INFORMATION BULLETIN: CHINA AND EAST ASIA
Transforming Trade and Policy for Forests and Livelihoods

Sino-Russian Trade of Wood Products

August 2006 | Issue 10

FOREST TRENDS

RIGHTS + RESOURCES

БРОК

Overview of the Wood Products Trade between Russia and China

China's flourishing economy, coupled with policy constraints limiting domestic forest production, has resulted in skyrocketing forest product imports over the last several years. Of all countries exporting to China, Russia is now the top timber product supplier by volume, and to a lesser degree, by value. Trade increased from 0.5 million cubic meters (m³) to over 20 million m3 in in just 10 years (1996—2005). China's growing import demand represents both an important opportunity for those who can take advantage of this growing market, but also a threat for the environment and local economies if forest harvesting and processing systems do not develop sustainably and equitably for all stakeholders. Analyses of this trade — its economic, social and ecological nature and future trade trends — will help to raise an understanding of the issues and help to ensure long-term sustainable and harmonious development and trade between Russia and China.

Background: In a decade, China has moved from a ranking of seventh up to second among all nations in total value of forest product imports and is also now the top importing country worldwide of industrial round wood. Of all countries exporting to China, Russia is now the top timber product supplier by volume, and to a lesser degree, by value.

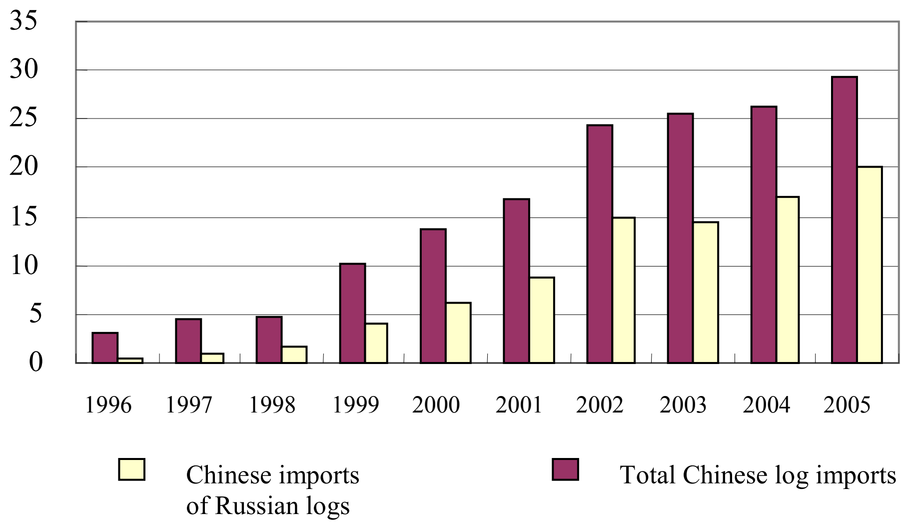
China's growing import demand is having major impacts on forests and forest peoples in producer countries. This represents both an important opportunity for those who can take advantage of this growing market, but also a threat for the environment and local economies if forest harvesting and processing systems do not develop sustainably and in a manner that brings adequate returns to local stakeholders. Russia's forests are so vast in extent that one could easily believe that they harbor an inexhaustible supply of timber. However, at current harvesting rates, the Russian Far East could be logged out in 20 to 30 years. In April 2006, the Russian government, hoping to boost value-added processing on the Russian side of the border, instituted a 15% tax on all log exports.

Chinese investors and entrepreneurs have been relatively successful in conducting forest processing and trade within the border of Russia itself, but their presence is causing rising tensions in a region with declining demographics where the local population fears losing their cultural identity and economic control to foreigners. Claims that the Chinese trade is exacerbating the problem of illegal logging in Russia are common. For their part, Russian entrepreneurs are frustrated at having less success penetrating the Chinese side of the commodity chain, such as the distribution networks.

With growing demand in China and lack of adequate domestic supply, increase in imports of Russian timber – particularly softwoods -- is likely to continue in the short term. In the long term, however, China's efforts in development of fast growing plantation softwoods would reduce the need for Russian softwoods. This, combined with Russia's desire to rapidly develop its value-added processing capacity in the Russian Far East and Siberia, will likely lead to a future shift in the structure of Russia – China forest products trade.

Russia-China Timber Trade Status and Trends: A common and central feature of current Sino-Russian relations has been the recent opening of their economies to international trade and investment. This market transition is reflected in the recent boom of the Sino-Russian trade of timber products. In 1996, Russian timber exports to China were just over 500,000 m^3. By 2005, they had risen to 20 million m^3, a dramatic 40-fold increase in 10 years. By 2000, China had replaced Japan as the most important market for Russian timber. Russia now ranks as the top supplier of China's timber imports, accounting for 48.8% of the total volume in 2005. Russia now provides China with over two-thirds of its raw log imports (Figure 1). 90% of Russia's timber exports to China are logs.

Figure 1: Russia's Share of China's Log Imports 1996-2005 (million m^3)



Source: Chinese customs statistics

Russia's importance to China's forest product trade can be attributed to a number of factors, namely: (a) similarity of wood species in the Russian Far East and northeast China (China's traditional timber base); (b) low prices and China's decision to reduce tariffs; (c) convenience in border trade and rail links between Russia and the neighboring Chinese provinces of Heilongjiang and Inner Mongolia; (d) favorable tax policies for border trade; and (e) Russia's resumption of maritime shipping of timber products in 2001, enabling Russia's timber to be directly shipped to the major timber consuming regions on China's eastern coast[1]. The volume of logs shipped by boat from Russia to China grew from 0.57 million to 2 million m^3 between 2001 and 2002 alone.

While the total volume flowing from Russia to China has been steadily increasing, the total declared con tract value of Russia's timber exports to China grew at a slower pace compared to the rapidly increasing volumes of these exports. This was due in part to the low volume of processed forest products exported to China and the large number of relatively inexperienced and uncoordinated exporters who were either undercutting each others' prices or knowingly underestimating the value of exported timber.

Although Russia exported timber products to China from dozens of different provinces and literally scores of places where timber can cross the border, the main provinces exporting to China are situated in

[1] Railway is still the predominant mode used to carry Russian forest product exports over the Chinese border. For example, in 2004, 85% of the logs exported from Russia to China were delivered by rail, 13% by sea and 2% by road.

the nation's main natural forest regions – the southern parts of the Russian Far East and Siberia (Figure 2). Most of the timber harvested in Siberia enters the country by rail through the "gateways" of Manzhouli and Erlianhot, while most of the timber harvested in the Russian Far East enters China at Suifenhe. In 2004, these gateways received 32.6%, 14.8% and 33.7 % respectively of officially declared Russian timber imports.

Figure 2: Area of Russian Forests Supplying China

Source: Geographicheskiy atlas Rossiyskoy Federatsii (Geographical Atlas of the Russian Federation). Moscow, Rosgeodesiya 1999.

Softwood logs and lumber have comprised the major part of China's timber imports from Russia. In 2004, 87% of Russian imports (17 million m^3 in total) were softwood and 13% hardwood. Korean and Scotch pine accounted for nearly half of the imports, larch for 19%, and spruce and fir for 18%. Around 98% of the imports which arrived in Manzhouli were softwoods. In recent years, Suifenhe has taken an increasing share of Russian hardwoods. In the first half of 2004, a third of the logs arriving in Suifenhe, when measured by volume, consisted of Mongolian oak, ash and other hardwoods.

It is estimated that 80% of Russian softwood imports are consumed domestically with the majority used in the construction industry (cement forms, support materials) and the rest processed into furniture (dining tables and outdoor furniture), interior decoration and packaging. The remaining 20% is thought to be processed within China and then re-exported. Re-exports of processed Russian wood products is increasing.

Distribution of Russian Wood Products in China: There were over 500 Chinese importers operating at the Russia – China border in 2002. These importers were mostly export-import trading companies ranging from state-owned trading corporations[2] with hundreds of employees to collective or one-person privately owned companies registered in major gateways. Approximately 60 such trading companies in Northeast China control over 80% of the Russian-Chinese timber trade.

Once Russian wood crosses the border, it is difficult to trace due to multiple re-sales in China's one thousand plus wholesale and retail timber markets across the country. Russian wood is often also mixed with domestic or other wood as it begins its journey across northeast China. At least 60% of the total volume of

[2] mainly provincial and, to a lesser extent, prefectural.

Russian logs imported by China is estimated to be distributed and processed within three provinces of northern and northeastern China. The remainder is sold by the northeastern Chinese traders and is either stored at traders' own sites or sold to domestic wood wholesalers from other regions of China at collectively owned large timber exchanges (situated in major railway junctions). The timber may then be resold an additional two or three times in some of China's one thousand various-sized wholesale and retail timber markets in provincial and county cities across the country. In other cases, the wood may be shipped directly from border regions to manufacturers or to the wood market by importers. Procurement managers of domestic wood wholesalers or processing factories usually travel to Manzhouli, Suifenhe, and Erlianhot to close supply contracts. Supply contracts for large lots of Russian wood may be quoted in well-known Chinese timber exchanges in Shanghai, Fuzhou and Guangzhou.

Impacts of Russia-China timber trade:

A Dwindling Resource: Over 57% of the Earth's coniferous forests are found in the Russian Federation, representing approximately one-fifth of the world's standing timber. But the vast resources are not infinite. At present cutting rates, most natural forests in the Russian Far East (RFE) will be logged out within 20 to 30 years. As it is, unsustainable harvesting and 'high-grading' (the extraction of the best and most valuable timber) are already degrading much of the best forest lands, particularly in Primorskiy Krai and Khabarovskiy Krai. In northern regions of the RFE and in Siberia, clear-cutting has left large swathes of open and damaged landscapes. In Primorskiy Krai, forests are being steadily degraded, with secondary broadleaf forests of aspen and birch gradually replacing Korean pine, larch and other conifers at the rate of 0.8% a year across the RFE. Catastrophic fires recently consumed an area equivalent to approximately four times the area harvested each year. Although fires are a natural phenomenon, these were made worse by poor forestry practices. In the meantime, the abolishment of the Federal Forest Service in 2001 introduced additional difficulties to the region's forest management and production.

By focusing on raw log exports, Russian timber companies are also speeding up logging and are faced with a growing scarcity of accessible stands. This has forced them to develop resources in roadless wilderness areas, a practice environmentally destructive but also economically unstable.

Illegal logging, related issues and corruption: Illegal logging is rife in the RFE and south-east Siberia, and in some places is said to account for up to two-thirds of the harvest. The highest levels of illegal logging in Russia tend to occur in export-oriented districts, with small enterprises tending to dominate the illegal logging business. With the profitability of illegal logging estimated to reach up to 100%, widespread illegal logging is leading to over-harvesting in many of the more accessible areas.

Russian forest regulations (logging methods, transportation control and export) are extremely strict. Yet due to corruption within the system (forest agencies, municipalities, etc.) timber companies have been able to circumvent the rules. Corruption of forest guards is a major problem, as are lack of effective incentives for improved law enforcement throughout the commodity chain. With municipal administrations, forest inspection bodies and militia no longer receiving portions of revenue from sequestered timber as in the past, incentives for log control are weak at a time when the strengthening of other measures have not yet had significant impact. Controlling illegal logging and trade has proven to be extremely difficult due to the complicity of government organizations charged with protecting forests. Within Russia itself, most illegal transactions are completed well before any enforcement checks are carried out, usually occurring between the logging and the first wholesale storage sites where the illegal logs are integrated into legal consignments and protected by local officials. Where corrupt officials are involved, they share all of the criminal revenues with the perpetrator.

In the most popular illegal export model, exporters label high-quality timber as "pulp logs" in order to reduce the official contract price. This strategy hides company profit on the Russian side and thereby reduces the profit tax due to the Russian government. On the Chinese side, the importer or wholesaler may reject the timber due to poor quality, forcing the Russian supplier to reduce the price. Lately, some Chinese merchants have used processing to launder illegally harvested and purchased logs because lumber exports do not require proof of harvesting licenses in Russia.

Increasingly more Chinese are involved in Russia's forest sector, with many residing or working illegally in Russia as timber wholesalers, exporters or loggers. Legitimate and responsible Chinese entrepreneurs have become aware that the reputation of Chinese industry as a whole in Russia is being damaged by the usually small-scale entrepreneurs who are acting illegally and irresponsibly within Russia's borders. The Chinese State Forest Administration has considered developing guidelines for Chinese entrepreneurs operating abroad, helping them to understand the regulatory and social frameworks within which they need to operate in order to help foster harmonious trade relations between the two large countries.

Who Benefits: The evidence suggests that most often the poor communities which are most closely tied to forests do not receive major benefits from the forest production and trade as local elites; logging companies, intermediaries and migrant workers capture most of the benefits. Wood processing in the RFE (which accounted for over 40% of production in the timber industry in 1992) has all but collapsed, and many towns and villages have lost the industries that once sustained them. Today around 95% of the timber harvested in Russia and destined for China is exported as raw logs, and nearly all the processing takes place in China. The Russian government is making the development of the processing sector a high priority, but it may be many years before the processing industry makes a significant recovery[3].

Conversely, Russian timber underpins China's dramatic economic expansion and enriches 200,000 people in China who are now employed in the transport and processing of Russian softwoods. The bilateral timber trade has also helped to develop dozens of Chinese towns along the border, such as Suifenhe, Manzhouli and Fuyuan.

Recommendations: Russia's forests are so vast in extent that one could easily believe in an inexhaustible supply of timber. Although the Russian forests will last longer than other countries which are currently export ing to China (notably, Indonesia, Papua New Guinea and Myanmar), they are still disappearing at an alarming rate.

Russia: Steps forward for Russia should prioritize strengthening efforts to address the underlying problems within the forest sector — which can also be seen as a "microcosm" of broader governance problems within a country. Cleaning up the forest sector alone will remain very challenging if the governance problems across all other sectors (judiciary, law enforcement, etc) are not simultaneously addressed. If positioned well, forest concerns can act as a catalyst for broader governance reforms within a country. Specific recommendations for Russian stakeholders in the forest sector include:

- Creation of a strong and stable forest policy, with internal procedures for eliminating corruption within government systems;
- Providing incentives to decrease the volume of timber leaving the country unprocessed (e.g. tax and duty privileges). Attempts have already been made to encourage more processing at a regional level, but with limited success.

[3] Note: sawnwood exports to China have begun to rise in the last few years, from 158,000 m^3 in 2000 to 801,000 m^3 by 2004.

- Establishment of direct links with Chinese buyers (Russian timber producers). As Russian exporters are not allowed to directly engage in the Northeast China timber market, a 20-30% margin on the timber price is earned by intermediaries. In order to serve as first-hand suppliers and get more revenues, Russian timber producers could establish direct links with final buyers in China or enter the Chinese dominated timber exchanges in Fuzhou and other large Southern China cities. These require the immediate attention and presence of Russian exporters in China, with official representative offices in China as well as adequate training and aggressive marketing. However, creating an appropriate commercial infrastructure may require considerable financial expenditure by Russian exporters.
- Support for professional associations of Russian timber exporters (e.g. the Primorskii Association of Timber Exporters) to defend the interests of exporters, be responsible for the collection, analysis and dissemination of information about timber markets in neighboring countries, and to represent the interests of the forest sector.

China: As critical drivers of the global market, consumers, retailers and governments of consuming countries can take important leadership to transfer the global market to a more sustainable path. Their leverage can help to transform the forest products market. While consumer countries like China cannot do much about governance within sovereign countries like Russia, there are some measures China could take to reduce its imports of illegally sourced timber and encourage sustainable harvesting practices:

- Improve customs collaboration with neighboring countries, using China's highly efficient customs system as a basis. Russian and Chinese customs could compare and harmonize national customs statistics and establish coordination on species that are not permitted for export. Decreasing the number and increasing the control of export sites has proven to be an effective approach;
- Educate Chinese nationals working abroad about their responsibilities (legal, social and environmental) while working in the timber industry in Russia. China could introduce anti-bribery legislation to cover nationals engaged in illegal activities abroad;
- Establish a public procurement policy which mandates that public projects ensure that all wood products are of known and legal province — including a pilot program for wood products used for the 2008 Beijing Olympic Games;
- Accelerate the reform of China's forest sector to increase its own production of timber in a way that both alleviates poverty and encourages more effective use of public and communal land. While greater plantation productivity within China would lead to a decrease in the demand for imports of foreign timber, it is expected that China will continue to source a significant portion of its timber needs from Russia and other countries in the coming decades.
- Fix market places at gateways for imported timber transactions, which would help to correct the problem of asymmetric information which has allowed middlemen to gain a disproportionately large proportion of profits. Timber exchanges and lumberyards at gateways could solve the above-mentioned problems; and
- Establish timber trade associations since the Chinese timber importers are mostly small-scaled and have little communication among themselves, and are at a disadvantage when negotiating with exporters of Russian timber, leading to relatively higher import prices and lower quality.

This Information Bulletin was written by Weng Qian of Forest Trends and the Rights and Resources Initiative. It is based on previous studies commissioned by Forest Trends and Rights and Resources, and executed in collaboration with the Bureau for Regional Public Campaigns and the Khabarovsk Economic Research Institute. The China – East Asia Information Bulletin is produced by Forest Trends as part of a joint program with the Rights and Resources Group, entitled "China and East Asia: Transforming Policy and Trade for Forests and Livelihoods." The series is edited by Kerstin Canby (kcanby@forest-trends.org); all issues can be found at www.forest-trends.org