

# C I N T R A F O R

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## Outlook for Russian Forest Product Trade with the People's Republic of China

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### Summary

Both China and Russia are and have gone through unprecedented change as both of their societies adjust away from the centrally planned approach and begin to adopt a mixed system incorporating facets characteristic of both private and public sectors. However, while Russia's economy has collapsed following the demise of the centrally planned system, GDP falling nearly 40 percent between 1990 and 1994 (25 percent between 1990 and 1993), China's economy has grown with GDP rising by 55 percent (40 percent by 1993). While the activity of the forest sector in Russia has fallen more steeply to a level of only 45 percent that existing in 1990 (63 percent 1993), being somewhat lower in Siberia and Russian Far East, China's forest sector has expanded though it is facing constraints imposed by the forest resource (27 percent between 1990 and 1993).

Ongoing growth linked to evolution of the Chinese system will translate into higher demand for forest products than can be met in the short to medium term by domestic sources. The looming shortages present emerging opportunities for regions rich in forest resources which must seek export opportunities abroad. Nowhere does this opportunity beckon more than in the relatively less developed forests of Siberia and the Far East.

By the year 2025 under a low growth assumption, China could face a deficit in industrial wood of some 200 million cubic meters annually, equal to slightly more than two times the domestic production of industrial roundwood in 1992. Outside of Siberia and the Russian Far East, very few regions have the ability to service this looming deficit. Furthermore, even the Russian region will seemingly be able to meet only up one-half of the short fall and only under conditions which promote capital investment in the Russian forest sector and development of the forest resource which is available subject to development of the infrastructure.

While on the surface conditions seem to be emerging which will favor increased trade activity between Russia and China in forest products beyond current levels of nearly one million cubic meters annually, much uncertainty remains regarding the longer-term outcome of reform and restructuring in both countries. Future China trade in forest products with Russia will depend on many factors on both sides – many of which are political in nature of speculative regarding future course of economic and market reforms. There is no doubt that in the near term China will experience increasing demand for all forest products and that the domestic supply will be insufficient to satisfy consumption a prevailing prices. Increased trade, including trade with Russia, is one of the several policy tools available to China to deal with this reality. Whether this will be selected as a major or significant element of overall timber strategies remains to be seen. Russia, the potential trading partner, will almost certainly seek new and expanded markets for timber from Eastern Russia (East Siberia and the Far East regions). The future status of economic reform and transition to markets will dictate outcomes with respect to Russian forests and potential for trade. International markets will grow in importance as traditional markets in European Russia and former Soviet Republics become increasingly economically inaccessible.

What is certain, however, that the People's Republic of China will increasingly play a major role in Asia and the Pacific Rim forestry, both as a producer and consumer market. Likewise, it is certain that Russia,

particularly Siberia and the Far East, will impact the overall equation for Forest products trade in the Pacific region, with important linkages to China. It is certain that China will need to compete with other Pacific Rim consumer countries in order to obtain timber. It is unlikely that Russia will offer substantial concessions in order to sell to China. Barter trade may persist (currently denominated in Swiss francs) but will be more difficult given competition from hard currency buyers for the available timber from Russia. The willingness to pay international prices for specific species and quality of timber will largely determine the competitiveness of China. Japan, as the major log importer in the Pacific Rim, is increasingly seeking timber supplies worldwide, including from the Russian Far East, to offset declines from traditional sources including the West Coast of North America.

It is also certain that Russia will seek expanded international market outlets for timber and forest products. The level and mix of timber for export will in turn depend critically on development strategies for the forests in East Siberia and the Far East. The lack of capital for investment in new and modern capacity and technology will slow the development of competitive processing, largely indicating future trade will continue to emphasize unprocessed roundwood in the near term. The near term outlook for unprocessed roundwood exports from Russia is not materially affected by the import tariff structure imposed by China, though there appear to be inconsistencies in how tariffs are applied to Russia.

China has historically had preferential tariff structures favoring the import of unprocessed timber with increasingly higher tariff rates for semi-processed and finished products, thus favoring domestic manufacture of the wood raw resource. Although 'special arrangements' can often prevail for trade with Russia, importers of Russian timber in the Northeast of China complain that they must pay full duties on wood imported even under barter arrangements or from labor-export agreements. Government officials indicated that this could be 'resolved' in the case of trade with Russia, although no clear policy appears to exist dealing with such issues. China's future policies with regard to timber substitution and regulations to enforce limitations on timber in many end uses (including construction) will be important with regard to meeting pressures for increased consumption as well as the future role of trade and import of timber from Russia or elsewhere.

The role of finance and credit arrangements will perhaps be most significant for China's importers. Russian enterprises have virtually no working capital and little possibility of credit. In many cases, supplies must be paid for in advance, in some cases including timber. Production is impossible without adequate credit or advance payment from buyers of timber products. Given the financial situation of many forest products enterprises with China, it is unlikely that advance payment for imported timber can be feasible any time soon. Greater roles for banking institutions, including letters of credit and foreign exchange accounts will be required if timber trade with Russia is to expand. Improved infrastructure, including rail, port and other transportation services for Russian trade remain critical, and although agreements in principle have been announced for cooperation on infrastructure development much remains to be accomplished.

From the perspective of China, timber from Russia has both advantages and disadvantages. Advantages for trade with Russia include the possibility of 'trade deals' as both countries seek to minimize the use of scarce foreign exchange in trade. Border trade, including barter trade, expanded between China and Russia from 1990-93 following some 20 years of closed borders. Various agreements were negotiated for the import of goods from Russia by China, including timber. In exchange China offered consumer goods, textiles, electronic goods, and a variety of other light industrial and agricultural products. Border trade declined during 1993-95, due to many perceived problems on both sides. The changing nature of policies and regulations in both countries contributed to charges of "difficulty" in reaching agreements that could be honored and enforced. In 1993, China also tightened credit in its efforts to control inflation, resulting in a drop in demand for imported products including timber. Tax regulations, trade policies including quotas and licenses, and foreign exchange restrictions also impacted trade. The 'political situation' in Russia was frequently mentioned as causing many difficulties for Chinese importers. This was noted particularly with regard to 'labor contracts' whereby China has sought to use Chinese labor to supplement Russian workers in exchange for both wages and timber which can be brought back to China.

Closeness to Russian timber is a considerable advantage for China importers. Access by rail or water is relatively low cost considering alternative timber supply sources, including North America. Trade with Russia also has the advantage of species familiarity. The common forests of NE China and the Russian Far East reinforce the dominant role of China's NE as a supplier of timber throughout China. Enterprises and users of timber are generally quite familiar with the attributes and characteristics of the Russian timbers and can easily substitute supply sources. Siberian larch, Korean (red) pine, spruce, and "white pines" (whitewoods) are all acceptable in the China market. Larch, a relatively abundant species in Eastern Russia, is commonly used for railroad ties, construction, vehicle floor boards, etc. and can substitute for Douglas-fir and hemlock in these and other lower-valued markets such as packaging. Internal river ports and coastal shipping complement rail connections directly linking China and Russia or passing through Mongolia. Improved infrastructures in the Far East and in China ease the problems of transportation and distribution. Although rail connections still require changing of rail car wheels, plans have been put forward to eliminate this difficulty in the near future. Coastal shipments (up to 40 percent of Russian timber imports) are by comparatively small ships, handling about 5,000 cubic meters. Most China buyers do not need (or cannot finance) larger shipload purchases, hence favor smaller and faster transport by smaller vessels. Shipments to Shanghai, Jiangsu, and Zhejiang have increased as wholesale markets have evolved, allowing brokerage of relatively small volumes to individual enterprises and other purchasers.

While having some advantages over competitors brought on by proximity and familiarity with species, China buyers and processing enterprises prefer North American timber to Russian timber. While technical characteristics are noted (for example strength), log size is the most common difference identified as leading to this preference. Russian timber is generally smaller diameter, normally less than 25-30 cm, and often 12-16 cm. China prefers larger timber, preferable over 30 cm diameter at a minimum. China imports also complain that Russian timber is 'old', having spent considerable time in storage or transit following harvesting, resulting in considerable drying and cracking, thus degrading product yields.

China importers also feel that Russia trade is not 'dependable' in terms of quality per orders, timely delivery, and other details of trade agreements. Contract disputes are difficult to resolve, as are questions of financing and credit. Quality of timber had declined, according to China importers, and comparisons were made to radiata pine from New Zealand which was considered much better and quite suitable for pulping.

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