Russia – China Forest Products Trade

Promoting Sustainable Trade

Kerstin Canby
Forest Trends
August 15, 2006
Importance of Russian – Chinese Trade

Overall Trade
China: Russia’s 4th largest trade partner
Russia: China’s 8th largest trade partner
Average annual growth rate of 30%

Forest Products Trade
10% of overall trade between the two countries
Russia: #1 forest products supplier to China
China: Most important market for Russian timber
40 fold increase in timber trade between 1996 – 2005

Clearly important trade relationship to both countries
# Russia #1 Supplying Country to China

<table>
<thead>
<tr>
<th>Timber Products</th>
<th>Logs</th>
<th>Lumber</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Russia 1</td>
<td>49%</td>
<td>68%</td>
</tr>
<tr>
<td>2. Malaysia</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>3. Indonesia</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>4. Thailand</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>5. PNG</td>
<td>4%</td>
<td>3%</td>
</tr>
</tbody>
</table>

1. 26.4 million m³

<table>
<thead>
<tr>
<th>Plywood</th>
<th>Wood Pulp</th>
<th>Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Indonesia</td>
<td>65%</td>
<td>1. Taiwan</td>
</tr>
<tr>
<td>2. Malaysia</td>
<td>21%</td>
<td>2. USA</td>
</tr>
<tr>
<td>3. Russia</td>
<td>3%</td>
<td>3. S. Korea</td>
</tr>
<tr>
<td>4. Japan</td>
<td>2%</td>
<td>4. Japan</td>
</tr>
<tr>
<td>5. Hong Kong</td>
<td>3%</td>
<td>5. Indonesia</td>
</tr>
</tbody>
</table>

26.4 million m³
Importance of Russian – Chinese Trade

China’s Timber Imports (RWE)

1996: 500,000 m³
2005: 20 million m³
40-fold increase in 10 years
2000: China replaced Japan as largest market for Russian timber
Top 3 importers of industrial roundwood are major markets for Russia

<table>
<thead>
<tr>
<th>Country</th>
<th>2004 Industrial Roundwood Imports (million m³)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. China</td>
<td>27.64</td>
</tr>
<tr>
<td>2. Finland</td>
<td>12.96</td>
</tr>
<tr>
<td>3. Japan</td>
<td>12.68</td>
</tr>
<tr>
<td>4. Sweden</td>
<td>9.4</td>
</tr>
<tr>
<td>5. Austria</td>
<td>8.81</td>
</tr>
<tr>
<td>6. Canada</td>
<td>6.70</td>
</tr>
<tr>
<td>7. S. Korea</td>
<td>6.54</td>
</tr>
<tr>
<td>8. Italy</td>
<td>4.61</td>
</tr>
<tr>
<td>9. Spain</td>
<td>2.97</td>
</tr>
<tr>
<td>10. Belgium</td>
<td>2.88</td>
</tr>
</tbody>
</table>
Within timber markets, China is world’s largest log importer
Russia supplies China with 68% of its log imports.

Russia exports 90% of its logs to China.

87% softwood.
China’s Timber Imports by Product Type
1997-2005

Logs & sawnwood up * Plywood & veneer down

Imports (million cubic meters RWE)


- Logs
- Sawn wood
- Wood chips
- Fiberboard
- Plywood
- Particleboard
- Veneer
- Other
China’s Spectacular Growth as a Wood Processing Center

Export – led growth

- Logs: 30 million m³ RWE
- Lumber: 10 million m³ RWE
- Wood chips: 5 million m³ RWE
- Particleboard: 2 million m³ RWE
- Veneer: 1 million m³ RWE
- Fiberboard: 3 million m³ RWE
- Plywood: 15 million m³ RWE
- Wood furniture: 12 million m³ RWE
- Other*: 4 million m³ RWE
Drivers of Russian – China Forest Trade

150 million cubic meters (m³) gap between domestic supply of industrial roundwood and demand (domestic consumption + exports)

Gap to be addressed by:
- Imports
- Substitution
- Efficiency
- Improvements in domestic production

(NDRC 2006)

Sources: Zhou (SFA) 2001, Bull and Nilsson 2004
Drivers of Russian – China Forest Trade

Domestic Consumption
GDP per capita and Paper Consumption

GDP per capita, USD 2000 prices
Consumption 2000, kg per capita

USA
China
Drivers of Russian – China Forest Trade

**Imports**
44.6 million m³ RWE

**Exports**
36.1 million m³ RWE

80% imported volume

China's net domestic consumption of timber products is quite low compared to its timber product trade

Pulp and paper different story: only 11% is re-exported

Estimated 80% of Russian softwood imports are consumed within China (construction industry and furniture)

20% processed within China and re-exported (increasing)
Drivers of Russian – China Forest Trade

Export-led Growth

- US +800%
- Japan +200%
- Others +600% **
- EU +700%
- Hong Kong 20%

Exports (million US dollars)

Year

(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 (0% log import tariff);
(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.
Russia – China Forest Products Trade

57% of Earth’s coniferous forests in Russia – 1/5 of the world’s standing timber

Not all is economically accessible at this time

Some estimate that at present cutting rates, most natural forests in RFE will be logged out in 20-30 years

Many of the best forest lands in Primorskiy Kraj and Khabarovsky Kraj are degrading
  • Large clear-cuts leading to open and damaged landscape
  • Secondary broadleaf forests replacing Korean pine, larch (0.8% / year)
  • Catastrophic fires made worse by poor forestry practices

Illegal logging and associated trade well documented and acknowledged under St. Petersburg Declaration
  • particularly around the border areas, involving both Russian and Chinese nationals
Who Benefits from Illegal Logging

1 cubic meter illegally logged hardwood

- Chinese middleman, $70
- Bribes, $30
- Purhcase of depot documents $10
- Gasoline, $5
- Forest leaser, $5
- Loggers, security and truck driver, $18
Russia’s Desire to Increase Value-Added Processing

China’s Timber Imports (Value)

By volume: 68%
By value: 25%

1992: 40% of RFE timber processed locally. 2005: 90% exported as logs

Low value:
Low volume of processed products

exporters who undercut prices or underestimate the value of exported timber.
Russia’s Desire to Increase Value-Added Processing

- April 2006, Russian government 15% tax on all log exports
- Incentives for investors in wood processing
  - No VAT to equipment imports
- Many international investors, however, see Russia as a risky investment climate
  - Uncertain policy environment (Forest Code)
  - Illegal logging undercutting the legal operators
  - Illegal logging causing reputational risk
2006: Russian and Chinese officials announce joint forestry venture in Siberia:
- Long-term lease of 1 million ha as pilot project on joint use of forest resources
- Joint enterprise to cut & process timber including pulp production with Chinese investment

- Other plans for such similar joint ventures (e.g. US$1 billion Chinese investment in pulp plant)
Sustainable Trade Policy

• Ministry of Commerce recognizes need to ensure cooperative and legal trade and investment relationships with major trade partners such as China
  • Need to combat the “China Theory”: fear of Chinese domination in the marketplace
  • Relative success of Chinese investors and entrepreneurs in Russia itself causing tensions in a region of Russia with declining demographics and fear of losing cultural identify and regional economic control
  • Recognition that small-scale illegal Chinese operations have created a bad reputation for larger legitimate operations that would like to invest in Russia
June 2006: Ministry of Commerce initiated Sustainable Development and Trade Task Force

- Recognition that China’s target of 400% increase in GDP by 2020 and raising per capital income to US$3,000 / year cannot be done with current resource supply and efficiencies
- Recognition of the need to ensure positive trade relationships in global markets
- Recognition of the increasing environmental sensitivity of major wood products markets (EU, N. America, Japan)

- Environmental impact of current and potential trade patterns
- Environmental components of WTO negotiations:
  - How can environmental measures align with strategic interests of export-led growth and poverty reduction? (Market measures to change incentives for environmental behavior)
Sustainable Trade Policy

- Innovative schemes to ensure legal and sustainable wood supply
  - Supply chain management systems
    - Log tracking systems and certification
    - Public procurement policies (e.g. UK and Japan)

- With its huge market leverage around the world, China has a huge potential to help transform the way that forest products are harvested and traded.