Tariff and non-tariff barriers to New Zealand’s exports of wood-based products to China

James Turner¹, Frances Maplesden¹, Bryan Walford¹ and Stephen Jacobi²

Abstract
In November 2004 the governments of the People’s Republic of China (China) and New Zealand agreed to negotiate a Free Trade Agreement. This study provides an assessment of the potential impact on the New Zealand wood-based industry of removal of tariff and non-tariff barriers impeding New Zealand’s trade in wood-based products with China.

Most published sources indicate that China continues to offer domestic companies more favourable treatment, and that trade barriers are the main obstacle to realising equal treatment for foreign and domestic products. In particular, China’s VAT regime and import-licensing procedures favour goods bound for exporting industries over those going to the domestic market.

Removal of non-tariff barriers, which favour China’s processing industry, would have a two-fold effect on forest product exports from New Zealand. Firstly, it would reduce demand for raw material imports as less competitive processors in China are forced to close. Secondly, it would encourage imports of processed forest products such as wood-based panels and paper.

Introduction
Background
China acceded to the World Trade Organisation (WTO) on December 11, 2001, after 15 years of negotiations with WTO members. In the accession agreement the Chinese government committed to remove trade barriers and open markets to foreign companies, as well as change legal frameworks to add transparency and predictability to doing business in China (WTO 2001; USTR 2003). The Chinese government also committed to undertake the obligations of the more than 20 multilateral WTO agreements covering areas such as most-favoured nation treatment, transparency of administrative decisions, agriculture, sanitary and phytosanitary regulations, technical barriers to trade, customs valuation and import licensing. For some of these obligations, China was allowed a transition period (USTR 2003).

China’s accession commitment included agreement to remove the designated trading system for logs, sawn timber, and plywood by December 11, 2004. This system grants timber and wood imports to 70 designated trade enterprises (WTO 2001; Gan 2004).

The Chinese government’s implementation of the WTO accession agreement has been complicated by conflicts between the monopolic Chinese Communist Party and the rule-of-law system of the WTO (Abnett 2002). Difficulties include a lack of economic means to implement WTO commitments, a lesser degree of commitment and familiarity with WTO regulations by officials and business people in China’s provinces, and failure to include government agencies in the WTO negotiations leading to accession (Abnett 2002).

At the end of 2003 a United States Trade Representative review of China’s compliance with its WTO commitments, found a number of positive developments had occurred (USTR 2003). However, the review also found continued use of tax policies to favour domestic production and intervention of Chinese government officials in the market in general.

As part of China’s process of opening its markets and liberalising trade, as well as accession to the WTO, the Chinese government has begun to explore bilateral trade agreements with a number of countries, including New Zealand. The New Zealand and Chinese governments established a formal Trade and Economic Cooperation Framework, indicating an intention to explore the negotiation of a Free Trade Agreement (FTA) on 28 May 2004. A New Zealand-China FTA is expected to benefit the New Zealand forest sector by improving market access, reducing compliance costs for exporters, and encouraging commercial partnerships. A FTA would address issues such as trade in goods and services, rules of origin, investment, customs procedures, intellectual property, technical standards, subsidies, sanitary and phytosanitary regulations, labour issues and environment issues (MoC/MFAT 2004).

The Trade and Economic Cooperation Framework included a joint feasibility study by New Zealand and China (MoC/MFAT 2004) carried out during late 2004. The purpose of the study was to provide an assessment of the factors relevant to negotiation of a FTA, including identification of existing barriers to trade and assessment of the impact of removal of these. Ultimately the joint feasibility study facilitates negotiations by making recommendations on their scope.

Information on current and potential barriers to trade is sufficiently out-of-date or incomplete to warrant a comprehensive update and analysis of what is, and has the potential to, restrict New Zealand’s exports of wood-based products to China. This paper is based on a study that updated the inventory of tariff and non-tariff measures impeding or distorting New Zealand’s trade in wood-based products with China, and qualitatively assessed their economic impact on the New Zealand wood-based industry (Forest Research 2004). This information provided the basis of a submission by the New Zealand Forest Industries Council to the Trade

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and Economic Cooperation Framework joint feasibility study (MoC/MFAT 2004) regarding forest sector concerns that should be addressed in a China-New Zealand FTA.

**China forest product trade trends**

China has grown rapidly as a market for wood-based products, with the value of major forest product imports more than doubling from US$4,730 million in 1995 to US$12,935 million in 2003 (GTIS 2004). The growth in China’s share of global imports is expected to increase still further and China is predicted to become one of the largest forest products markets by 2030 (Turner et al. 2005). The largest increase in import shares has been for raw materials; industrial roundwood, chemical pulp and recovered paper. The import shares for processed products have grown less rapidly (GTIS 2004).\(^1\)

![Graph showing value of New Zealand's forest product exports to China, 1990 to 2003.](image)

**Fig. 1: Value of New Zealand’s forest product exports to China, 1990 to 2003.**

There has been rapid growth in the value of China’s wooden furniture exports, increasing almost sevenfold from US$600 million in 1995 to US$3,800 million in 2002 (GTIS 2004). Wooden furniture now represents almost half the value of China’s total wood-based product exports.

China accounts for a growing share of New Zealand’s forest products exports, particularly logs, fibreboard, mechanical and chemical pulp, kraft and coated paper (Table 1). A small market has developed for New Zealand sawn timber and there is increasing interest in development of markets for structural engineered wood products, about which little is known in China. New Zealand solidwood products compete with Russian and Scandinavian spruce, fir and other coniferous species.

The rapid growth in New Zealand forest product exports to China in recent years (Fig. 1) means this market has been singled out as having significant potential for future growth. Unrestricted market access will be a prerequisite to realising this market’s potential.

**Trade liberalisation - opportunities and challenges**

David Ricardo developed the original argument for the benefits of free trade, in the early 19\(^{th}\) century. The basis for the argument is that free trade allows countries to specialise in the production of goods and services that they are best at producing. These are goods and services that a country produces at a lower relative cost than other countries (NZIER 2001). Countries can then export these products, and import those that they are not as good at producing. However, barriers to trade distort prices so that inefficient producers are subsidised and resources are used in less efficient production (Easterly 2001).

Modern trade theory (Caves et al. 1999), as well as real world experience, provides support for the benefits of free trade suggested by Ricardo, though it is also recognised that trade liberalisation creates losers, as well as winners. The experiences of recent decades have shown that more open economies are richer, and grow faster (Easterly 2001; Sachs & Warner 1995). However, while export industries gain from free trade, import-competing industries will lose (Caves et al. 1999). Because it takes time for workers to move into the more productive export industries from the import-competing industries there can be short-term job losses.

**Methods**

**Definition of non-tariff barriers to trade**

While tariffs are the most visible instruments of protection, non-tariff measures (NTMs) are defined as government laws, regulations, policies and practices that either protect domestically produced products from the full weight of foreign competition, or artificially stimulate exports of particular domestic products (Forest Research 1999). “Natural” barriers such as cultural attitudes, language and distance from markets are not NTMs.

The original purpose of laws or regulations that act as NTMs are rarely known. As a result, a legitimate regulation with unforeseen and unintended trade implications may be identified as a NTM, though that was not the original intent of the regulation. Here, given the difficulty of determining the true purpose of policies, NTMs are identified as policies.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Logs</td>
<td>7.6</td>
<td>2.0</td>
<td>5.5</td>
<td>19.5</td>
</tr>
<tr>
<td>Lumber</td>
<td>0.0</td>
<td>1.6</td>
<td>6.1</td>
<td>6.6</td>
</tr>
<tr>
<td>Fibreboard</td>
<td>0.0</td>
<td>0.4</td>
<td>6.6</td>
<td>14.4</td>
</tr>
<tr>
<td>Chemical pulp</td>
<td>1.7</td>
<td>4.3</td>
<td>19.8</td>
<td>23.7</td>
</tr>
<tr>
<td>Mechanical pulp</td>
<td>2.1</td>
<td>0.3</td>
<td>6.7</td>
<td>17.5</td>
</tr>
<tr>
<td>Newsprint</td>
<td>4.4</td>
<td>10.5</td>
<td>6.2</td>
<td>n.a.</td>
</tr>
<tr>
<td>Paper from kraft pulp</td>
<td>29.6</td>
<td>41.8</td>
<td>29.0</td>
<td>41.1</td>
</tr>
<tr>
<td>Uncoated paper</td>
<td>3.9</td>
<td>5.4</td>
<td>34.1</td>
<td>15.4</td>
</tr>
<tr>
<td>Coated paper</td>
<td>5.0</td>
<td>16.4</td>
<td>13.1</td>
<td>20.7</td>
</tr>
</tbody>
</table>


\(^1\) GTIS (2004) data for New Zealand are obtained directly from Statistics New Zealand.
regulations, etc., which have the potential to be discriminatory, regardless of whether or not this was the intent.

NTMs can be grouped under three headings based on the reasons used to justify them; Social/Political, Health and Safety, and Environmental. Social/Political measures are motivated by a desire to increase domestic growth, add value to existing resources, and protect local employment and processing. These measures include surcharges, import and export taxes, and licence and quantity control measures. Health and Safety measures are intended to protect the economy, its population and natural resource base from the risks of introduced pests and diseases, and from inappropriate use of materials. These measures cover phytosanitary and quarantine requirements, and the codes and standards relevant to the use of wood in structural and non-structural end-uses. Environmental measures are certification and labelling requirements, and technical standards designed to achieve particular environmental goals. Although not a category of NTM, illegal activities may be the result, or consequence, of some NTM, and they do have trade implications.

Data Sources

The published information in this report is mainly derived from North American sources because United States organisations - US Trade Representative, US Department of Agriculture Foreign Agricultural Service, and US-China Business Council - provide a large volume of published information. Most of the United States information is also relevant to New Zealand, as was ascertained by interviewing New Zealand exporters of forest products to China.

The scope of the project was to infer qualitatively the impacts of trade barriers on New Zealand’s trade with China. Some subjectivity is therefore involved in this assessment.

Tariffs

Though China has made significant progress in reducing tariffs (Gan 2004), tariffs on value-added wood-based products remain high. There are also reports of inconsistent application of tariffs.

Tariff rates have been progressively decreasing in accordance with China’s WTO accession agreement (Table 2), and the government’s policy to supplement domestic timber supply. The (applied) tariff for logs and sawn timber was reduced to zero in 1 January 1999. This has positively impacted New Zealand’s exports of wood-based products to China, with significant growth in the log, sawn timber, and medium-density fibreboard exports (Table 1 and Fig. 1).

Table 2: China tariff schedule for forest products (percent ad valorem).

<table>
<thead>
<tr>
<th>Wood Product</th>
<th>HS code</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logs</td>
<td>4403</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sawn timber</td>
<td>4407</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Builder’s carpentry and joinery</td>
<td>4418</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coniferous wood, continually shaped, tongued, grooved</td>
<td>440910</td>
<td>7.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Veneer</td>
<td>4408</td>
<td>4-10</td>
<td>4-10</td>
<td></td>
</tr>
<tr>
<td>Plywood</td>
<td>4412</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Particleboard</td>
<td>4410</td>
<td>4-7.5</td>
<td>4-7.5</td>
<td></td>
</tr>
<tr>
<td>Fibreboard</td>
<td>4411</td>
<td>4-7.5</td>
<td>4-7.5</td>
<td></td>
</tr>
<tr>
<td>Wood pulp</td>
<td>4701, 4703</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Waste paper</td>
<td>4707</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newsprint</td>
<td>4801</td>
<td>12</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Paper from kraft pulp</td>
<td>4804</td>
<td>2-5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uncoated paper</td>
<td>4805</td>
<td>7.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coated paper</td>
<td>4810</td>
<td>7.5-5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seats with wooden frames</td>
<td>94016900</td>
<td>12.8</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Wooden furniture</td>
<td>94036099</td>
<td>14.7</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Engineered wood products</td>
<td></td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
</tbody>
</table>

Source: WTO (2001), AFPA (2004a) citing China Ministry of Commerce (www.mofcom.gov.cn), and New Zealand Ministry of Foreign Affairs and Trade (pers comm.).

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The United States Trade Representative (USTR 2004) claims that Chinese customs officers have wide discretion in classifying particular imports, and while this may benefit some businesses that are able to negotiate their goods into the lower tariff rate classification, the lack of uniformity makes it difficult to anticipate border charges. In 2003, a number of new tariff product categories were introduced for a range of wood-based products (USDA FAS 2003). However, wood Harmonised Schedule (HS) code categories for China still show fewer categories compared with other countries. While this may be favourable for many products, for more processed solidwood products a higher tariff is applied, with some scope for ambiguity in their application.

Waiving remaining tariffs on New Zealand value-added wood-based products could improve the competitiveness of these products compared with other countries’ exports. This may stimulate investment in the New Zealand wood-processing sector due to the more favourable market for value-added wood-based products. Consistent application of tariffs would increase the transparency in the entry process and lower the cost of New Zealand wood product exports to China.

**Application of value-added tax**

Although value-added tax (VAT) applies to all goods that are to be consumed in China there is inconsistent application of VAT exemptions and rebates. The development of specific industries, products and regions are being encouraged by the differential application of VAT. This allows central government to stimulate China-based industries by providing lower cost raw materials for production of value-added products.

In order to promote economic development in China’s border regions the Chinese government reduced by one-half the VAT on all goods entering from border countries. Although the policy was intended to allow small-scale traders to operate in border communities, the United States Trade Representative (USTR 2004) reports that larger operators are taking advantage of the system to import into China’s interior at preferential rates. This gives the Russian border trade of softwood logs and sawn timber a competitive advantage over softwood exports from other countries.

China retains an active VAT rebate programme for its own exports of value-added wood products. In January 2004 China began a policy of reducing VAT rebates on the export of lower value wood products (Table 3). Although the primary motivation of the reform was to alleviate the financial burden of rebates (AFPA 2004a), the domestic industry may benefit from an increase in domestic supply of raw materials, and production and export of value-added products.

The Chinese remanufacturing and export sector of particular significance to New Zealand sawn timber suppliers is the furniture industry. The Chinese government has encouraged furniture exports by continuing to provide VAT rebates on imported wood that is used to produce furniture for export (USDA FAS 2003).

VATs have been shown to have a relatively small impact on China’s imports of wood products (Ernst & Young 1996), and Gan (2004) assumed their impact to be equivalent to a 1 percent to 2 percent tariff. Consistent application of VAT could, though, improve the competitiveness of New Zealand logs and sawn timber, particularly compared with Russian material. The competitiveness of New Zealand value-added products might be improved compared with those produced from China-based industries. However, demand for New Zealand raw materials imported by China based export industries may decline due to removal of the VAT rebates for imported wood, which makes this cheaper than domestic wood.

**Table 3: Current and revised value-added tax rebate rates (percent) for export of wood-based products.**

<table>
<thead>
<tr>
<th>Product</th>
<th>pre-2004</th>
<th>post-2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logs</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Sawn timber</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Wood continuously shaped</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Veneer sheets</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Plywood and veneered panels</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Particle board</td>
<td>13</td>
<td>5</td>
</tr>
<tr>
<td>Fibreboard</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Pulp and recovered paper</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Paper and paperboard</td>
<td>13</td>
<td>0</td>
</tr>
</tbody>
</table>

*Source: China Ministry of Commerce (www.mofcom.gov.cn)*

**Transparency of customs and entry procedures**

The customs and entry process for New Zealand exporters to China can be costly and burdensome, particularly if the documentation is not standard. The European Union alleges that inspections carried out by Chinese Inspections Offices are costly, burdensome and discriminatory (CEEI 2002). The United States Trade Representative (USTR 2004) reports that importers often face inappropriate valuation methods by customs officials, resulting in higher-than-necessary customs charges. Despite new valuation regulations to bring practices into conformity with the WTO Customs Valuation Agreement, importers report that many Customs officials continue to use minimum and reference price lists, rather than the actual transaction price for valuation purposes, increasing the fees for many products.

Improvements in the transparency of customs and entry procedures for New Zealand exports would lower the cost of New Zealand wood and fibre-based product exports to China. This would improve the competitiveness of New Zealand forest products, compared with China’s domestic products.

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Processing subsidies

China’s domestic wood processing sector is subsidised through a variety of policies, such as value-added tax exemptions, local import tax rebates, government loans, and loan interest subsidies. The American Forest and Paper Association (AFPA 2004a) claims, though the source of this claim could not be verified by the authors, that government loans and loan interest subsidies of US$1.67 billion were used for technological improvements in 21 state-owned paper mills. AFPA (2004) claim that the terms of the loan subsidy were such that if a paper mill required US$10 million for technology renovations, at 6 percent interest, the Chinese Ministry of Finance would provide a two-year loan interest subsidy of US$1.2 million. These subsidies were mainly targeted to improve the competitiveness of China’s wood processing sector, by increasing efficiency and reducing costs.

Removing China’s subsidies to wood processing would have two impacts on New Zealand forest product exports. Firstly, it would decrease competition for New Zealand’s value-added products in China’s domestic and export markets. Secondly, it may decrease demand for New Zealand raw materials due to decreased production in China. Chinese subsidies to technological innovation also serve to decrease China’s demand for raw materials.

Phytosanitary regulations

Phytosanitary regulations are imposed to protect China’s forest resource from exotic pests imported with forest products. These regulations should be set such that they reduce the risk of importing exotic pests, without unduly adding to the cost of imports. Phytosanitary certificates, certifying that products are free from quarantine pests, are required for logs, sawn timber, and wood packaging made with coniferous wood (MAF 2004). China allows the use of phosphine to treat cargo below deck (MAF 2004). At half the cost of traditional methyl bromide fumigation, this treatment reduces the cost of meeting phytosanitary requirements. However, methyl bromide application rates for above deck cargo (120g – 20g, MAF 2004) are high compared with the international application rate of 48g.

Concerns also exist regarding the application of phytosanitary standards at the Chinese border. United States industries have commented that inspection requirements for agricultural imports are selective, unwarranted, burdensome, and questionable. These issues are compounded by a lack of co-ordination among Chinese customs and quarantine agencies, and failure to notify the World Trade Organisation of all new standards (USTR 2004).

Reducing inspection requirements and methyl bromide application rates would reduce the cost of New Zealand logs and sawn timber exports to China. This will increase the demand for these products in China. The extent of the impact is dependent on the proportion of New Zealand logs and sawn timber that are shipped above deck compared with below deck. If most exports go as below deck cargo, a reduction in methyl bromide application rates will have little impact on the cost of New Zealand exports.

Building codes and standards

The United States Trade Representative (USTR 2004) notes a concern among foreign companies regarding the lack of transparency in China’s standards development process, particularly the development of China-specific requirements, despite the existence of well-established international standards. These standards have the potential to create barriers to entry because of the high cost of compliance for foreign countries. Regulations are also applied by a host of different ministries and governments at the central, provincial and local levels, and it is not unusual for the resulting regulations to be at odds with each other.

The Chinese Ministry of Construction has developed a suite of standards that will govern timber-housing construction in China. These standards, published in January 2004, constitute a new Building Code for China. The Code as finally published ‘recognises’ New Zealand radiata pine but has a number of elements that effectively mean that New Zealand radiata pine structural sawn timber cannot be used in code-approved light timber frame construction.

Specific elements of the Chinese code for design of timber structures, which discriminate against New Zealand radiata pine structural sawn timber are:

- it permits use of North American commercial species and standard sizes and grades of sawn timber but not those from New Zealand, increasing the cost of conformance to the Chinese code for New Zealand compared with North American manufacturers;
- standards for the production, identification, and verification of machine-graded sawn timber have not yet been established;
- 2 x 4 construction is limited to North American sawn timber as design stresses published for dimensional sawn timber are only for material from North America; fast-grown timbers are required to be preservative treated against insect attack. As radiata pine is classified as being fast grown, treatment is required. However, less durable species that are slow growing do not require treatment, though timber durability is a more valid basis for requiring treatment.

New Zealand’s position is that there is no valid scientific or technical reason why New Zealand radiata pine should be disadvantaged or discriminated against in Chinese regulations. Since the publication of the Code, New Zealand industry and Chinese officials have worked co-operatively to resolve the remaining issues, which will be addressed in a supplement to the Code, expected before mid 2005. While good progress appears to be being made, any limitations on the inclusion of radiata pine in the construction code may have wider implications for radiata pine’s acceptance in other end-use sectors.

Changes in the Chinese code for design of timber structures that are favourable to New Zealand structural

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sawn timber would reduce the cost of New Zealand structural sawn timber (due to removal of preservation requirements) and allow access to markets serving the domestic housing sector. New Zealand sawn timber exports to China's furniture market are not restricted by standards, as individual companies set requirements. However, for New Zealand sawn timber exports to China to grow significantly, improved access to the structural sawn timber market is needed.

Environmental regulations

Environmental regulations in China with the potential to affect New Zealand forest product exports include the Cleaner Production Promotion Law, and a variety of policies (USDA FAS 2003; Yang 2003; AFPA 2004a) encouraging a shift in harvesting from natural forests to industrial plantations. The Cleaner Production Promotion Law aims to improve resource utilisation efficiency, mitigate and avoid pollutant emission, and protect and improve the environment (Zhang & Quoqiang 2003).

Environmental policies may affect market access for New Zealand forest products in a variety of ways. Firstly, because standards differ across countries, due to differences in environmental capacities and problems, New Zealand products may not meet Chinese standards. Secondly, measures to encourage afforestation, and recycling and utilisation of waste products, could provide low-cost raw material for processing industries, improving these industries' competitive advantage. The actual impact of these policies, however, does not appear to be large. None of the New Zealand exporters contacted identified these policies as barriers to trade.

Afforestation subsidies (Natural Forest Conservation Programme)

The Natural Forest Conservation Programme (NCFP) and Fast-growing Timber Plantation Programme (FGTPP) are a continuation of numerous programmes, such as the 1998 Forest Law of China, aimed at shifting China's industrial roundwood production from natural forests to industrial plantations. One objective of the NCFP is to establish 21.3 million ha of timber plantations from 2000 to 2005 in the upper reaches of the Yangtze and Yellow Rivers (Yang 2003). The FGTPP aims to establish 6.18 million ha of plantations, providing 133.4 million m³ per annum; 40 percent of China's domestic commercial timber demand (USDA FAS 2003). Other mechanisms to encourage plantation establishment include tax and credit breaks (AFPA 2004a), loan interest subsidies (AFPA 2004a), employment of workers formerly in harvesting in protection, management and planting jobs, and encouraging use of technological advances, such as improved planting stock (Yang 2003).

The Chinese government's investment in plantation forestry, while reducing the demand on natural forests, is also aimed at increasing domestic supply of industrial roundwood. Such policies have previously been used, most notably in New Zealand and Chile, to create highly competitive forest industries (Forest Research 1999). By funding the establishment of plantation forests, governments create an abundant, low-cost resource for forest sector processing industries to utilise, improving these industries' competitive advantage.

Illegal log imports from the Russian Far East

Russia is the largest exporter of logs to China, due to proximity, similarity in tree species, and price advantages (AFPA 2004a). Some of these exports are suspected to be illegal (Forests Monitor 2002; Kotlobay 2003; AFPA 2004b), though the scale of illegal logging and trade in the Russian Far East is uncertain. Kotlobay (2003) suggests that harvest volumes are 20 percent higher than permitted and that the area cut is 1.2 to 2 times that allowed. AFPA (2004b) provide an estimate of 15 to 20 percent. The illegal log trade is estimated to represent 20 percent of transported logs, and the true weight of log exports may be underestimated by 20 to 50 percent (Kotlobay 2003). AFPA (2004b) estimate an average of 25 percent of log imports is illegal. AFPA (2004a) report industry sources as estimating that 10 percent to 30 percent of wood and wood pulp trade between China and Russia is unregistered.

Several current practices in China enable illegal logging. In particular, Chinese trading companies actively purchase illegal wood (Gordon 2001; Kotlobay 2003), there are no requirements for wood to be legal or certified (Forests Monitor 2002; Kotlobay 2003), and there is little monitoring or legal overview of the Russia-China timber trade (Forests Monitor 2002).

Access to and utilisation of, the illegal log trade is likely to give Chinese producers a competitive advantage by reducing raw material costs.

Conclusion

China's government policies continue to offer domestic companies more favourable treatment. Trade barriers are the main obstacle to realising equal treatment for foreign and domestic products. In particular China's VAT regime favours domestic products over imports, and import-licensing procedures favour goods bound for exporting industries over those bound for the domestic market. These non-tariff measures may slow down the growth of China's processed product imports, compared with raw material imports, while it may stimulate the growth in its processed product exports.

Removal of non-tariff barriers favouring China's processing industry would have a two-fold effect on New Zealand's wood-based product exports. Firstly, it would reduce demand for raw material imports, such as industrial roundwood and sawn timber, as less competitive processors in China are forced to close. Secondly, it would encourage imports of processed forest products such as wood-based panels and paper. If such a shift in the mix of New Zealand's exports to China occurs, the New Zealand forest sector may experience a period where demand for New Zealand's raw materials declines. Only once New Zealand processing capacity is developed to export to the Chinese market will
Demand for raw materials increase in New Zealand.

A free trade agreement with China provides opportunities for increasing New Zealand wood-based exports to the Chinese market. It is important, though, to recognize the opportunities to reduce barriers outside of a formal FTA through industry and government organizations working directly with the relevant Chinese authorities. Examples of this are the ongoing work to resolve issues around the treatment of New Zealand structural timber in the Chinese code and the gaining of acceptance of phosphine treatment of logs.

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