

# CHINA'S ANTIDUMPING INVESTIGATIONS AGAINST CELLULOSE PULP

By Michael Stone

## A. Introduction

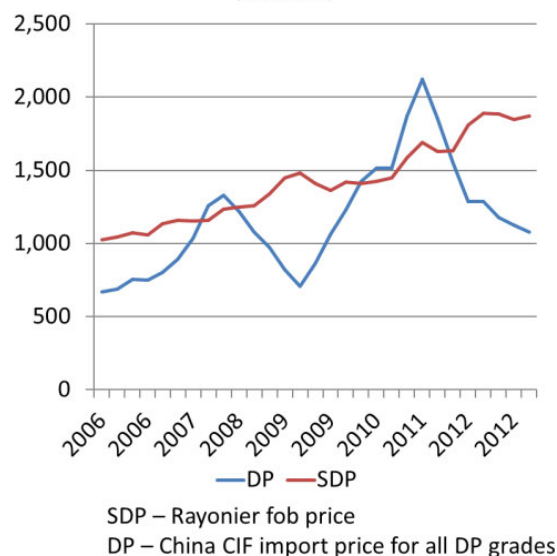
In February 2013, the Chinese government announced that it would be conducting an antidumping duty investigation of dissolving pulp producers in Canada, the United States and Brazil. This article examines the structure of the dissolving pulp market, the factors that have negatively affected China's domestic producers and the likely effect of a duty on China's domestic price. We conclude that the imports from the countries being investigated are not the root cause of the problems faced by China's domestic producers, that any duty imposed can at best provide only short-term relief to the domestic producers and that any duty imposed may have significant negative impacts for Chinese industries that consume dissolving pulp.

## B. Grades of Dissolving Pulp

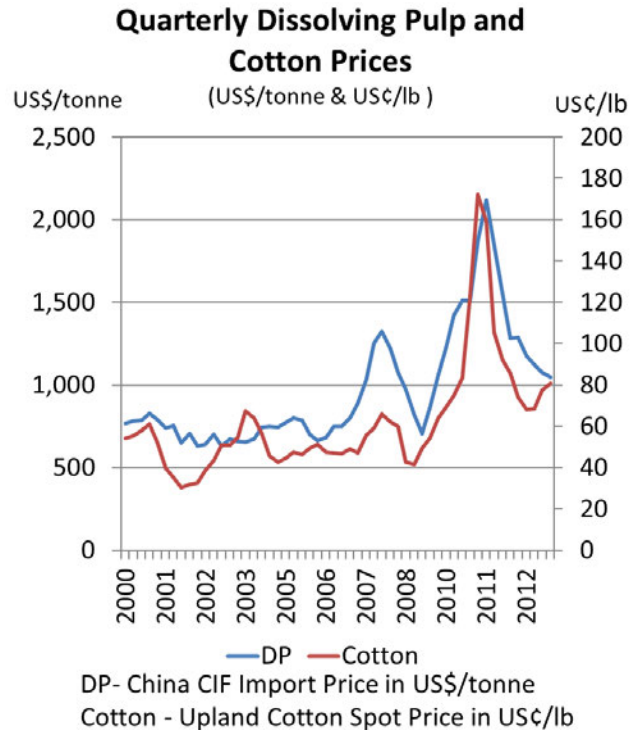
Dissolving pulp is not a homogenous market. There are two distinct grades of dissolving pulp: specialty grade dissolving pulp and commodity dissolving pulp. This is an important distinction, as the two grades are used in vastly different end-products and are not treated by consumers as substitutes. Specialty dissolving pulp is used for cigarette filters, tire cords, explosives and other specialty uses. Commodity dissolving pulp is used for the production of viscose fibre which is used in the manufacture of textiles. Commodity dissolving pulp mills cannot produce specialty dissolving pulp without significant modifications with a high capital cost.

As specialty dissolving pulp is used for products unrelated to those which use commodity dissolving pulp, it is not surprising that the price (US\$/tonne) of specialty dissolving pulp and dissolving pulp are not correlated as shown in the graph below. As a result, China's Ministry of Commerce or MOFCOM should ensure that in evaluating the dissolving pulp market, it distinguishes between data, particularly price data, pertaining to specialty dissolving pulp and data pertaining to commodity dissolving pulp.

**Quarterly Dissolving Pulp and  
Specialty Grade DP Prices**  
(US\$/tonne)



Viscose fibre is a close substitute for cotton. Its price, therefore, correlates very closely with the price of cotton. As shown in the graph below, cotton prices dramatically increased in 2010/11 due to widespread cotton crop failures. As a result the price of viscose fibre showed a similar increase. In turn, the increase in viscose fibre price caused the price of commodity dissolving pulp to increase. This increase was caused by the change in price of cotton and not by changes within the commodity dissolving pulp market. The prices for commodity dissolving pulp and cotton have since returned to more normal levels.



### C. Changes in the Price for Dissolving Pulp

Demand for commodity dissolving pulp is driven by growth in the global demand for viscose fibre. From 2004 to 2012, world production of viscose fibre grew by 84% and China's share of global production increased from 38% to 61%. Hence, China's viscose fibre production has been the major driver of global demand for commodity dissolving pulp.

To meet the growth in demand, global dissolving pulp capacity expanded by 3,120,000 airdried metric tonnes from 2008 to 2013, nearly doubling capacity. Of that growth in capacity, China saw the largest increase, expanding its dissolving pulp capacity by 945,000 airdried metric tonnes, or 30% of the total global expansion. Over 2012 and 2013, the global expansion of dissolving pulp capacity continued, with China continuing to be the largest contributor to that growth in both years.

This global expansion in dissolving pulp capacity was also driven as a response to the short-term price increase for commodity dissolving pulp in 2011 caused by cotton crop failures.

The changes in price for commodity dissolving pulp, therefore, have largely been influenced by a rapid increase in the demand for viscose fibre in China and fluctuations in the price of cotton. The recent return to a more normal commodity dissolving pulp price has been driven by a drop in the price of cotton and an increase in dissolving pulp capacity, which has primarily occurred in China.

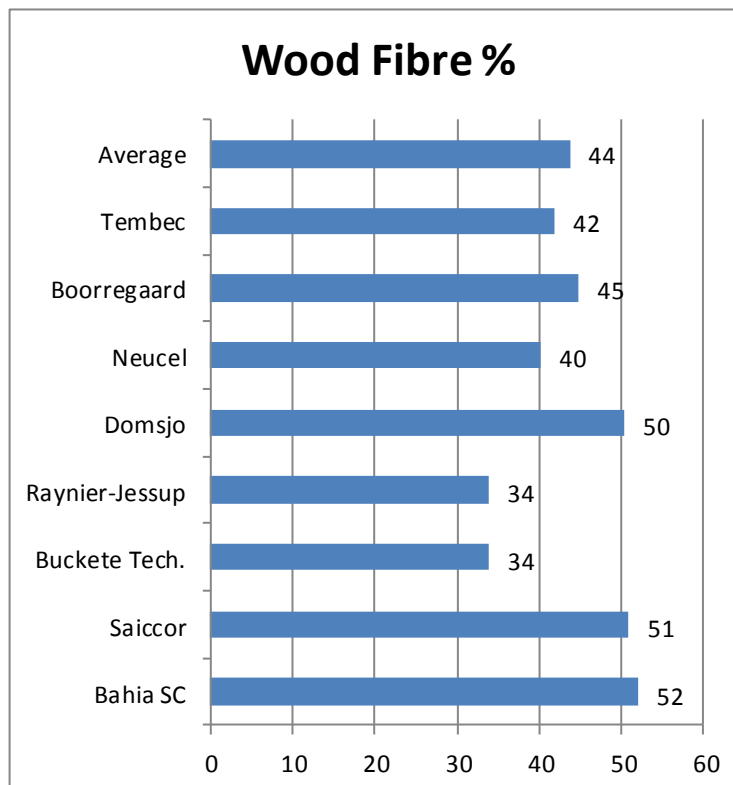
Neither of these factors is the result of any alleged downward pricing pressure caused by exports from Canada, United States or Brazil.

#### D. Cost Structure of Dissolving Pulp Producers

While China may have seen a rapid expansion in its dissolving pulp capacity in recent years, driven in large part as a response to a short-term spike in dissolving pulp prices, those producers are not able to adequately supply the local viscose fibre market due to comparative disadvantages relative to other countries. As the price for commodity dissolving pulp continues to normalize, China's high-cost producers will continue to be less competitive due to their own high-cost structure.

Of all pulp types, dissolving pulp has by far the lowest yield (35%). Yield is the dry weight of pulp produced per dry weight of wood consumed in pulping. As the yield for dissolving pulp is so low, there is a considerable cost advantage to be gained from being in close proximity to the wood source. This is because large amounts of wood are required in the production of dissolving pulp, so a close proximity to the wood source reduces transportation costs.

The cost of the wood fibre itself is also a large driver of the total cost of dissolving pulp. When reviewing eight international producers, as shown in the chart below, wood fibre represents on average 44% of the total cost of dissolving pulp production. The production cost of dissolving pulp, therefore, is very price sensitive to the cost of wood fibre. For those dissolving pulp producers which must import their wood fibre, their cost structure is closely tied to their wood import price.

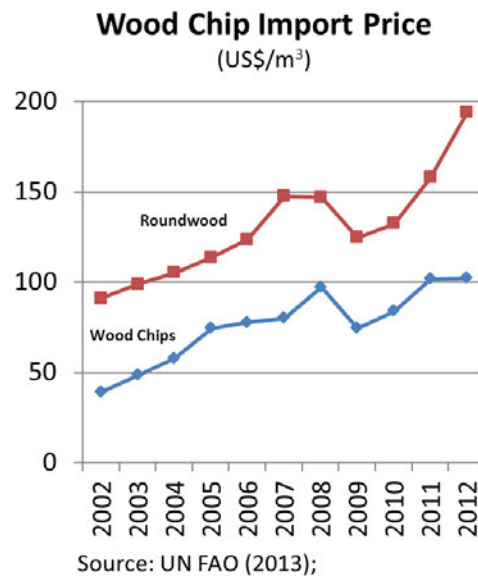


Source: Derived from data in PCI Fibres Report 2011

Unlike dissolving pulp producers in timber rich countries like Canada, United States and Brazil, dissolving pulp producers in China must import most of their wood fibre. Since 2000, China's domestic production of timber has shown little growth. Growing domestic demand for timber in

China, therefore, must be met by growing imports. China now accounts for 36% of world timber imports.

Global domestic consumption of timber, however, is also rising. This results in less timber available for export. The net result is increasing global competition for shrinking timber export volumes. The chart below shows the upward trend in China's wood import prices. Unsurprisingly, China's dissolving pulp producers are at an increasing disadvantage to dissolving pulp producers in timber rich countries due to the rising cost of their wood imports.



China's dissolving pulp producers are also seeing their comparative advantage in labour costs eroded by changes in the Chinese labour market. Since 2003, the per capita gross national income in China in US\$ has increased almost three times. During the same period, the exchange rate between the Renminbi and the US\$ has increased, which in relative terms makes imported dissolving pulp cheaper for consumers to purchase.

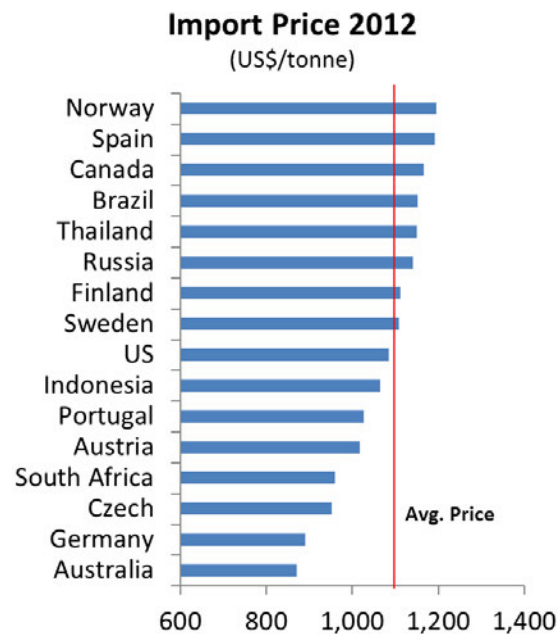
China's dissolving pulp producers have also seemingly over-expanded their production capacity in anticipation of dissolving pulp prices remaining at artificially high prices. Between 2006 and 2012, global utilization rate for dissolving pulp producers has varied between 80-100% at different price levels (utilization rates derived from Celco (2013) data). By comparison, at the end of 2012 the utilization rate in China was reported to be only 50%. This will increase the average cost for Chinese producers, and is further evidence that Chinese dissolving pulp producers have a higher cost of production versus producers in other countries.

As a result of these factors, China's domestic dissolving pulp producers have been unable to remain price competitive against global dissolving pulp producers. This is not due to any dumping by the rest of the world, but rather is due to the high-cost structure of domestic dissolving pulp producers in China caused by the need to import wood fibre at great expense, rising labour costs, a dropping exchange rate and over capacity. Chinese dissolving pulp producers simply do not have a comparative advantage versus dissolving pulp producers in timber rich countries, which include Canada, the United States and Brazil as well as other nations not subject to MOFCOM's investigation.

## E. Causation Link

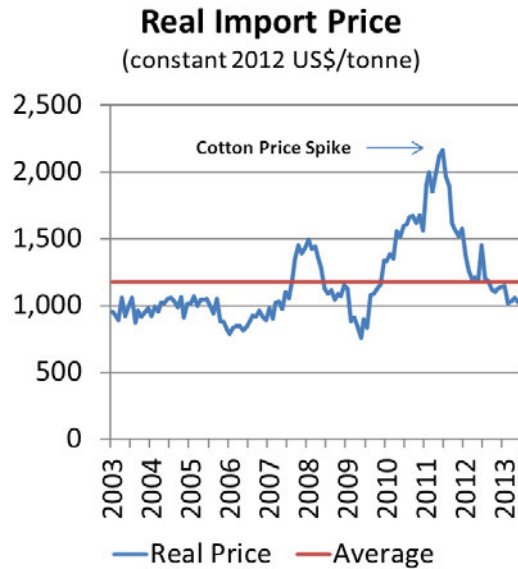
As noted earlier, the price for commodity dissolving pulp is strongly correlated with the price of cotton. As evidence of this fact, in 2011, when a large scale cotton crop failure left cotton fibre in short global supply, cotton prices spiked and, at the same time, so did commodity dissolving pulp prices. The subsequent fall in commodity dissolving pulp prices, therefore, was largely driven by a fall in cotton prices as the price for cotton normalized. The drop in price for commodity dissolving pulp during the period under investigation, therefore, was not caused by alleged dumping from dissolving pulp producers in Canada, United States or Brazil.

More specifically, when commodity dissolving pulp import prices in 2012 are averaged by exporting nation, Canada had the third highest China import price, which was well above the average import price for commodity dissolving pulp that year. Surprisingly, MOFCOM has chosen not to investigate exports from nations with considerably lower prices, such as those in the European Union, Indonesia and South Africa.



Source: CCFGroup (2013).

At present, prices for commodity dissolving pulp are currently near the ten-year average for commodity dissolving pulp when adjusted for inflation, as shown in the graph below. If dissolving pulp producers cannot compete at the current price level due to their high cost structure, they are unlikely to be able to remain competitive in the industry. It is not reasonable for MOFCOM to assume the price spike in 2011 is reflective of normal market conditions and then artificially maintain that high price point through import duties.



Dissolving pulp is also becoming more expensive relative to the import price of all wood pulps. This is contrary to the argument that dissolving pulp is being dumped into the Chinese market. Rather, it appears the dissolving pulp prices have appreciated in cost relative to other types of wood products. This is largely due to a rapid growth in commodity dissolving pulp demand by viscose fibre producers in China.

As a result, the current price levels for dissolving pulp imports are at or around the long-term average for dissolving pulp and are more reflective of a normal price level for dissolving pulp than the artificially inflated prices in 2011 caused by temporary changes to the cotton market. Chinese dissolving pulp producers are also high-cost producers of dissolving pulp due to their distance from wood supply, increasing labour costs, a rising exchange rate and over capacity. As a result, any alleged injury that Chinese dissolving pulp producers have suffered would be as a result of extraneous influences on the market price for commodity dissolving pulp and their own cost structure, and not as a result of any alleged dumping by Canadian, American or Brazilian dissolving pulp producers. Furthermore, the high price of imports of dissolving pulp from Canada relative to other countries indicates that Canadian dissolving pulp producers are not responsible for the fall in the price of dissolving pulp imports to China. Rather the world market is responding to market fundamentals that are beyond the control of any subgroup of world producers.

#### **F. Restricting Dissolving Pulp Imports would Threaten the Viability of China's Viscose Fibre Industry**

Despite the recent growth in China's dissolving pulp producing capacity, China is the world's largest net importer of dissolving pulp as shown in the table below. This is because, unlike in Canada, the United States and Brazil, dissolving pulp producers in China are not situated near appropriate forest resources and are, therefore, unable to meet the growing domestic demand for commodity dissolving pulp. In addition, China is the leading viscose fibre producer in the world, with a 61% market share in 2012, as China's viscose fibre producers benefit from their close proximity to China's textile manufacturers, which are the primary consumers of viscose fibre.

**Major Net Exporting and Importing Countries, 2012**

Region/Country	Net Exports	Net Imports
South Africa	705,929	
Canada	676,861	
U.S.	405,363	
Brazil	390,600	
Sweden	375,987	
China		1,681,588
Indonesia		431,432
Germany		371,000
Thailand		152,943
India		148,360

Source: UN FAO (2013)

China's status as a net importer of dissolving pulp is not surprising given its comparative disadvantage at producing dissolving pulp and comparative advantage in viscose fibre production. Without a growing supply of dissolving pulp imports, China's viscose fibre producers will be unable to meet the growing demand for their product.

An antidumping duty imposed by MOFCOM on Canada, United States and Brazil will result in a short-term price increase in dissolving pulp in China and a reduction in supply. Faced with higher prices and lower supply, China's viscose fibre producers will have two options. First, they could pass on the increased costs to their consumers by raising their prices, which will result in such consumers shifting their supply to offshore fibre producers and/or using substitute products. Alternatively, China's viscose fibre producers could maintain their pricing levels and not pass on the cost increase, in which case many will no longer be profitable and some will cease to operate. In either scenario, China's viscose fibre producers will be negatively impacted by any antidumping duty.

The market for viscose fibre has grown rapidly in recent years which has benefited China's economy and provided China's textile industry with a growing supply of viscose fibre as a substitute to cotton. This segment of China's economy will be severely impacted by a sudden price increase and reduction in supply of its primary input, and will cause some companies to shut down.

While China's viscose fibre producers will suffer the bulk of the impact, the increase in cost of viscose fibre and reduction in supply could have further impacts down the supply chain. Consumers of viscose fibre, such as textile manufacturers, will either see their costs increase and/or their supplies reduced. Should supplies of cotton become limited again in the future, the textile industry may face shortages and an inability to meet demand for their products. The total effect of a duty to China's economy at large, therefore, could be highly detrimental.

### **G. Future Market Price for Dissolving Pulp**

While China's dissolving pulp producers will benefit from a short-term price increase for dissolving pulp which will arise if MOFCOM imposes a duty on some producers, an artificially high market price for dissolving pulp is not sustainable. This is because MOFCOM has chosen to single out Canadian, American and Brazilian imports for investigation, whereas many other countries export dissolving pulp to China.



In 2012, companies not subject to MOFCOM's investigation had shipments of 1,655,000 tonnes of dissolving pulp to China, whereas companies subject to the investigation only had exports of 908,000 tonnes. In response to a price increase in the market for dissolving pulp, non-affected companies will respond by increasing their exports to China which will put downward pressure on the domestic price. Absent collusion by the non-affected companies, China's and other countries' prices will quickly converge.

A duty would also produce inefficient behaviour in the marketplace. For example, integrated viscose fibre producers which operate outside of China may start to sell their non-duty affected pulp into China and buy their needs on the world market. This represents an arbitrage opportunity for those producers to increase their profits which would not be available to Chinese companies.

Unless MOFCOM restricts all imports of dissolving pulp into China, which would have catastrophic effects on its domestic viscose fibre production industry, China's dissolving pulp producers must be able to compete at the global price for dissolving pulp. Any price increase caused by a duty which MOFCOM imposes will be eroded due to increased exports by companies not affected by the duty. This economic reality contradicts any rationale for imposing a duty on the producers being investigated.

## **H. Conclusion**

The price for commodity dissolving pulp is affected by many global factors including the price for cotton, a close substitute for viscose fibre that is the end-product of commodity dissolving pulp. In 2011, the price for cotton spiked due to temporary changes in the supply of cotton which, in turn, caused the price for commodity dissolving pulp to spike. This was a temporary occurrence, and not reflective of the real long-term price for commodity dissolving pulp.

In response to this price spike for commodity dissolving pulp, global dissolving pulp capacity rapidly increased, primarily in China. As a result, when commodity dissolving pulp prices dropped as cotton prices normalized, China's dissolving pulp producers were no longer competitive due to over capacity, and a high-cost structure caused primarily by their reliance on wood fibre imports.

Changes in the market price for commodity dissolving pulp have not been driven by dumping from Canadian dissolving pulp producers. In fact, import prices from Canada are some of the highest in the world and yet MOFCOM has chosen to include Canadian dissolving pulp producers. If MOFCOM were to impose an anti-dumping duty it would have a significant negative effect on China's viscose fibre producers, which rely on commodity dissolving pulp as their primary input. The preliminary dumping margins, if imposed, would cause a significant short-term increase in the price for commodity dissolving pulp and a drop in supply. This, in turn will cause viscose fibre producers to lose market share to substitute products, such as cotton, and foreign viscose fibre producers. The net effect to China's economy, therefore, will be negative, which contradicts the rationale to imposing an antidumping duty on these products.

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