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China's Impact on the Forest Products Industry in the Pacific Northwest

My name is Dr. Ivan Eastin and I am a professor of forest products marketing and the Acting Director of the Center for International Trade in Forest Products (CINTRAFOR) in the College of Forest Resources at the University of Washington. I very much appreciate this opportunity to present my views of the impact of China (as both a market and a competitor) on the forest products industry in the Pacific Northwest.

The forest products industry is an important component of the regional economy in the Pacific Northwest (comprised of Washington, Oregon, Idaho and Montana), providing more than 100,000 jobs in 2003, many of which are located in rural, timber dependent communities. Forest products are a major component of the export mix in the Pacific Northwest. For example, exports of forest products from the state of Washington exceeded $1.3 billion in 2002 and were the third largest export commodity behind aircraft and industrial machinery. While regional exports of forest products to China represent just 6.6% of total PNW forest products exports, they have been growing faster than the overall average (increasing by 12.8% over the first three quarters of 2004).

Over the past five years, exports of wood products from the PNW to China have increased substantially, making China our third largest export market in 2003. Wood products exports from the PNW to China exceeded $80 million in 2003. Over half of PNW wood exports to China were lumber (two-thirds of which was hardwood lumber) with the remainder being primarily logs and veneer. Taken together, these three products comprised almost 90% of wood product exports to China in 2003. A summary of US and PNW trade of forest products with China is provided in Tables 1-5.

Clearly the Chinese market is of growing importance to the forest products industry in the Pacific Northwest. However, forest products exporters in the PNW, already adversely impacted by a wide variety of factors and constraints in China that erode the

competitiveness of their products in China, must now contend with rapidly increasing Chinese exports of wood products (many of which receive direct and/or indirect subsidies) in the domestic US market. It is this dual impact of the Chinese trade relationship that fuels charges of unfair trade practices against the Chinese. The factors that have had the greatest competitive impact on the PNW forest products industry include: the undervalued yuan, the importation of illegally harvested and illegally sourced logs and timber into China, the unequal application of the value-added tax and import tariffs, building code restrictions, counterfeiting of US lumber and plywood structural grade stamps, the requirement of in-country testing for product standard conformity, and public sector subsidies to Chinese forest products manufacturers. Taken together, these factors impose a significant competitive burden on forest products exporters in the PNW. Please allow me to briefly outline each of these factors.

1. An Undervalued Yuan

There is wide recognition and agreement within the international financial community that the Chinese yuan, which is officially pegged to the US dollar, is highly undervalued, with some estimates suggesting that the yuan is undervalued by as much as 40%. The undervalued yuan provides a tremendous competitive advantage for Chinese goods exported to the US market where Chinese firms reap the dual benefits of lower labor and manufacturing costs and an undervalued currency, the combination of which puts extreme downward pressure on product prices in the US. While this may provide a short-term benefit to US consumers, the longer-term negative impact results in a loss of domestic manufacturing capacity and jobs. In either case, the undervalued yuan represents an indirect subsidy to Chinese manufacturers and exporters, providing them with an unfair competitive advantage over US firms and products. It is imperative that the US work with the Chinese government to achieve a revaluation of the yuan, either by maintaining the current linkage to the US dollar and expanding the range within which the yuan fluctuates relative to the US dollar or by transitioning towards a linkage to a currency basket system. However, there should be no misunderstanding of the fact that the undervalued yuan represents a massive competitive threat, especially when combined with significantly lower labor costs and a relaxed regulatory environment. For example, in 1999 China was a net importer of approximately 1.6 million cubic meters of plywood while in 2003 it had become a net exporter of approximately 1.7 million cubic meters, displacing US plywood exports from South Korea, Japan and the UK.

2. Imports of Illegally Harvested and Illegally Sourced Timber

Chinese imports of illegally harvested logs and illegally sourced timber undermine global efforts to promote sustainable forest management, erode public confidence in the international trade of legally harvested and traded wood while representing a huge indirect subsidy to domestic Chinese wood products manufacturers. Not only do these raw materials have significantly lower prices than legally sourced products, but they also often evade Chinese value-added tax and import tariffs levied against legally sourced materials. The magnitude of this problem is substantial since China is dependent on imported wood fiber from Russia and Southeast Asia to fuel the exploding capacity of its wood products manufacturing industries (For example, China is now the largest plywood manufacturer in the world). Some environmental groups have estimated that illegal logging is responsible for approximately 40% of the timber harvest in Russia and as much as 80% of the timber harvest in Indonesia. In addition, flows of illegally harvested logs and timber often pass through intermediate countries before reaching China. Recent research by CINTRAFOR has clearly demonstrated large disparities in the bi-national trade statistics between the value of logs and lumber imported by China from Malaysia, Indonesia and Russia (Table 6); an indication that there are significant irregularities in the timber trade between these countries. In addition, Chinese imports of logs and timber from west and central Africa, where illegal logging is a huge problem, have increased rapidly over the past several years. Our own research and a recent report commissioned by the American Forest and Paper Association has estimated that illegal log and lumber imports into China exceeded 8 million and 1.4 million cubic meters, respectively. The current influx of illegal materials is estimated to depress domestic timber prices in China by approximately 5%. In addition, lost exports to US industry in 2005 have been estimated to be $182 million (logs: $82 million, lumber: $24 million, and plywood: $76 million). Reducing or eliminating the importation of illegally harvested or sourced logs and lumber into China would have a strong positive impact on US exports of wood products to China.

3. Inconsistent Application of the Value-Added Tax (VAT) and Import Tariffs

The inconsistent application of import tariffs and the valued-added tax represents another competitive burden to forest products exporters in the PNW. In many cases, US exporters have had their products misclassified under the harmonized system resulting in the imposition of abnormally high import tariffs. In addition, there have been numerous reports of reduced levels of VAT being applied to logs and timber imported from Russia. In many cases, either no VAT is being applied or, as is more often the case, only half of the

official VAT (which is 17% for processed timber and 13% for logs) is applied. Clearly this practice severely disadvantages US logs and lumber and limits our competitiveness in the Chinese market.

4. Building Code Restrictions

Another factor affecting the market for US wood products is related to building code restrictions that exclude the use of wood frame construction (WFC) for multi-family, multi-floor residential housing as well as commercial buildings. Past experience in gaining building code approval for WFC in single family residences clearly shows that the Chinese are willing to cooperate with US industry and trade associations in this arena. While efforts continue in gaining building code approval for WFC in multi-family, multi-story as well as commercial construction, it is important that this topic remain a high priority for both US trade negotiators and the US forest products industry. Given the high cost and relatively restricted market for single family detached homes in China at this stage of their economic development, successfully gaining regulatory approval for wood frame construction in the much larger multi-family, multi-story segment of the residential construction market as well as the commercial building sector would provide tremendous opportunities for US wooden building materials in the near term.

While the U.S. has been successful in working with China to gain approval of U.S. design values and grading rules into the newly released GB50005-2003 (design code) and GB50206-2002 (construction code), neither code requires materials quality conformance, such as grade-stamps for dimension lumber and structural panels. This disadvantages US structural wood products and jeopardizes the structural performance of WF homes. This deficiency could potentially result in performance problems in wood frame buildings (e.g., earthquake performance and longevity). For example, in some cases, Chinese builders are using non-structural plywood in structural end-use applications (such as exterior wall sheathing, sub-flooring or sub-roofing). While some progress has been made in this area, more work is needed to ensure Chinese builders, architects, inspectors and consumers can readily determine that the quality of structural building materials being used matches that specified by architects and engineers.

5. Counterfeit Grade Stamps

Counterfeiting of US lumber and structural panel grade stamps represents a huge potential problem both from a public safety perspective as well as from its potential to undermine US efforts to expand the use of wood frame construction technology and US structural building materials within the residential and commercial construction industries in China. Recent visits to China by representatives of US lumber and panel grading agencies have clearly demonstrated the counterfeiting of US grade stamps on structural lumber and panel products used in China. While structural wood materials bearing counterfeit US grade stamp have not been found outside of China, plywood products manufactured in China and bearing counterfeit European CE grade stamps have been reported in Europe. In addition, it has been reported that lower value domestic Chinese wood species are being mislabeled and substituted for higher value US wood species. Failure of WFC due to use of counterfeit materials could undermine the entire US effort to promote WFC technology in China, especially since this is a new building technology in China and Chinese builders do not have a history of building with wood.

6. Mutual Recognition of Performance Standards

Another issue is related to the topics of standard conformity assessment, labeling for structural wood products as well as the issue of mutual recognition of product test results from internationally accredited laboratory facilities in the US. Currently the lack of Chinese structural wood product labeling standards has effectively restricted US structural plywood entry into the Chinese market. For example, US structural plywood and OSB can currently meet the structural performance requirements of the Chinese standard for light frame construction but there is no Chinese labeling program available for identifying this conformity. Ideally the US industry would prefer to label the product in conformity with Chinese standards at the time of manufacture. Unfortunately, mutual recognition agreements do not exist recognizing US and Chinese accredited testing facilities. As a result, test results generated in the US cannot be utilized for product approval and labeling of material bound for China.

Current practices in China require that structural products receive approval at the municipal level, meaning that testing of imported products for conformity to Chinese product standards must be performed in China and new testing must be undertaken in each municipality where the product is used. This is both time consuming and expensive for both the US manufacturer as well as the Chinese customer, further reducing the

competitiveness of US structural wood products in China.

7. Direct and Indirect Subsidies to Wood Products Manufacturers

Subsidization of loans essentially builds capacity in sectors where the Chinese might not have an existing competitive advantage. Types of subsidization which have been noted in the wood sector include below-market interest rates, loan interest subsidies, and unusually long payback periods). The PNW industry is concerned that these subsidies will lead to the development of excess production capacity in the wooden door, moulding and millwork and plywood sectors which will eventually threaten the strength of PNW firms in these sectors (both in their traditional US markets and in export markets).

Over expansion of production capacity is a concern with the domestic plywood industry where capital requirements are substantial and the return on investment from servicing the domestic market may not currently justify the initial investment. The vast majority of the plywood industry relies on imported raw materials, much of which appears to be illegally harvested or illegally sourced. This below market price material, in conjunction with public sector subsidies and an undervalued currency, provides exporters with an overwhelming price advantage in export markets. This same phenomenon of rapidly expanding plywood exports was observed with Japan during the 1960s and Korea during the 1970s (Figure 1). In both cases the plywood export booms that resulted were fueled by imports of low priced logs rather than by any inherent competitive advantage within the plywood industry. In fact, cutbacks in log exports to both Japan and Korea led to immediate and sharp declines in plywood exports, but not before substantial damage had been wreaked upon the US plywood manufacturing industry. Today we can observe the same sequence of events occurring in China where plywood exports are not the result of any inherent competitive advantage, but rather an artificial advantage resulting from low cost raw material supplies, public subsidies and an undervalued currency. As a result, Chinese plywood exports are experiencing rapid growth (increasing from 500,000 m^3 in 1999 to 2.2 million m^3 in 2003) and are displacing US plywood exports from their traditional markets.

There is also concern that China's value-added wood products industry is in the process of adding production capacity and upgrading its quality capabilities. While concern currently is focused on the wooden door manufacturing sector, similar developments in the wood flooring and moulding and millwork sectors could eventually threaten PNW strength in this area. While Chinese wooden door production is primarily for domestic consumption,

Japanese JAS approved factories in Dalian are improving their quality control and increasing their production capacity. Eventually this will impact US wood door manufacturers; already Home Depot is sourcing pre-hung doors out of Dalian. Exports of wooden doors from China have increased very quickly (Table 4) and it is expected that, in the absence of constraining action, jobs within the PNW wooden door industry (including Buffelen, Simpson, Nord, Jeld-Wen, and others), traditionally our strength, could well be displaced.

In conclusion, while forest products manufacturers in the PNW recognize the strong potential for market development in China, they are very concerned about the issues I have discussed and their potential impact on the competitiveness of US forest products both at home and in the Chinese market. Resolving these issues will go a long way to leveling the playing field and restoring the competitive position of US and PNW wood products in global trade.

Thank you very much and I appreciate the opportunity to share my views with the Commission.

Table 1. PNW forest products exports, 1999-2003 ($US1,000).

	1999	2000	2001	2002	2003
Japan	1,217,930	1,168,443	849,839	673,325	636,453
Canada	222,984	244,987	208,214	210,578	240,761
Korea	92,968	93,740	67,557	84,524	88,110
China	24,172	38,802	60,292	81,935	80,707
Italy	44,635	45,733	35,085	28,222	29,065
Hong Kong	23,009	21,883	16,948	22,083	22,540
Taiwan	28,607	33,476	25,953	24,440	22,325

Table 2. PNW exports of wood products to China, 1999-2003 ($US1,000).

	1999	2000	2001	2002	2003
Logs	2,946	8,301	18,677	18,433	8,333
Lumber	13,391	22,619	34,244	45,194	50,897
Moulding/Millwork	0	0	10	1,250	4,771
Builders Joinery	821	463	566	1,560	2,022
Plywood	230	574	627	190	912
Particleboard	1,043	979	1,374	3,049	2,101
Fiberboard	973	671	515	843	1,288
Veneer	2,124	3,414	3,610	8,294	5,985
Total	24,172	38,802	60,292	81,935	80,707

Table 3. PNW imports of wood products from China, 1999-2003 ($US1,000).

	1999	2000	2001	2002	2003
Logs	38	62	51	28	46
Lumber	20	52	221	298	580
Moulding/Millwork	7,493	6,111	9,150	18,212	28,712
Builders Joinery	201	1,969	2,003	1,942	3,242
Plywood	3,153	3,922	6,258	14,699	21,624
Particleboard	0	0	2	197	27
Fiberboard	0	0	11	49	452
Veneer	1,687	2,859	2,522	3,085	5,298
Total	12,592	14,975	20,218	38,510	59,981

Table 4. Chinese imports of selected wood products from the US, 1999-2003 ($US1,000).

Product	1999	2000	2001	2002	2003	Change 03-04*
Logs	8,747	19,124	43,181	62,992	62,613	+89.3%
SW Lumber	1,213	2,332	14,137	21,091	20,119	+47.4%
HW Lumber	29,898	53,991	59,675	84,475	109,270	+40.6%
Plywood	568	846	879	425	2,081	+97.4%
Mouldings	980	262	122	3,935	10,956	-72.7%
Doors	194	259	260	818	1,881	+10.9%
Windows	352	124	51	97	741	+222.5%
Builders Joinery	1,726	1,318	1,299	157	76	+3,781.2%

** Percentage increase in imports over the first 9 months of 2004 compared to same period in 2003.*

Table 5. Chinese exports of selected wood products to the US, 1999-2003 ($US1,000).

Product	1999	2000	2001	2002	2003	Change 03-04*
HW Plywood	22,479	26,952	40,772	97,234	155,206	+161.3%
SW Plywood	32	94	1,676	1,270	2,785	+254.2%
HW Lumber	2,264	2,590	718	1,193	1,981	+78.8%
HW Mouldings	17,017	37,788	45,956	63,501	104,840	+87.7%
SW Mouldings	10,479	1,740	4,642	9,198	16,428	+59.6%
Doors	1,065	1,616	3,013	7,617	12,989	+127.7%
Builders Joinery	15,106	25,121	28,599	36,901	48,395	+94.5

** Percentage increase in imports over the first 9 months of 2004 compared to same period in 2003.*

Table 6. Disparities in trade statistics for logs, 2001-2003. ($US)

	2001	2002	2003
Indonesia			
Exports reported by Indonesia	21,514,398	4,469,826	162,472
Imports reported by China	170,981,909	36,750,818	15,541,395
Malaysia			
Exports reported by Malaysia	81,059,233	96,338,003	110,637,028
Imports reported by China	152,653,245	243,088,657	396,059,595
Russia			
Exports reported by Rusia	541,642,703	735,941,000	718,868,188
Imports reported by China	551,826,115	975,270,140	969,024,232

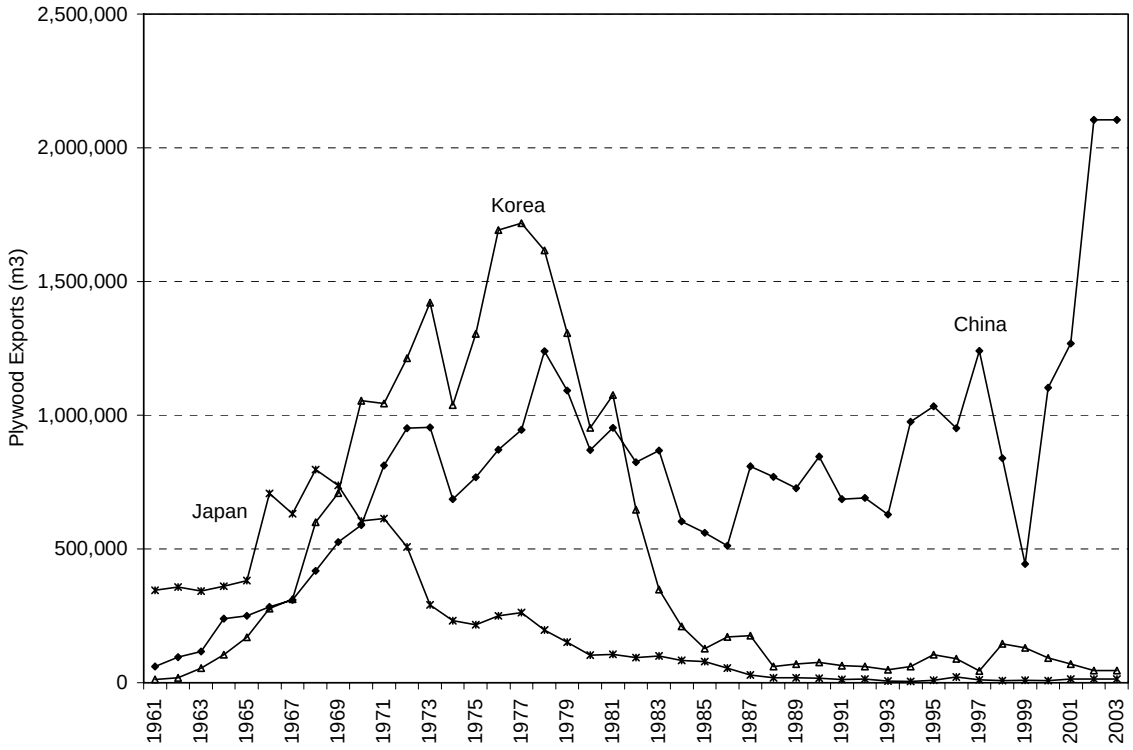

Figure 1. Volume of plywood exports from Japan, Korea and China, 1961-2003.