibility, noting that "The Economic Policy Institute receives about one-third of its funding from labor unions and the report thanks Alliance for American Manufacturing for its support. That alliance is run by the United Steelworkers, one of the petitioners asking for increased duties on imported coated free sheet paper from China and Indonesia."

The EPI report estimates that subsidies to China's paper industry totaled \$3.1 billion over the eight years from 2002 to 2009, with all subsidies falling sharply in the final year when world prices for all commodities plummeted during the recession.

Pulp. Pulp received the largest share with a total of \$25 billion between 2004 and 2009 when data were

available, yet the study claims to greatly underestimate the overall amount because "large backward-integrated companies and state-owned enterprises receive highly discounted pulp through transfer pricing mechanisms for which data are publicly unavailable."

Coal. Subsidies for coal consumed by China's paper industry reached \$3.1 billion, increasing steeply in 2008 when the price of coal soared. Coal meets over two-thirds of China's energy needs, with more than 75% of recent demand growth coming from the power sector.

Recycled paper. Subsidies for recycled paper totaled \$1.7 billion from 2004-2009, with old corrugated containers for boxes being the largest component. Subsidies spiked in 2008 due to the sharp increase in global prices that was not reflected in Chinese prices, but because of incomplete data, no subsidies could be calculated for 2004, 2007, and 2009.

Loan interest. China's state development and planning commission (now the NRDC) allocated \$2.1 billion in loan-interest subsidies from government funds to 13 projects focused on integrating paper-processing facilities with fast-growth high-yield plantations in 2002-2010. But again this understates the amount because public information was unavailable on 30 other projects that were also due to receive loan-interest subsidies.

Electricity. Subsidies for electricity used by China's paper industry reached \$777.8 million between 2002 and 2009, although the study relied on published prices and official disclosures that "probably underrepresented" provincial subsidies on electricity.

Company-reported subsidies. Subsidies reported in Chinese paper companies' annual reports in 2002-2009 reached \$442.2 million, with much of it reported as "subsidy income." They shot up in 2008 and 2009 when Lee & Man and Nine Dragons reported receiving large cash grants, but as many companies had no legal requirement to disclose government cash grants or subsidies much data is lacking. Nine Dragons Paper and Lee & Man Paper are the No. 1 and No. 2 largest containerboard producers by capacity in China, respectively.

Overall Chinese paper and board production rose a total of 53.5% from 61.8 million short tons in 2005 to almost 94.8 million tons in 2009, while US production declined 14.4% from 92.6 million tons in 2005 to 79.28 million tons in 2009, according to industry reports.

Further, Chinese paper and board, and paper converted product imports into the USA in 2009 represented 7.6% of total imports, up from about a 5% import share in 2007, based on US government figures from the AF&PA. Of China paper-board imports into the USA in 2009, 368,648 tonnes were paper, 82,762 were paperboard, and 460,105 tonnes were converted paper and board products with a third of the converted products being tissue/sanitary goods.

The EPI report notes that globally, and in China, labor constitutes a very small part of the costs of the paper industry while high capital investments play a major role.

"China has no natural competitive advantage in papermaking, and lacks the natural resources to fuel the industry. Labor makes up about 4% of the costs in this industry; in contrast, imported recycled paper and pulp comprise over 35% of the costs," Haley wrote.

"Raw materials, which make up three-fourths of the costs of producing Chinese paper, as well as electricity, coal, and transportation, have nearly doubled in price over the last decade. Yet, Chinese paper sells at a substantial discount compared to US or European paper," according to Haley.