Mobilizing Wood in Russia in the light of the new forest code

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Presentation of the system of wood mobilization
Present and future importance of wood energy

Likely changes in the future in the structure of wood supply and mobilization
Impact of the new forest code on wood mobilization in Russia

Forest resources of Russia

Total timber stocks – 81.5 billion m³, including 42 billion m³ mature and over-mature. The average annual increment is 993.8 million m³.

Forest industry in Russia and the World

The total amount of production of Russian forest industry does not exceed 3 % from world volume

Change of species structure of Russian forests

Mature and overmature forest

1961 year – 56 bill. m³

Coniferous – 49 bill. m³
Deciduous – 7 bill. m³

2005 year – 44 bill. m³

Coniferous – 34 bill. m³
Deciduous – 10 bill. m³

Percent utilization of Annual Allowable Cut

Distribution of forest resources on Federal districts (ФО)

AAC, mill. m³
Removal of wood products, mill. m³
Percent utilization of Annual Allowable Cut
Growing stock (m³) per hectare of stocked forest lands

Net annual increment (m³) per hectare of stocked forest lands

Factors which determine amount of economically accessible forest resources

Density of transportation network

Factors which determine amount of economically accessible forest resources

Forest road, Leningrad region

Pilot projects in several regions of the European part of Russia: introduction of intensive technologies of forest management

The areas of undesirable tree species in experimental regions of the European part of Russia
Efficiency of carrying out reforestation works in experimental regions

Natural growth
Introduction of intensive methods of reproduction of forests

Mature and overmature, mill. m³
- unvaluable deciduous species
- coniferous species

1. Efficiency of carrying out reforestation works in experimental regions.

Increase of forest utilization level

<table>
<thead>
<tr>
<th>Forests for lease</th>
<th>Did not use announced harvest</th>
</tr>
</thead>
<tbody>
<tr>
<td>89 mill. ha</td>
<td>101 mill. ha</td>
</tr>
<tr>
<td>135 mill. m³</td>
<td>50%</td>
</tr>
</tbody>
</table>

In an accessible zone 4.8 billion m³ is unused

- Overmature deciduous stands
- Damaged forests
- Annual wood residues of timber cutting 70 million m³

- Wide introduction of modern technologies of wooden housing construction
- Use of wood fuel in municipal power
- Construction of mills on processing softwoods

Dynamics of parameters of a domestic market (consumption)

- Sawnwood, mill. m³
- Particleboard, thou. m³
- Fibreboard, mill. m²

Commodity and cost structure of Russian export

A roundwood and sawnwood make up over 90% of commodity volume of Russia, their share in proceeds – about 50%
Role of the Russian roundwood in rough provision of the countries which are producing timber goods

The Russian roundwood forms a basis of production:
- Pulp & paper industry – Finland, China;
- Building materials (LVL) – Japan, Korea
- Finishing materials (veneer, plywood) – Japan, China, Korea

The Russian roundwood serves the principal countries-importers, its shares in raw material balance of these countries makes:
- China – 17%;
- Japan – 21%;
- Korea – 16%;
- Finland – 22%

Up-to-date Russia forest policy targets:
- Controlled decrease of round wood export
- Increase of own wood processing and value added
- Increase of forest utilization level
- Increase of forest income
- Attraction and increase of investments
- Partnership between state and business
- Combat against illegal loggings

The main contents of the new Forest Code
- The forests belonging to the Forest Fund lands are the property of the Russian Federation
- Forests on other land categories shall be defined as established in land legislation
- The forests are divided to three categories:
  - protected forests,
  - utilization (exploitation) forests and
  - reserved forests

Material and financial flows of timber production of Russia
(physical parameters of production show as conditional m3 of standing wood)

<table>
<thead>
<tr>
<th></th>
<th>Physical parameters</th>
<th>191 million m³</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wood supply</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export</td>
<td>Roundwood</td>
<td>48 million m³</td>
</tr>
<tr>
<td></td>
<td></td>
<td>70 $/m³</td>
</tr>
<tr>
<td>Wood residues and fuel</td>
<td></td>
<td>40-50 million m³</td>
</tr>
<tr>
<td>Export</td>
<td>Pulp &amp; paper</td>
<td>4 million m³</td>
</tr>
<tr>
<td></td>
<td></td>
<td>150-200 $/m³</td>
</tr>
<tr>
<td></td>
<td>Sawnwood</td>
<td>30 million m³</td>
</tr>
<tr>
<td></td>
<td></td>
<td>100 $/m³</td>
</tr>
<tr>
<td></td>
<td>Plywood</td>
<td>2 million m³</td>
</tr>
<tr>
<td>Import</td>
<td>About 3 billion $</td>
<td></td>
</tr>
<tr>
<td></td>
<td>particleboard, fibreboard and other</td>
<td>8-9 million m³</td>
</tr>
<tr>
<td></td>
<td></td>
<td>200-700 $/m³</td>
</tr>
</tbody>
</table>

The world market of timber production
Production from above than on 12 billion $ is made and sold on foreign markets from the Russian roundwood

Up-to-date Russia forest policy targets:
- Controlled decrease of round wood export
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- Increase of forest utilization level
- Increase of forest income
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The forests are divided to three categories:
- protected forests 33%
- utilization (exploitation) forests 48%
- reserved forests 19%

Coming to force of the new Forest Code
- The Code has come in the force on January, 1, 2007 (1 month after official publication)
- The shift of Forest Management Units (FMU = "leshoz") to regions ownership will be formulated by February, 1, 2007
- Lower level acts for implementation of the Forest Code will be formulated by July, 1, 2007
- Forest tickets can be issued and sylvicultural works can be carried out by FMUs until January, 1, 2008. After that sylvicultural activity can be done only through auctions and order.
The main contents of the new code

- The forests belonging to the forest land are the property of the Russian Federation.
- Forests on other land categories shall be defined as established in land legislation.
- The forests are divided into three categories:
  - protected forests,
  - utilization (exploitation) forests and
  - reserved forests.
- Free entry to forests is guaranteed for citizens. However, they must obey the regulations (regeneration, forest fire etc.).
- A long term forest lessee is responsible for sylvicultural activities.
- Forest use is announced by a harvest declaration.
- The main harvesting methods in the utilization forests are: final felling (clear cutting) and selective felling.

Forest utilization rights can be acquired through leasing or against stumpage payment (valid one year or less).

Forest lease period is 10-49 years.

Forest management rules will be prepared separately for each forest region.

Lower level forest administration units: “Lesnichestvo”

New classification of forest regions

Organisation of the forest administration

Duties of the Federal and Regional Forest Administration

Duties of Lesnitsestreva and Lezhoz
Transfer of organizational structures and resources for execution of the transferred powers (2007 year)

<table>
<thead>
<tr>
<th>Organization</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forest Agency</td>
<td>8,3</td>
</tr>
<tr>
<td>Regions of the Russian Federation</td>
<td>7,1</td>
</tr>
<tr>
<td>Territorial bodies</td>
<td>81</td>
</tr>
<tr>
<td>Subordinated organizations</td>
<td>5</td>
</tr>
<tr>
<td>Leshoz</td>
<td>1,759</td>
</tr>
<tr>
<td>Lesnitsestvo</td>
<td>7,743</td>
</tr>
<tr>
<td>Branches of Avialesoohrana</td>
<td>24</td>
</tr>
<tr>
<td>Number of personnel</td>
<td>190 thousand</td>
</tr>
<tr>
<td>Production assets</td>
<td>34 billion</td>
</tr>
</tbody>
</table>

Structure of financing of Russian forestry in 2007 year

<table>
<thead>
<tr>
<th>Category</th>
<th>Bill. Roubl.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forest Agency</td>
<td>8,3</td>
</tr>
<tr>
<td>Regions</td>
<td>7,1</td>
</tr>
<tr>
<td>Forest science and education</td>
<td>2,5</td>
</tr>
<tr>
<td>Other Territorial bodies</td>
<td>6,0</td>
</tr>
<tr>
<td>Silvicultural works</td>
<td>6,4</td>
</tr>
<tr>
<td>Fire extinguishing</td>
<td>0,7</td>
</tr>
<tr>
<td>Reserve in view of the new Forest Code</td>
<td>0,40,7,1,2</td>
</tr>
</tbody>
</table>

Important for wood mobilization

- Leshozes will work in 2007 basically the same way as earlier.
- There will be a new law for investment projects. The law will provide privileges such as forest resources without an auction, possible tax redemptions, support to infra investments.
- Forest Agency has classified these investments into three categories: sawmill, panel and pulp investment. A list of priority investment projects in the area of forest development shall be prepared and approved.
- Priority investment agreement can be made also for present forest areas.
- All the forest leases will need to be renewed during 2007. This is not an automatic procedure and it will favor enterprises with wood processing.
- Leases with less than 10 years lease period will not be renewed.

Forestry sector development programs

- Forest industry strategy 2015 under preparation
- Forest sector target programme 2015 under preparation
- Government approval planned in Jan-Feb 2007
  - Target: big integrates and value add production
  - Projects collected from the Regions
  - Production increase of 52% from 2004 to 2010.
  - Production value in 2010 around 16 billion euro
  - Ultimate target: 100 billion USD

Forest industry development: focus in value add production

- Road map for the near future development, which includes new type of interaction between the state and business.
- Establishment of favourable investment conditions: long term investment agreements and state partnership.
- Encouraging wooden house building.
- Expansion of harvesting machine production.
- Infrastructure development to open new forest areas.
- Wood energy promotion.
- Decrease of import custom duties for foreign wood processing machines.
- Decrease of export custom duties for value add wood products.

Influence of the transition process on the forest sector

Risks

- Changes in forest ownership;
- The weakening of forest sector institutions during the transition, e.g. reducing their ability to enforce forest law;
- Insufficiency of financing of measures on protection and reproduction of forests as a result of change of their executor;
- Decrease in an occupation level, delays of payment of wages;
- Decrease in a level of timber cutting;
- Decrease in efficiency of preventive fire-prevention actions in connection with reforming of a control system of a forestry;
- Decentralization of actions on protection of forests;
- Loss of quality of Forest inventory and forest statistics;
- Increase the area of forest will reclassify from “not available for wood supply” (e.g. for nature conservation reasons) to “available for wood supply”.

The modeling results for 200-years period (40 steps): average (for 5 years period) income/outcome

Future targets
- Growth in 2006 compared to same period in 2005
  - Harvesting -6.6%, sawnwood -3.4%, plywood +7.0%, market pulp -3.9%, paper +2.0%, board +9.9%,

**Targets**
- Paper and board production 49,1 82,7 125,9
- Paper and board consumption 37,4 56,0 77,8
- AAC utilization level 25 % 34 % 42 %
- GDP growth 6,1% 5,8% 6,7%

Round wood export custom duty
- Export custom duty for fire wood was increased to 6.5% ad valorem but at least to 4 euro / m3 in March 2006
- Export custom duty for softwood round wood was increased to 6.5% ad valorem but at least to 4 euro / m3 in April 2006
- The Russian Commission on Safeguards and Tariff Policy is preparing a detailed plan to increase export duties on round wood for 2007-2010:
  - 1.7.2007 10 %, min. 6-9 €/m3
  - 1.7.2008 12 -13,5 %, min. 12-14 €/m3
  - 1.7.2009 15-17 %, min. 18-19 €/m3
  - 1.7.2010 20 %, min. 24 €/m3
- In addition to custom duty, Russia plans to increase also the custom declaration fee
  - The present fee is 500 roubles per custom declaration (0,28 euros/m3)
  - The new suggestion is 10 000 or 11 000 roubles per declaration (around 6 euros/m3)