Timber

The splendours and risks of **the Russian timber business**

The famous tale "The Snow Queen" by Hans Christian Andersen starts with a story of a bad goblin making a devil's mirror. Everything good that was reflected in this mirror seemed to dwindle while ugly things became conspicuous. The timber business as a magical mirror exposes the peculiarities of the developing Russian market. It offers fabulous opportunities, but it conceals many secrets and traps.

According to the official statistics Russia hosts up to a quarter of the world's total forest and half of the world's coniferous wood. The amount of land covered with forests is estimated at 774 mln hectares. Wood resources are 80 billion cubic metres, of which 44 billion cubic metres are mature forest ready for exploitation. Not all forest, of course, can be harvested. The amount allowed to be cut is determined by the forestry authorities and is around 500 mln cubic metres a year. Historically these figures have never been reached. These days no more than 160 – 170 mln cubic metres of timber are actually cut. It appears that potentially, the timber business may well be compared to the oil and gas industry.

Today, Russia is exporting mostly logs and planks, raw materials with little added value. The irrationality of such an approach is obvious. Wood cutting is a difficult and, perhaps, the most economically ineffective stage in the production chain. There is no money in logs; it's in the more sophisticated products.

Over 90% of all domestic timber companies are small enterprises with an aggregate market share of around 40%. Such companies can be described as those with relatively small initial investments, a cheap workforce and a rather voluntary attitude to taxation. Among the timbers sold by these companies there may be some of uncertain origin.

Small disorganised producers of logs, always have cash flow problems and are a source of cheap timber for foreign traders, especially those on the Russian borders. However, there is a trend towards the consolidation and enlargement of the timber enterprises. Today nine timber and paper companies with aggregated sales over 2 billion dollars are among the largest Russian corporations. These are: «Ilim Pulp Enterprise», Syktyvkarskiy LPK, Arkhangelsk CBK, JSC 'Volga', Continentalinvest, Kondopoga, Svetogorsk, Solikamskbumprom, Segezhskiy CBK. Less than 10% of all companies control 60% of the market. Investments into the timber industry are growing faster than in other area of the economy.

The most vulnerable point of these Russian companies is the underdevelopment of the domestic market and, consequently, dependence on foreign, first of all, European buyers. This, however, may change. Russia, with a population of 140 mln people is one of the most promising markets. During the last two years the Russian economy has grown at 7% per annum. Real-estate prices have been growing at a rate 15-20% whose growth is followed by an increase in demand for timber.

On the other hand the Chinese market is becoming very important. The border between China and Russia extends approximately 4,000 kilometres, from the south western Primorski Region in the Russian Far East to the Chita and Altai Regions in eastern Siberia. Timber imports from Russia to China have increased nearly 50 times in 10 years from around 350 thousand cubic metres in 1995 up to 17 million cubic metres in 2004. According to some researchers[1] over the next few years the demand for Russian timber in Asia will increase even more dramatically. By 2025 China could be facing a deficit of 200 million cubic metres of wood every year. To satisfy the demand, it will continue looking northward to Russia, and if the current trends are maintained Russia will become the single largest supplier of wood to China.

It is now clear that exploitable forests in Russia are not that inexhaustible as it may appear from the official statistics. Most Russian forests cannot be harvested without substantial infrastructure investments. Today, 70% of harvesting is done in the European part of Russia and the Urals. At the same time these regions house less than 30% of the resources. It sounds paradoxical but Russia may face a wood shortage.

The eminent English historian Arnold Toynbee believed that the destiny of a nation is determined by the decisions made by the national elite. Russia to some extent depends on its timber industry, and some regions, such as Arkhangelsk or Kareliya for example, depend on the timber almost entirely. It's quite clear that the extensive way of exploitation (when mostly raw materials are exported) is where the anti-globalists' worst dreams come true.

The Russians seem to realise this. The new forest code, which is now being debated in the State Duma, is designed to support domestic companies: a forest lease is to be contracted and concluded at auction and for a longer period of time, the concept of less control over forest exploitation from the authorities assumes responsible leaseholders. It's expected that the enlargement of the industry would reduce the amount of illegal cut and related crimes such as tax evasion and smuggling. It seems inevitable that export duties will increase on logs and reduce on sophisticated timber products. Despite the fact that the regulation of the forestry is deemed to be in the mutual competence of the Federation and regions, the trend is on centralisation. Regional authorities still take part in controlling local forestry but apparently they are loosing influence. The legislator's idea perhaps is to establish a uniform regulation of forestry all over Russia and, at the end of the day, to restrict local corruption.

It can be expected, therefore, that in the near future the timber industry may face remarkable changes. Small producers may be forced out of business and resources shared between vertically integrated companies.

It may put foreign traders in the position of a difficult choice. On one hand they may decide to exploit the opportunities and expand into the market. Currently less than 1% of Russian timber companies owned or controlled by foreign enterprises have 25% of the market. Paradoxically the course of events is favourable, first of all, to foreign companies. Despite the developing domestic market and appearance of very promising Asian markets, distribution will remain the weakest point for Russian companies. Growing domestic producers have a great appetite for know-how in timber processing, development of construction materials, furniture, frame houses, and that again is the great opportunity for foreigners. Assistance from such institutions as EBRD, specialised funds or export credit agencies allows western companies to enter the Russian market with relatively little own investment. On the other hand, reluctant to invest into this no doubt difficult market, they may soon find themselves competing for resources with a consolidated group of local enterprises, backed by the state.

Sergey Matyunin LLM, Dip in Law, MSc
InterBusiness Consulting (UK) Ltd.
tel: 0131 466 6738
e-mail: sergey.matyunin@ibcinfo.co.uk
www.ibcinfo.co.uk

[1]Analytic report by BROC, Friends of Siberian Forests and Forests Monitor Ltd, October 2001.