Foreign Agricultural Service
GAIN Report
Global Agriculture Information Network

Required Report - public distribution

Date: 2/12/2003

GAIN Report #RS3005

Russian Federation

Solid Wood Products

Annual

2003

Approved by:
Randall J. Hager
U.S. Embassy
Prepared by:
Mark Petry and Marina Muran

Report Highlights:
Russian production of total solid wood products is expected to increase by over four percent in 2003 and 2004, mostly in the areas of lumber and plywood. Though expansion of the Russian forestry sector is still progressing slowly, increases are being registered in response to new investment, higher domestic demand from the furniture industry, and an expanding export market. Russia's exports of forest products is forecast to increase in all areas in 2003, though exports of low value products still dominate Russian trade.

Includes PSD changes: Yes
Includes Trade Matrix: No
Annual Report
Moscow [RS1], RS

Executive Summary

Production of total solid wood products is expected to increase by over four percent in 2003 and 2004. Softwood log production is forecast to increase by three percent in 2003, while softwood lumber is forecast to increase by four percent. In 2003, hardwood and softwood plywood are forecast to increase by 12 and five percent, respectively. Though significant improvement in the Russian forestry sector is still slow, increases are being registered in response to new investments in the sector, government policies to reduce exports of unprocessed products, higher domestic demand mostly from the furniture industry, and an expanding export market. Russia's exports of forest products is forecast to increase in all areas in 2003, though exports of low value products still dominate Russian trade.

Production

Forest Situation Report/Outlook

Though Russia accounts for one quarter of the world's timber stock and an estimated 70 percent of Russian territory is covered with forest, Russia's forestry sector continues to struggle. According to the Forest Industry and Export Council of Russia, the Russian forest sector has an estimated production capacity valued at $100 billion, but only seven to ten percent is currently being exploited. Among the factors that impede the forest sector from meeting its production capacity are poor management systems, the lack of efficient, modern equipment, and a poorly developed infrastructure.

However, despite the severe lack of capital resources, production in Russia is slowly growing. Production of timber, processed wood, and pulp and paper are all forecast to expand in the coming years. The expansion in these industries is supported by: a) sustainable domestic demand for board and cardboard packing, paper products, fiberboard and particle board; b) increased profitability in exports of logs, lumber, and plywood; and c) introduction of new and competitive products.

According to the Audit Chamber of the Russian Federation, the use of forest resources in Russia as a whole and in the most forested of the country's constituent regions is not a net contributor to the government's budget. Spending on forest conservation and replenishment exceeds tax revenues and is offset with federal budget money; government spending topped revenues by 164 million rubles in 2001. In 2001, the quality characteristics of forests worsened because while less land was replanted, the amount of illegal felling almost doubled, and the level of resources devoted to forest management decreased by half. Thus, the forestry sector is vastly underperforming in terms of its natural resource capacity and the government faces serious challenges in promoting long term growth.

The forest sector in Russia is comprised of about 22,000 companies, of which only 3,000 are large and mid-sized companies. About 95 percent of these companies are joint venture companies. The sector employs more than one million people, and seven percent of the workforce is located in processing facilities.

Solid Wood Products Situation/Outlook

Temperate Hardwood and Softwood Logs. Production of softwood logs is forecast to increase by 3.7 percent, while temperate hardwood logs will increase by six percent in 2003. The difference in growth is attributed to an increase in domestic consumption for hardwood logs to be used in the plywood sector and construction.

Temperate Hardwood and Softwood Lumber. Production of both hardwood and softwood lumber is forecast to increase by an average of three percent in 2003. Production is responding to the higher level of investment that is being made in lumber production facilities. This sector is attractive because it takes advantage of the abundant raw material, but does not require as high investment as higher-value-added products. Additionally, higher domestic demand due to the expansion of the furniture sector and expanded exports are expected to be medium-term driving forces behind the expansion in lumber production.

Production of hardwood and softwood lumber was hindered in 2002 due to an early spring that forced companies to halt wood transport along winter logging roads, thereby preventing the build up of reserves for subsequent processing.

Recently, the Swiss holding Kronoholding AG decided to build two new lumber plants in Russia, which will account for five percent of the Russian market. Kronostar also has a long term goal of making its Russian particle board facility the largest in the world, capable of producing two million cubic meters of MDF fiberboard a year.

Hardwood and Softwood Plywood. Hardwood plywood output is forecast to increase by 12 percent in 2003, while softwood plywood is forecast to grow only by five percent. Since plywood production is still growing from a fairly small base, each individual investment and production upgrade is a significant change in overall production. The growth in this sector is a result of higher industrial demand on the domestic market and the expanding furniture sector. The export market continues to drive the plywood industry, as Russia exports more than 60 percent and 70 percent of hardwood and softwood production, respectively.

Particle Board. Annual production of particle board is estimated at 2.5 million cubic meters, with a market value between $250-300 million. Increased production of particle board in Russia is attributed to the growth in demand from the domestic furniture industry and by new investments in the sector aimed at the export market.

Medium Density Fiberboard (MDF). Currently, the sector is growing at an average rate of 14 to 16 percent per year, against an average of about four percent for the overall forest products sector. Production in 2002 is estimated at 24 million square meters, with a market value of around $90 million. There are two main producers of MDF in Russia, but domestic demand is generally filled with imported products, mostly from Germany.

Veneer. Production of veneer in 2002 is estimated at 1.71 million cubic meters. Growth in this sector remains high as Russia accounts for 37 percent of the high quality birch veneer in the world.

Furniture Industry. The local furniture sector is facing stiff competition from imported products from nearly 100 countries. Since 1999, furniture imports have increased 3-4 times, with a strong presence of European furniture. According to the Department of Industrial and Innovation Policy in the Forestry Sector of the Ministry of Industry and Science, low import tariffs (current at 20 percent "ad valorem") are the main reason for the lack of development of the domestic furniture sector. However, possibly more serious obstacles include old plant equipment, low quality, and poor/outmoded furniture design.
Despite these factors, there are a number of new furniture companies with products that have become competitive in both domestic and foreign markets. The five percent growth registered over the past two years belies the strides this

industry is making. This sector is becoming more important for the lumber, plywood, and veneer sectors. Some companies, such as the Swedish retailer Ikea, have transferred or opened new furniture operations in Russia to support the growing domestic furniture demand.

Paper and Pulp. According to the Russia's State Statistics Committee, the paper and pulp sector produced 2.8 million metric tons of pulp in 2002, six percent more than 2001. Production of paper increased by 3.7 percent in 2002, reaching 1.7 million metric tons. Production of cardboard and cardboard packing increased 11.4 percent, reaching 1.2 million metric tons. The Timber Department of the Ministry of Industry and Science attributes the increase in output of the paper and pulp sector to an expansion of the major vertically integrated holdings, such as Syktyvkar Timber Complex and Arkhangelsk Pulp and Paper Combine.

Table 1. Russian Production of Wood Products, 2000 - 2002

Commodity	**2000**	**2001**	**2002**
Cut roundwood, 1000 m3	1,000,000	97,000	90,200
Workable roundwood , 1000 m3	78,400	77,700	79,500
Sawn timber, 1000 m3	18,700	19,000	17,600
Window blocks, 1000 m2	3,416	3,254	3,156
Door blocks, 1000 m2	4,153	3,994	4,080
Ore bars, 1000 m3	24,600	18,600	8,400
Mine boards, 1000 m3	16,600	12,000	7,000
Plywood, 1000 m3	1,480	1,590	1,808
Parquet, 1000 m2	1,991	1,705	1,666
Box sets, 1000 m3	228,000	184,000	193,200
Fiberboard, 1000 m2	273,000	277,000	300,000
Particle board, 1000 m3	2,293	2,482	2,732
Railway ties, 1000 m3	5,518	4,801	4,070
Industrial Houses, 1000 m2	81,300	90,500	135,000
Containers, pieces	8,175	12,500	8,734

Summer houses, pieces	2,557	1,905	1,413
Matches, 1000 boxes	6,961	7,716	6,728
Tables, 1000 pieces	3,573	3,665	3,751
Chairs, 1000 pieces	3,511	3,108	3,124
Wardrobes, 1000 pieces	2,724	2,597	2,630
Wooden beds, 1000 pieces	649,000	630,000	627,000

Source: Russian State Statistic Committee

Consumption

Domestic consumption of solid wood products in Russia is expected to grow by an average of three percent during 2003-2004. However, growth will be highly dependent on the construction, furniture, and interiors sectors. Growth will be stimulated by higher demand in housing construction due to new incentives and programs developed by the government; allocation of new investments in the furniture sector, investment in the the interiors sector to meet the demand from higher income consumers, and a growing export market.

However, overall demand in Russia is still low as wood is not the most frequently used construction material, nor as frequently as in Europe for interiors. Moreover, Russian foresters continue to export their best quality items and the remainder is used domestically. As a result, consumers often do not regard domestic wood products as high quality. Imported wood products still have higher demand in the local market due to better quality and reasonable prices.

Trade

The major products exported by the Russian Federation are softwood logs (46 percent of export value), softwood lumber (32 percent), and hardwood plywood (9 percent). Post estimates that in 2002, the total value of Russian exports of forest products reached $2.89 billion, a slight increase from $2.5 billion in 2001. China is the major destination of Russian forestry exports, about 25 percent of all exports. Exports to China generally consist of softwood logs and accounted for 13.2 million cubic meters in 2001, approximately $700 million. Japan ($265 million) and Finland ($165 million) are the next largest export destinations for Russia. Though the government is attempting to re-orient Russian producers towards exports of higher value products, lack of investment will likely hinder plans to decrease the 40 percent export share of softwood and hardwood logs.

Exports of all forest products are expected to increase in 2003 as the slowly increasing supply is exported due to the lack of strong domestic demand. Specifically, exports of hardwood and softwood logs are forecast to continue to expand due to the lack of capital investment and high production costs necessary for the production and export of higher value products. Truly representative data in this area is difficult to obtain because of the high level of informal exports.

Table 2. Russian Exports of Wood Products, 2000-2002

	2000		2001		2002	
	Volumes	$/millions	Volumes	$/millions	Volumes	$/millions
Roundwood, 1000 m3	30835	1338	37176	1666	40465	1840
Sawn timber, 1000 m3	7763	733	7730	715	8040	846
Plywood, 1000 m3	974	221	1020	240	1107	282

Source: Russian Union of Forest Industry and Timber Exporters and Russian State Statistic Committee

Marketing

Competitive Position of Russian Producers

Despite all the problems that the Russian forestry sector faces in terms of lack of investment and policy focus, it still enjoys several competitive advantages in the near and far term versus other suppliers, including U.S. suppliers. The main advantages include geography, resource base, and low production cost.

In terms of geography and resource base, Russia is strategically positioned with resources close to some of the largest world markets, Europe and Asia. In Asia, Russia has vast raw material reserves, shares a long border with China, and is close to Japan and South Korea. This means that the Russian raw material base in Asia is close to potential markets that are net wood importers. However, this area is difficult for Russia to develop because of the lack of infrastructure in these areas. This proximity has also created a serious level of illegal logging, especially along the Chinese border. In Europe, Russian ports also have relatively good access to European markets. Lastly, Russia currently has relatively low labor cost, thus future investment into labor intensive, value added products could enjoy a competitive edge in this area versus manufacturers in the United States and Europe.

However, the current problems that have been outlined in other parts of the report (lack of investment and modern equipment, infrastructure, absence of clear policy, and outmoded production practices) are currently shaping the direction and extent of Russian trade. Moreover, Russian trade in logs and low value items is a reflection of the difficulties in Russian industry. Thus, as Russian manufacturers struggle with investment and infrastructure development in the near term, Russia is likely to remain an exporter of lower value items. For American exporters, this generally means that Russian exports of logs or low value items displace semi-finished products in third markets.

Policy

There is no single government agency or body regulating activity in the forestry sector. However, the government has been actively formulating regulations that address this and other problems of the timber industry. Two documents were developed with participation of the Forest Industry and Export Council of Russia in 2002, "The Strategy Development in the Forestry Sector of the Russian Federation until 2016", and "Basic Guidelines for Forest Sector Development." These were approved by the Government of the Russian Federation in November. The regulations try to facilitate a more complete use of forest resources, improve product quality and increase Russia’s role in the export sector. The development project is divided into three phases. The first phase, which is to be implemented by 2005, envisages legislative amendments, improvement of the Forestry Code to increase investment, and the development and signing of major investment projects. The second phase, which is to be implemented from 2006-2010, involves an intense renewal of existing technological capacity. In the last phase, from 2011-2015, new chemical industry companies will be set up and exports of highly processed timber will be increased. Analysts are concerned that these objectives may not be implemented by the bureaucracy and the these well meaning documents will have no real impact.

However, the scale of investment needed to solve some of the basic problems will continue to strain the government's efforts to revive the forestry sector. A vicious cycle of lack of investment drags hinders Russian production potential. For example, in order to access much of Russia's forest resources, the transportation infrastructure needs to be seriously expanded. It is difficult for any one firm to build roads or rail networks for hundreds of miles, while the manufacturing facilities use extremely old equipment that do not make the most of the raw material. The question of efficient allocation of extremely scarce investment resources, in terms government or private investment, is critical. The irony of such vast territories of forest resources is that it creates the challenge of having to spread minimal government resources over a forested area dispersed over thousands of kilometers.

Tariffs

According to the latest Government Resolution # 931, dated December 26, 2002, custom duties for certain types of construction parts, firewood and some paper and carton products were abolished. The Russian Government is planning to establish higher export duties on some types of logs, and lowering export duties on high-value forest products. The goal is to stimulate local producers to export more value added products. Import duties for wood products have remained unchanged and are reflected in Table 4 in GAIN Report RS#2009 of 2002.

Illegal Logging

The Federal Forest Protection Service was abolished last year and the new department on Usage and Reforestation within the Ministry of Natural Resources has not been organized as quickly as projected. Thus, control over the usage and security of the Forest Fund (the total area covered with forests managed by the central government) in many regions was lost. According to the analysis conducted from 1996-2001, most forest violations have significantly increased due to the lack of proper enforcement and resources for the regulatory agencies. According to the World Wildlife Fund, the volume of illegal cut in the country has reached 30 percent and even 50 percent in some regions. Official statistics state that 150 million cubic meters of wood has been cut this year, though some experts estimate the actual cut at about 500 million cubic meters. As a result, Russia is losing more than one billion dollars annually in terms of illegal logging and trade of timber.

Timber Certification

A resolution on Certification of Forest Products was adopted by the Russian Government at the Ministry of Justice on November 22, 2002. The resolution highlights the general provisions, organizational structure, functions, rights and responsibilities of the Central Body (Department of Raw Materials of the State Standards Committee) for forest products certification. The resolution outlines the main objectives and principles for forest certification, the certifying body's structure and functions, and the rules for conducting certifications.

Regional Focus - Arkhangel'sk

Arkhangel'sk is in the Russian Far North and a traditional trading port on the White Sea and is heavily dependant on forestry, with more than 50 percent of the workforce engaged in this industry. This oblast is often considered to be the center of the forest industry in European Russia and is home to some of the largest sawn wood and paper producers in European Russia. The industry in the Arkhangel'sk region is heavily focused on exports, especially to Western Europe.

There is 2.2 billion cubic meters of timber in the region, with annual allowable cut of 21.5 million cubic meters. The forests consist of 70 percent of spruce, 20 percent pine and the remainder are birch and aspen. Three of Russia's largest pulp and paper plants are situated in the region: their share of paper in the total paper production of Russia is 30 percent. There are four hundred timber processing enterprises, including 150 large and 250 middle-sized and small ones. However, the actual annual amount of logging is 10 million cubic meters of timber per year. About 98 percent of the enterprises are under private ownership.

The region is basically export-oriented, where 85 percent of all the production is going for export to the markets in Europe, England, Israel, China and countries in Africa. As forests are federal property, and can be rented for a maximum of 49 years, it is hard to attract long-term investments in the industry. Some of the parts of the region do not have roads and are unaccessible during cold or wet times of the year. Arkhangel'sk oblast is working closely with the neighboring region of Komi in constructing the better railroads and roads. However, due to the constraints in this area, local producers are actively seeking investment to increase production and modernize equipment.

Currently, over 50 percent of raw timber is brought to the mills by railcar, 30 percent by river, and the remaining by truck. Infrastructure costs are still high because infrastructure is built at the expense of the company, there are few high quality public roads to the remote areas, the river freezes in winter and does not have enough water the entire year, and railroads are inconsistent, expensive, and not extensive.

Currently, paper production is most profitable, but lumber and component parts for furniture are also marketed on the international markets. However, taking into consideration the regions' potential, the saw timber and paper industries are still below capacity.

The Federal Government is helping the region with compensation of part of the interest on loans. However, this amounts to only a few percentage points and most firms prefer not to participate in the program due to the bureaucracy involved. In terms of investment, many industry representatives state that developing a flexible mechanism for custom duties on imported equipment is important due to the lack of quality Russian forestry machinery. It is clear that companies that have easy access to international markets are better able to capitalize and orient their business, whereas inland producers cannot. For example, Arkhangel'sk producers sell 80-90 percent of their production on the export market, while generally have minimal sales in the Russian market.

The forest resource situation in the region is quite stable due to the less than optimal use of regional forestry resources. Moreover, a campaign on forest certification started in spring 2002. Two non-commercial partnerships on certification have been set up in the region and some of the plants have been already certified. The main objective is to create a market of services to assist in conducting the European standard FSC (Forest Stewardship Council) certification. Forest certification is mainly the a result of requests from the European importers and foresight by the industry and regional authorities.

The Solombala Sawing and Woodworking Combine, Sawmill No. 3, and Timbex are the main production and sales arms of the Solombala group, clearly the top wood products producer in the region and a company that also controls 15 logging operations, production, shipping, and trading. The group combined produced about 900,000 cubic meters of sawn wood in 2001, of which approximately 75 percent was European construction grade lumber, 10 percent finished products, and the remainder was lumber products for the Russian market. Moreover, this company is the largest wood products manufacturer in European Russia.

The member components of this company were purchased by investors after its bankruptcy in 1998. Since that time, the company has increased production by 50 percent and has increased production by 100 percent since the low point of 1995. The company has invested in logging enterprises, transportation and infrastructure, and equipment in the past several years. Currently, the company mainly sources from logging enterprises that it owns (though by law, it only pays rent for the land and trees) and transports it via rail, road, sea, or river.

Additionally, Solombala is a key initiator of the forest certification program in Arkhangel'sk region. Currently, greater than half of their raw materials are certified to the European FSC standard and expect the remainder to be certified within a few years. This is part of the response by Solombala and other local producers to the requests of European customers.

The Arkhangel'sk oblast is expected to continue to grow in the near future. While it is clear that the pace of development depends on the rate of investment from internal and external sources, the resource base is excellent in terms of quality and accessability for Russia. The Arkhangel'sk oblast can be expected to play a bigger role on international, especially European, markets in the future.

PS&D Tables

Table 3. Production, Supply, and Distribution of Softwood Logs

PSD Table						
Country	Russian Federation					
Commodity	Softwood Logs				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	66000	66000	68000	68000	0	70500
Imports	0	0	0	0	0	0
TOTAL SUPPLY	66000	66000	68000	68000	0	70500
Exports	21500	21500	22500	22500	0	23500
Domestic Consumption	44500	44500	45500	45500	0	46500
TOTAL DISTRIBUTION	66000	66000	68000	68000	0	70500

Table 4. Production, Supply, and Distribution of Temperate Hardwood Logs

PSD Table						
Country	Russian Federation					
Commodity	Temperate Hardwood Logs				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	23500	23500	24000	24000	0	25500
Imports	0	0	0	0	0	0
TOTAL SUPPLY	23500	23500	24000	24000	0	25500
Exports	9600	9600	10000	10000	0	10000
Domestic Consumption	13900	13900	14000	14000	0	15500
TOTAL DISTRIBUTION	23500	23500	24000	24000	0	25500

Table 5. Production, Supply, and Distribution of Softwood Lumber

PSD Table						
Country	Russian Federation					
Commodity	Softwood Lumber				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	14100	14100	14500	14665	0	15400
Imports	0	0	0	0	0	0
TOTAL SUPPLY	14100	14100	14500	14665	0	15400
Exports	4400	4400	4800	4750	0	5225
Domestic Consumption	9700	9700	9700	9915	0	10175
TOTAL DISTRIBUTION	14100	14100	14500	14665	0	15400

Table 6. Production, Supply, and Distribution of Temperate Hardwood Lumber

PSD Table						
Country	Russian Federation					
Commodity	Temperate Hardwood Lumber				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	4700	4700	4720	4795	0	4890
Imports	0	0	0	0	0	0
TOTAL SUPPLY	4700	4700	4720	4795	0	4890
Exports	380	380	390	400	0	420
Domestic Consumption	4320	4320	4330	4395	0	4470
TOTAL DISTRIBUTION	4700	4700	4720	4795	0	4890

Table 7. Production, Supply, and Distribution of Softwood Plywood

PSD Table						
Country	Russian Federation					
Commodity	Softwood Plywood				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	258	258	265	270	0	275
Imports	2	2	2	2	0	2
TOTAL SUPPLY	260	260	267	272	0	277
Exports	182	182	186	186	0	190
Domestic Consumption	78	78	81	86	0	87
TOTAL DISTRIBUTION	260	260	267	272	0	277

Table 8. Production, Supply, and Distribution of Hardwood Plywood

PSD Table						
Country	Russian Federation					
Commodity	Hardwood Plywood				1000 CUBIC METERS	
	Revised	2002	Preliminary	2003	Forecast	2004
	Old	New	Old	New	Old	New
Market Year Begin		01/2002		01/2003		01/2004
Production	1300	1300	1350	1450	0	1500
Imports	0	0	0	0	0	0
TOTAL SUPPLY	1300	1300	1350	1450	0	1500
Exports	880	880	900	920	0	950
Domestic Consumption	420	420	450	530	0	550
TOTAL DISTRIBUTION	1300	1300	1350	1450	0	1500