



## Featured Topic

### China – Global Competitor or Growing Export Market?

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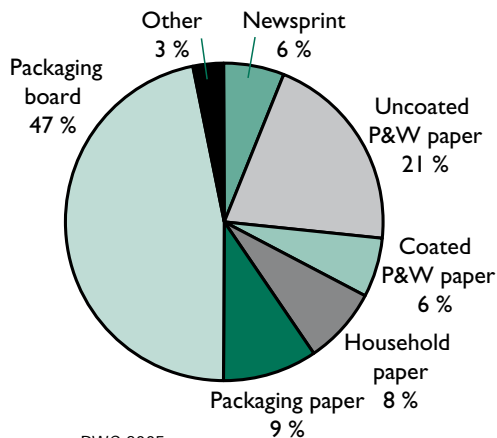
The annual rate of growth in the Chinese economy in the ten-year period to 2005 averaged 8.5%. As a producer and consumer of paper, China is now surpassed only by the United States. If its paper consumption continues to rise at the rate of the past ten years, the coming decade will see China accounting for about 40% of the global growth in paper and paperboard consumption and about 30% in sawn softwood consumption. The state of the Chinese economy and its forest industry would then be the largest individual factor influencing the global forest sector. The impact on Finland would be both direct and indirect and would concern not only global sales and market prices of roundwood and forest industry products and the industry's location decisions, but also, more generally, the sustainable use of forests worldwide.

#### Rapid Growth in China's Demand for Paper and in its Furniture Exports

Growth in the Chinese economy has stimulated the country's demand for forest industry products to such a level that imports have roughly tripled since 1997. China's demand for paper and paperboard has been growing in recent years at an annual rate of about 13%, whereas the figure in Europe and North America has been 2–3% or less. According to the China Paper Association, China's annual consumption of paper will be about 70 mill. tonnes by 2010, or almost 40% more

than at present. In addition, figures from the independent forest industry information provider RISI show that China's consumption of sawnwood will double to approximately 40 mill. m<sup>3</sup> by 2015. Despite this growth in paper and sawnwood consumption, China's per capita demand for paper will be only one fifth of the level in Western countries, and its per capita sawnwood consumption considerably lower. The relationship between the demand for forest industry products and their prices has become stronger in China, and the impact on prices in international forest product markets is also apparent. This will continue in the future as China gradually becomes a more market-oriented and open economy.

Packaging board accounts for almost half of China's paper and paperboard production. In 2004, China produced 49.5 mill. tonnes and imported 6.1 mill. tonnes of paper and paperboard. The increase in its paper production has boosted imports not only of pulp but also recovered fibre, the latter rising from less than 1 mill. tonnes in 1995 to 12.3 mill. tonnes in 2004. China's paper industry makes extensive use of recycled fibre (45%) and non-wood-based raw materials (35%). About 84% of pulp production uses non-wood-based raw materials, principally straw. It is forecast that by 2020 some 40% of the world's paper investments will be in China, which will mean a doubling of its production capacity.



Source: PWC 2005

*Structure of paper and paperboard production in China, 2004.*

The most important products in China's wood products industry are plywood, MDF and fibreboard. Production of plywood in 2004 amounted to 21 mill. m<sup>3</sup> and MDF and fibreboard about 30 mill. m<sup>3</sup>. Production of sawnwood totalled 17.9 mill. m<sup>3</sup> in 2005, of which about half was sawn softwood. Sawnwood production is nevertheless thought to be much higher than this because small-scale local producers are not included in the statistics. Even the official figures on the production of forest industry products are not entirely accurate for China.

The volume of China's forest industry exports has tripled since 1997, and the country has become an important exporter of low-priced wood products. The growth in China's production and the competitiveness of its exports on the world market are based above all on its low labour costs. In recent years the composition of China's imports of forest industry products has altered somewhat. In the late 1990s, for example, China imported a lot of plywood, whereas now it imports roundwood for the needs of its own plywood industry. At the same time, its pulp imports have grown and now exceed imports of paper. This is largely due to the decisions of international forest corporations to locate paper production in the growing Chinese market.

Furniture and wood-based panels are the most important of China's forest product exports. Between

1997 and 2004, the value of China's exports of wooden furniture increased annually by about one third, and the country's share of the global furniture trade is already about 30%. The key export destinations are the United States, Japan, Hong Kong and the EU. With Chinese products already accounting for one fifth of the US furniture market, the US has begun to limit Chinese furniture imports through special duties. The success of Chinese exports is based on China having the world's lowest labour costs: for example, the cost of one furniture industry worker in Western countries is the same as that of 35 furniture industry workers in China. Besides cheap labour, the growth in furniture exports is also attributable to China's massive production of MDF.

In addition to furniture, China has also increased its production and exports of wood-based panels, especially plywood. China is already the world's biggest exporter in the plywood market, the main export destinations being the United States, Japan and the EU. In 2005, China's exports of hardwood plywood to Germany, for instance, were up by one fifth, while exports of softwood plywood to the German market almost tripled. This raised China's share of Germany's imported plywood to almost 10%.

In 2005, China accounted for about 1%, or EUR 133 mill., of the Finnish forest industry's exports. About two thirds of this consisted of paper industry products. This figure was in fact down by 10% on the 2004 total, due to the increase in Finnish-owned capacity in China. Chinese exports of forest industry products to Finland in 2005 amounted to EUR 28 mill., most of which consisted of products of the wood products industry. Furniture imports from China amounted to EUR 5 mill. in 2000 and are expected to total EUR 40 mill. in 2006.

### Foreign Investment a Key Factor for China's Forest Industry

The foundation for the powerful growth in China's economy in recent years has been provided by its WTO membership in 2001 and the country's continued success in attracting foreign investment. More than half of China's exports are currently from foreign-owned companies operating in the country, and in the paper

industry this proportion is almost 30%. China's economic success in recent years has also been based on the weak exchange rate of its currency, the renminbi, which has also benefited foreign investors exporting from China. Under pressure to do so, China revalued the renminbi in 2005, but by only 2%. A key attraction for foreign companies locating in China is access to the rapidly growing Asian market. In circumstances of tough competition, companies are also looking to improve the competitiveness of their global operations, which is possible by combining technology transfer with low production costs.

Two of Finland's major forest corporations, UPM and Stora Enso, have also invested considerably in China. The value of UPM's Changshu fine paper mill, opened in 2005, was approximately EUR 900 mill. For comparison purposes, this is about three times more than the amount Finnish companies have so far been willing to invest in Russia. UPM's China strategy also includes the establishment of a paper industry research unit there.

Concentration in the Chinese paper industry, with its 3500 mills, is still very low, as only about 10 mills reach an annual production figure of 300 000 tonnes. Consolidation in the sector is thus expected in the next few years. The biggest producer of printing and writing papers is the multinational Asia Pulp and Paper (APP), which has grown considerably in recent years.

### China's Imports of Wood Will Be a Challenge for the Sustainable Use of the World's Forests

The volume of China's roundwood imports has more than tripled since 1997, because of its relatively scarcity of forest resources. In 2005, it imported about 35 mill. m<sup>3</sup> of roundwood, most of which was from Russia. Other sources are Malaysia, Papua New Guinea and Myanmar. China is the world's second biggest importer of roundwood and wood chips after Japan.

The anticipated growth in forest industry production and other use of wood (e.g. firewood) will also increase the major gap that exists between China's wood resources and its demand for wood. Estimates show that fellings in Chinese forests already exceed the level that sustainable forest use will allow, and the gap will grow in the future. The situation will be

exacerbated further by illegal fellings and continued growth in firewood use. China is developing its own national forest certification system, which is mainly an adaptation of the FSC criteria. There is still a considerable amount of work to be done on this, though several trials have already been carried out.

The Chinese government's aim is to establish a total of 13.4 mill. ha of planted forest in the period 2001–2015. The existing plantations are able to produce only 8–10 mill. m<sup>3</sup> of pulpwood annually. In view of this, Stora Enso, for instance, has invested USD 150 mill. in eucalyptus plantations in Southwest China in order to safeguard future roundwood procurement for its investments. Nevertheless, according to a number of different estimates, China's future fellings of industrial wood will be far short of the target set, due to factors such as the nutrient-poor soil of planted forests, poor silvicultural standards and the distant locations of planted forests.

China's level of roundwood imports will inevitably have unwanted effects on the environment and on sustainable use of forests in the countries of origin. China has already faced obstacles to its EU exports, as increasing attention has been directed at environmental considerations and the sustainable use of forests (above all illegal fellings and issues concerning the origin of timber).

### China Will Have Positive Impact on Finnish Forest Industry Cluster in Short Term

From the producers' viewpoint, the growth in demand for forest industry products in China will have a positive effect on world market prices of forest industry products. China's increasing imports and investment will open up new opportunities for Finnish forest companies as well, and so its importance for the Finnish forest sector as a whole will remain positive in the next few years. The market for Finnish paper industry machines, equipment and technological know-how in particular has been extremely good in China in the past few years. On the down side, however, the investments in China by Finnish forest industry companies will also have an adverse impact on the development of Finnish-based production units by tying up capital and human resources.

China's dependence on imports will probably grow in the future because of the strong growth in demand and the shortage of home-grown roundwood resources. Increased consumption will mean greater imports of roundwood, pulp and recycled fibre in particular, which will affect the world market for these products. A tighter market could lead to major price fluctuations. China's demand growth will also bring further pressure on world market prices for roundwood and recycled fibre. With production growing rapidly, it is possible that price fluctuations will intensify, for example in the market for coated fine paper. If China's own consumption does not grow quickly enough to keep up with the growth peaks in production, exports from China could grow, leading to a temporary downward pressure on prices, which has already happened on the fine paper market. On the plywood market the growth in China's exports is forecast to level off as domestic demand rises.

In the longer run, China's ability to increase its exports of forest industry products will improve and, as a highly competitive producer, its exports may grow considerably faster than its imports. There will also be a growing proportion of value-added exports as a result of the increasing adoption of modern technology, the rising volume of imported raw materials and higher freight costs. This will mean even tougher competition on the European markets of importance to Finnish forest industry companies. Thus, the answer to the question posed in the title of this article is that China

is undoubtedly both a competitor and a growing market for the Finnish forest industry. The competitiveness of China's forest industry will, however, depend not only on demand and movements in exchange rates, but also on the national economy in general, complete with its political risks. Future developments will also be determined by the strategies adopted by the globalising forest industry companies themselves.

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