AF&PA

AMERICAN FOREST & PAPER ASSOCIATION

GROWING WITH AMERICA SINCE 1861

June 28, 2004

Mr. Ronald Lorentzen
Acting Director, Office of Policy
Import Administration
U.S. Department of Commerce
Room 3713
14th Streets & Constitution Ave
Washington DC 20230

RE: Comments on Unfair Trade Practices Task Force

Dear Mr. Lorentzen:

This document is being submitted by the American Forest & Paper Association (AF&PA) in response to the *Federal Register* notice Vol. 69, No. 103, Page 30285 (May 27, 2004). AF&PA is the national trade association of the forest, pulp, paper and paperboard and wood products industry.

AF&PA urges that the Department of Commerce's newly established Unfair Trade Practices Task Force quickly identify and tackle foreign subsidies and other unfair trade practices before they cause more injury to the U.S. forest products and other manufacturing industries. The U.S. needs to move aggressively against subsidies, currency manipulation and other foreign unfair trade practices through a range of approaches, including direct negotiations with offending countries, in pending and future free trade agreement negotiations, negotiating greater disciplines over government subsidies in the WTO and by self-initiating trade cases to protect U.S. industry.

SUBSIDIES

Subsidies provided by foreign governments for capacity additions or to maintain uneconomic manufacturing capacity are a serious and growing problem for the U.S. forest products industry. The forest products industry shares many common characteristics with other capacity-sensitive sectors. Government subsidies distort markets by financing new capacity in sectors already suffering from global overcapacity and supporting production capacity in inefficient mills that would otherwise be closed in a competitive, market environment. In a global market, the distortions associated with subsidized capacity building or capacity maintenance are worldwide in impact. Limiting and eliminating these types of market distortions on a global basis is critical to the economic health of our industry and to ensuring that U.S. companies are competing on a level playing field.

1111 Nineteenth Street, NW, Suite 800 ▪ Washington, DC 20036 ▪ 202 463-2700 Fax: 202 463-2785 ▪ www.afandpa.org
America's Forest & Paper People® - Improving Tomorrow's Environment Today®

In the Doha round of WTO trade negotiations, the U.S. should press for stronger disciplines over government subsidies for capacity-sensitive industries. Specifically, countries should agree to prohibit substantially all subsidies in capacity-sensitive sectors, whether directly or indirectly through government owned or government controlled banks, except perhaps for capacity closure and associated worker adjustment assistance. This would entail expansion of existing subsidies disciplines, enforced through the WTO dispute settlement process. In addition to direct subsidies, there are other forms of official support that should also be eliminated, including export credits for plant and equipment and multilateral development bank financing for projects that would contribute to expanded global capacity.

China Subsidies: The Chinese government employs an array of industrial policy tools intended to prop up state-owned enterprises and to promote the rapid expansion of China's paper and wood processing industry. The result has been a substantial drop in market opportunities for U.S. manufacturers. This is particularly troubling since China doesn't have the large fiber resources necessary for the development of a competitive domestic forest products industry, and is largely dependent on imported fiber in the form of logs and other wood products, wood pulp and recovered paper.

In an effort to catalogue these practices, AF&PA spent six months studying the Chinese industry. Our report, *"China's Subsidization of its Forest Products Industry"* was just completed. A copy of the report's key findings is attached. The report outlines several non-market practices that have lead to the buildup of the Chinese paper and wood processing industry. A few examples:

- Between 1998 and 2002 the Ministry of Finance provided 1.67 billion dollars in loan interest subsidies for technology renovations of 21 state-owned paper mills.
- The Ministry of Finance has designated 1.73 billion dollars for the development of fast-growth-high-yield plantations by 2015.
- Policy banks such as the China Development Bank and the Agriculture Bank of China are providing companies in the forest products sector with low interest loans or loans with unusually long repayment terms.
- At the provincial and municipal levels, banks are engaged in non-standard lending and other practices to attract foreign investment, including debt forgiveness and debt-for-equity swaps, extended loan repayment terms and preferential loan interest rates.

The effect of these subsidies, together with other industrial policies, has been to encourage large investment in the sector, both by domestic enterprises and international manufacturers. As a result, in a number of product segments there is significant overcapacity accompanied by growing exports and reduced import opportunities for the U.S. forest products industry.

Korean Government Subsidies to Coated Free Sheet Paper Manufacturers: The government of South Korea has played a leading role in the creation, development, and subsequent expansion of the Korean pulp and paper industry. The Korean government has given, and continues to give, a number of direct and indirect subsidies to domestic producers, keeping several of the otherwise bankrupt paper companies afloat. This has resulted in a significant increase in Korean production capacity, primarily directed at the export market.

In particular, export-driven capacity expansion in the coated free sheet (CFS) paper sector has had a negative impact on competitors in the United States. Korean CFS exports to the United States have rapidly accelerated over the past several years.

A number of the Korean government programs aimed at assisting the Korean paper industry appear to be actionable subsidies, as defined by the World Trade Organization Agreement on Subsidies and Countervailing Measures and U.S. unfair trade laws. These measures include:

- Korea Development Bank loans and corporate bond guarantees,
- Directed lending through low-cost facility investment loans,
- Bailouts of major coated free sheet producers that should have been liquidated,
- Preferred access to raw material, including development of Korean pulp supply, and
- In excess of $2 billion in government-sponsored funding from 2000 to mid-2003.

An increase in subsidized Korean imports has significantly injured U.S. producers. The U.S. coated free sheet paper industry is well-established and highly-competitive. Beginning in 1997, imports of subsidized Korean papers have steadily eroded U.S. market share, resulting in declining revenues and profits. U.S. producers have been forced to close mills and lay off workers. In 2003, U.S. imports of coated free sheet paper from Korea reached 337,908 metric tons with a value of $273 million, compared to just 116,602 metric tons and a value of $93 million in 1999.

It is critical that the Korean government withdraw its support for the Korean coated free sheet paper sector and let market mechanisms determine the amount of capacity and production in Korea. Korea should not export the problems in its paper industry to the United States or third country markets. AF&PA will continue to work closely with U.S. trade agencies to achieve this objective.

European Subsidies: In recent years, a number of European nations and regional governments have provided state aid to pulp, paper and wood processing projects. Germany has been most active in giving aid in the form of grants, loans and loan guarantees for pulp, paper and wood products capacity building, particularly for projects in the eastern part of the country. While these projects tend to be in so-called economically depressed regions, these projects add substantial new capacity to a European and world market that is already suffering from overcapacity. This situation has contributed to the substantial drop in U.S. pulp and paper exports to Western Europe and a rise in European paper and wood exports to the U.S. and third country markets.

The European Commission gave approval for state aid to these projects under its "multisectoral framework on regional aid for large investment projects." A major aspect of the Commission's decision is based on the economically unjustifiable principle that appropriate European capacity equals European area demand (i.e., that there is no role for imports) so the Commission doesn't take into account global overcapacity in a particular sector.

Since these government subsidies have a direct impact on U.S.-EU trade and the health of the U.S. forest products industry, the U.S. government should engage the European Commission in a dialogue on establishing greater disciplines over state aid in sectors such as pulp, paper and wood that are suffering from global overcapacity. This subsidies issue also needs to be addressed in the WTO as part of broader consideration of stricter disciplines on government aid and other subsidies that have an impact on international trade and the global marketplace.

EXCHANGE RATES

The relative value of the dollar and other major currencies is critical to the competitiveness of U.S. forest products in the global marketplace. Gains made in tariff negotiations can be wiped away by a country manipulating its currency. Eliminating foreign currency manipulation would make the U.S. forest products industry more competitive in the domestic and international markets.

Distortions in foreign exchange markets and the sharp appreciation of the dollar since 1997 have distorted the U.S. forest products industry's international competitiveness. As a result, the U.S. trade deficit in forest products ballooned from $6 billion in 1997 to $13.6 billion in 2001. The impact on the U.S. forest products industry has been severe – more than 240 pulp, paper, paperboard and wood processing mills have shut down and more than 140,000 mill jobs have been lost since early 1997. At the same time, foreign producers have expanded capacity to capture the growth in global demand and expand their market share at the expense of U.S. producers.

The value of the U.S. dollar has declined substantially against the Euro since early 2002, and has dropped to a lesser extent against the yen and the Canadian dollar. However, the dollar has declined to a much lesser degree against a broad basket of currencies suggesting that the dollar is still overvalued and continues to be a de facto tariff on U.S. producers selling into foreign markets while allowing suppliers a competitive advantage in the U.S. and third country markets.

There is clear evidence that foreign exchange values are being manipulated by foreign governments to establish competitive advantage for their industries. Research conducted by Ambassador Ernest Preeg of the Manufacturers Alliance/MAPI, and others, shows that currency manipulation by a number of countries, especially China, Japan, South Korea, and Taiwan, have exacerbated the tendency toward a strong dollar and distort market function. These countries have accumulated dollar holdings well in excess of recognized or necessary reserve requirements for the purpose of keeping down the value of their currencies and maintaining export price competitiveness. Importantly, these four countries account for some 60 percent of the U.S.'s entire global trade deficit in manufactured goods.

The critical role of exchange rates in determining the quality of market opportunities obtained in trade negotiations is widely accepted. For this reason, the Trade Promotion Authority legislation includes language which recognizes that significant or unanticipated changes in exchange rates can negate U.S. market access gains in trade agreements and calls for consultations with our trading partners. AF&PA, as a leading proponent of TPA legislation, calls on the Administration to include an assessment of exchange rates impacts in its negotiating strategy and provide for consultations on this subject in the text of trade agreements. Otherwise, U.S. trading partners may be able to retrospectively diminish the export opportunities for U.S. industry negotiated by the U.S.

China has been accumulating large U.S. dollar reserves in order to keep its currency, the Yuan, significantly weaker than its value would be otherwise if it was based on international market forces. As a result, U.S. exporters of forest and paper products have seen their competitiveness decline, while imports from China have been rising.

China devalued its currency by about 30 percent in 1994 and has maintained that value since then despite a huge increase in the size and strength of its economy, productivity, foreign direct investment and other factors that would normally cause a currency to appreciate. The value of the Yuan is controlled by the government through massive increase in its dollar reserves. There are various estimates of where the Yuan would move if its value was not controlled. Research conducted by Ambassador Ernest Preeg of the Manufacturers Alliance/MAPI shows that the Chinese currency could be undervalued by as much as 40 percent. The Chinese currency is the key not only because of the huge bilateral imbalance, but also because other Asian countries are not allowing their currencies from appreciating against the dollar due to fear that they would lose markets to Chinese exports.

The effect of the significant undervaluation of the Yuan has impacted more than just the trade balance. China's accumulation of dollar reserves means that for every dollar the Central Bank of China purchases it is creating 8.3 new Yuan. As a result, China's money supply is growing at a rapid pace, providing a large source of cheap funds for investment in massive manufacturing capacity in the paper and wood sectors, as well as other manufacturing capacity.

The U.S. Government should use every means possible to press the Chinese government to revalue the Yuan to levels consistent with market forces. The U.S., if possible in cooperation with other major trading countries, should use IMF and WTO rules to force China to stop manipulating currency levels to gain trade advantage. Clearly, exchange rate manipulation by China offsets the market access benefits the U.S. negotiated with China as part of its WTO accession.

NON-TARIFF BARRIERS

Non-tariff barriers (NTBs) can severely hinder trade and erode the benefits of tariff elimination. Elimination of NTBs is essential to ensuring that forest products have equitable market access in international markets. In 2003, AF&PA, at the request of the Department of Commerce, compiled a list detailing 62 non-tariff trade barriers that affect paper and wood producers in overseas markets. Specific barriers were identified in Brazil, China, EU, India, Indonesia, Japan, Korea and Mexico. Each of these countries represents either a major export market for U.S. product or a major competitor to our sector's exports in 3rd country markets. These barriers result in increased costs to our industry and in some cases effectively ban U.S. product from certain segments of the market.

The list of NTBs was summarized into the following priority areas:

1. Subsidies
2. Exclusive environmental standards
    - Eco-labeling
    - Certification
3. Building Codes and standards

4. Lack of product acceptance
5. Poor enforcement of regulations
    - Discriminatory import surcharges, permits and licenses
    - Inconsistent application of VAT
    - Sudden enforcement and inconsistent interpretation of phytosanitary regulations, logging bans and illegal imports
6. Evasion of SPS/TBT disciplines

AF&PA is continually updating this list and will continue to work with our colleagues at the Department of Commerce to highlight and address priority issues.

ILLEGAL LOGGING

The U.S. forest products industry has taken an aggressive position to make certain that products entering international commerce in general and U.S. markets in particular, are produced in accordance with sustainable business and forestry practices. We oppose trade practices that permit or foster environmental degradation to gain competitive advantage. We support U.S. trade policies that promote enforcement of domestic environmental laws and encourage improvements in environmental practices. Furthermore, the U.S. industry believes that trade liberalization has a positive effect on environmental quality by raising the efficiency of resource use and generating economic growth that make increased expenditures on environmental protection and social benefits possible.

Illegal logging is a shared concern among governments and producers, manufacturers, importers and exporters of forest products and a problem that compromises the economic, environmental, and social objectives of sustainable forestry. Illegal logging also affects the competitiveness of legal players when illegally harvested wood enters the marketplace without reflecting the true cost of sustainable forest management. The cost of wood is the largest cost in any forest product making it hard for honest companies to compete.

AF&PA has been monitoring the global illegal logging issue for some time and are very proud that we were the first industry group in the world to make a major, public commitment to end illegal logging. AF&PA believes that the best approach to combating illegal logging is strengthening the rule of law and ensuring appropriate enforcement of the law. The implementation of effective anti-corruption and anti-bribery laws is also an essential component of good governance.

AF&PA commends the Commerce Department for undertaking a comprehensive review to identify unfair foreign trade practices that undermine the U.S. manufacturing global competitiveness. We stand ready to work with the Unfair Trade Practices Task Force on developing strategies for addressing unfair trade practices in the forest products sector.

Sincerely,

Ann Wrobleski

Ann Wrobleski
Vice President, International

Attachment

China's Subsidization of its Forest Products Industry

Key Findings

Prepared by the American Forest & Paper Association
June 2004

KEY FINDINGS

The Chinese government has set ambitious capacity expansion targets for its pulp, paper and wood processing industries over the last five years. To achieve those objectives, a series of aggressive development policies have been set in motion, backed by central government policy directives and funding, to speed the development of China's pulp, paper, and wood processing industries.

These policies are premised on the following objectives:

- Reduce China's dependence on imported wood fiber, paper, and processed wood products by developing the domestic wood fiber base through:
  - Development of fast-growth-high-yield plantations.
  - Reduction of high taxes and fees on plantations to stimulate investment.
  - Tariff reductions on imports of raw materials and processing machinery.
  - Protection of China's forestry base.

- Encourage foreign investment in the wood fiber, pulp, paper and wood processing sectors through a variety of financial and tax incentives.

- Promote exports of value-added wood and paper products through value-added tax (VAT) rebates (although many of these VAT rebates are being reduced, some are still in effect for certain wood and paper product sectors).[1]

- Subsidize the restructuring of state-owned pulp or paper and wood processing companies through:
  - Government loans and loan subsidies for technology renovation.
  - Promotion of foreign investment in state-owned enterprises.
  - Protection of debt-ridden state-owned enterprises that maintain excess or idle production capacity through local government soft loans and loan forgiveness.

[1] Although VAT tax rebates are gradually being phased out over time, especially on commodities such as timber and pulp, it is expected that they will remain in place for the foreseeable future on value added products (i.e., fiberboard, plywood) to promote exports of these goods. Any further reductions of VAT tax rebates on these value added goods are expected to be marginal.

To further ensure achievement of capacity and policy objectives, a key point of the central government's development policies has been to devolve decision-making power for approval of new investments to local governments. This has had the two-fold effect of greatly expediting investment approvals and significantly improving the scope and content of favorable development schemes offered to domestic and foreign investors alike. In practice, local governments have gone well beyond central government directives when offering development aid, including tax, financing and trade measures, in support of investment in their regions. Finally, local governments have been extremely supportive of domestic industry in applying to the central government to receive preferential assistance (e.g., central government loan interest subsidies for paper companies investing in plantation projects).

1. Government Capacity Expansion Targets

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

- 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 are planned for completion by 2005, representing a total capacity increase of 2.72 million cubic meters of wood products.

2. Finance and Investment Policy

- Central government's loan interest subsidies: $1.73 billion (USD) has been designated by the Ministry of Finance for the development of fast-growth-high-yield plantations by 2015.

- Central government's loan interest subsidies: $1.67 billion (USD) was provided by the Ministry of Finance for technology renovations of 21 state-owned paper-processing projects across China from 1998 to 2002.

- Policy banks' (e.g., the China Development Bank and the Agricultural Bank of China) low interest loans and long repayment terms: Fast-growth-high-yield plantation projects receive low interest loans at 90 percent of the standard rate with extended repayment terms between 10-15 years (normal repayment terms are between three to five years).

- Local governments' fast track approvals: Local governments have been permitted to issue fast track approval, bypassing central government authorization, for integrated plantation/pulp/paper projects resulting in:

    - Large-scale influx of foreign investment, particularly in the area of paper processing, in certain forestry-rich provinces where investment incentives offered by local governments are particularly favorable (e.g., Guangxi, Hainan).
    - Foreign investment in tree plantations aiding development of China's wood fiber base in the medium to long term (i.e., five to eight years).
    - Accelerated capacity expansions, particularly in the wood fiber and paper product sectors.

3. Role of Financial Institutions

- Domestic banks play the leading role in providing loans to forestry/paper/pulp enterprises.

    - The China Development Bank and Agricultural Bank of China provide the majority of financing to these sectors in the form of policy loans and allocation of loan interest subsidies.
    - Domestic commercial banks also provide financing, primarily to the forestry sector, in the form of loans and loan interest subsidies, although the latter is primarily administered through policy banks.
    - To date, domestic banks have not issued official preferential policies favoring domestic wood and paper enterprises over foreign companies.

- Domestic banks engage in a variety of non-standard banking practices to attract foreign investment in certain provinces/localities, including:

    - Debt forgiveness and debt-for-equity swaps.
    - Extended loan repayment terms.
    - Preferential loan interest rates above and beyond central government policy.

- The majority of these practices occur at the provincial and municipal level to either attract foreign investment and/or protect domestic state-owned enterprises from competition.

- International banks are playing a lesser role in the financing of paper and wood enterprises in China.
    - Since the mid-1990s, the World Bank and the Asian Development Bank have focused almost exclusively on sustainable forestry, environmental protection and infrastructure projects.

4. Tax Policy

- Reduction on forestry taxes and fees: Reduction or elimination of agricultural fees and taxes for companies developing forestry resources.

- Tax holidays are provided to attract foreign investment. More preferential terms, not governed by national laws, can be negotiated by local governments on a case by case basis including:
    - VAT exemption if enterprises use certain grades of wood for production.
    - Local income taxes are sometimes returned to companies; percentages vary by region.

- Preferential VAT rate on border trade resulting in a large volume of Russian wood and pulp flow into China.

- VAT rebates are provided for exports of valued-added wood products, including particle board and plywood.

5. Trade Policy

- Tariff Measures
    - Zero tariffs on logs/lumber and pulp/waste paper imports beginning in 1999 to supplement the insufficient domestic supply.
    - Tariff exemptions for high-grade paper machinery to both support technology renovations in large state-owned enterprises and encourage foreign investment in China.
    - Continued tariffs on value-added wood and paper products.

- Anti-dumping Investigations
  - Protect less competitive state-owned producers through the continuation of prohibitively high dumping margins on newsprint imports.
  - Promote domestic investment – including international players – in coated wood-free paper, by effectively controlling the level of imports, which are mainly coming from Japan and Korea.
  - Chinese anti-dumping procedures have allowed some domestic companies, in some cases one to two players, to manipulate the process to gain a strategic advantage and market share.
  - The government is supporting anti-dumping investigations to encourage greater foreign investment in the Chinese forest products industry.
  - At the request of a small number of Chinese linerboard producers, the Ministry of Commerce, on March 31 2004, initiated an anti-dumping investigation against kraft linerboard and test linerboard imports from the U.S., South Korea, Taiwan and Thailand.

6. Impact of Development Policies on Paper and Wood Industries

- 42 pulp/paper projects, involving both domestic and foreign investment, are designated for approval and implementation by 2010.

- Targeted investment of $2.13 billion (USD) to fund 13 of the 42 projects that are designated for fast-track approval by the government (these projects will be funded in part through domestic bank loans whose interest is subsidized by the central government for a two to three year period).

- Encouragement of all sources of foreign and private investment in the development of forestry plantations.

- Empowerment of local governments to have more freedom in the approval of foreign investment projects in both forestry plantations and large-scale processing facilities.

AF&P A©

AMERICAN FOREST & PAPER ASSOCIATION
GROWING WITH AMERICA SINCE 1861

1111 Nineteenth Street, NW, Suite 800 ■ Washington, DC 20036 ■ 202 463-2700 Fax: 202 463-2785 ■ www.afandpa.org
America's Forest & Paper People®—Improving Tomorrow's Environment Today®