

Status and Trends in Trade and Investment in the Khabarovskii Krai's Forest Sector

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Status of Forest Sector at the RFE market

- Most part of the RFE Forest Sector's output is exported (95 % in 2006)
- Timber export is mainly of raw materials, 96 % in 2006.
- Absolute volume of timber export from RFE made 14,0 million m³ in 2006.
- In 2006, 99 % of the RFE timber was exported to 3 countries, China - 64, Japan – 23 and Republic of Korea 12 %.
- Khabarovskii and Primorskii regions are the main timber exporters in the RFE, providing 60 and 27 % of the RFE timber exports, respectively.

Comparative data on Khabarovskii Krai's forests and RFE

	Russia	Russia n Far East	Khabarovskii Krai		
			Total	Share in RF %	Share in RFE %
Area of forest stock lands, million hectares	1133,4	501,5	75,2	6,6	15,0
Including forest covered area, million hectares	738,6	280,6	52,3	7,1	18,6
Total wood stock, billion m3	75,3	19,4	4,9	6,5	25,3
Including per 1 inhabitant	519	2732	3500	-	-
AAC, million m3	524,7	90,9	23,8	4,5	26,2
Under concessions, million m3	190,0	19,0	11,2	5,9	58,9
Concessions share of AAC, %	36,2	20,9	47,2	-	-
Use of AAC, %	25,1	16,9	32,9	-	- ³

Specificity of the Khabarovskii Krai's Forest Sector

- Use of AAC in Krai is higher than on the average in Russia and in the Far East.
- The Krai is leading also in volumes of long-term concessions in the RFE region, nearly a half of AAC under such concessions.
- Specificity of the Krai is its large forest tracts in its northern areas, demanding considerable investments in infrastructure. It distinguishes the Krai from other big forest resources region like Primorskii Krai.

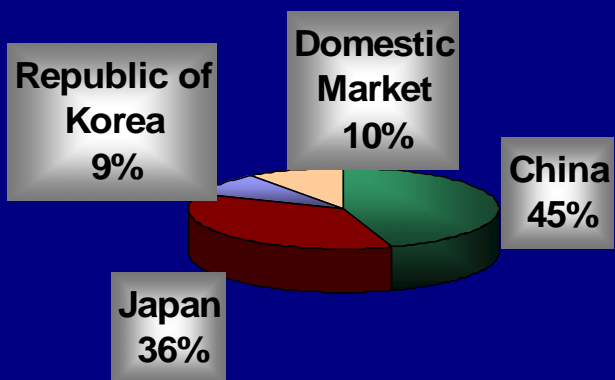
Forest Sector in Khabarovskii Krai's Exports

	2004	2005	2006	2007
The Krai's total exports, million USD	1974	3026	3669	1850
Including forest products exports, million USD	538	575	733	1019
Share of forest products in total exports, %	27,2	19,0	20,0	55,1

Forest Sector in Khabarovskii Krai's Exports

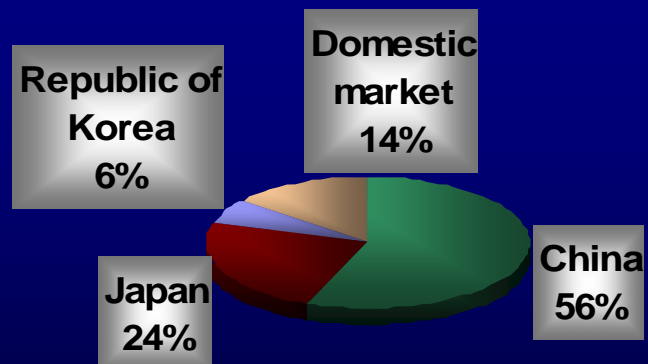
- Timber exports is a stable source of revenues to the Krai's budget than its other export branches.
- Share timber export in total amount of the Krai's exports steadily grows.
- Sharp growth of forest export in 2007 is associated substantially with a rise in prices for timber (33 %), and to a lesser degree due to an increase in physical volumes of exports (by 8 %).

Directions in Forest Products Trade in Khabarovskii Krai



2004

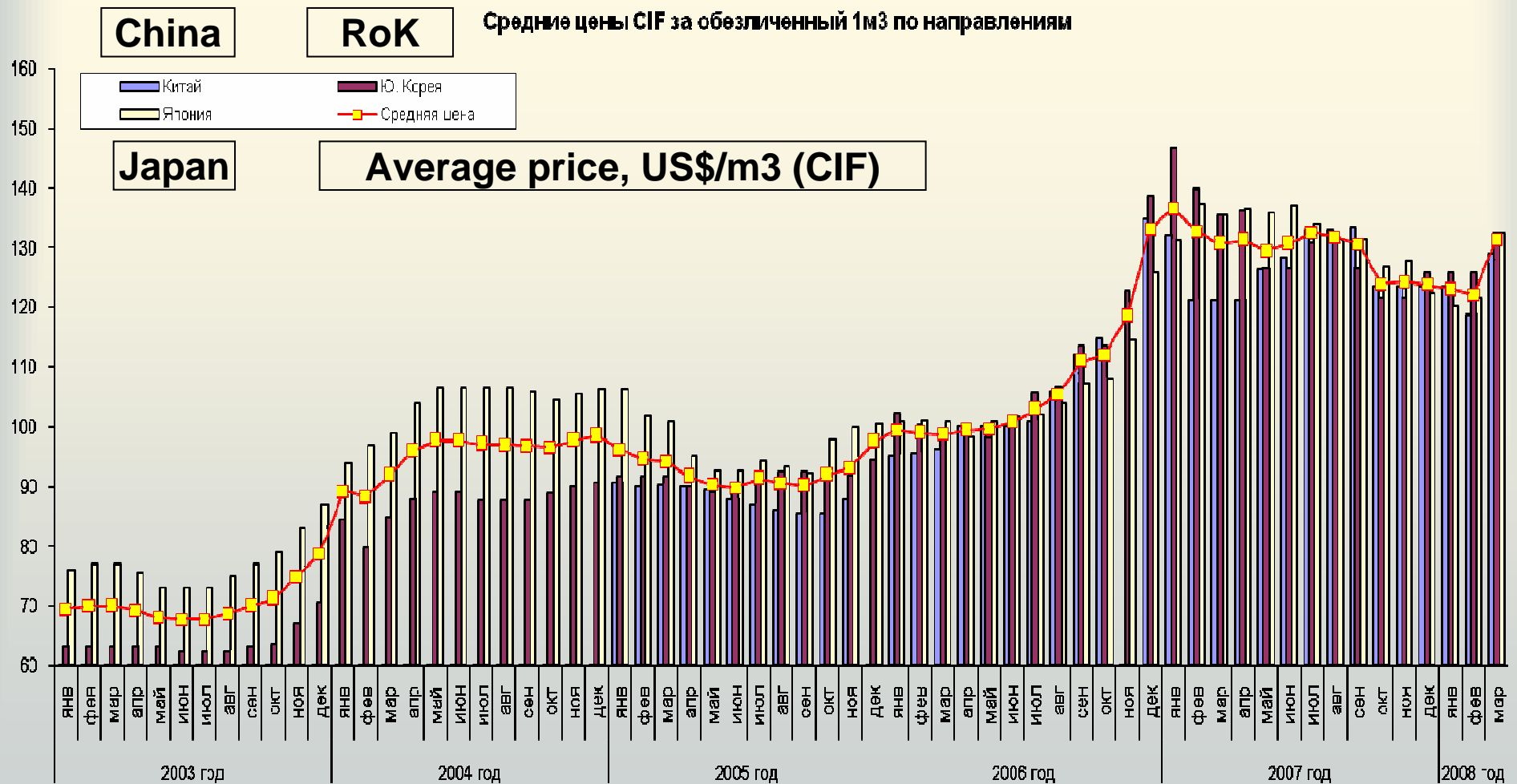
2007



Markets for Russian Far East Timber

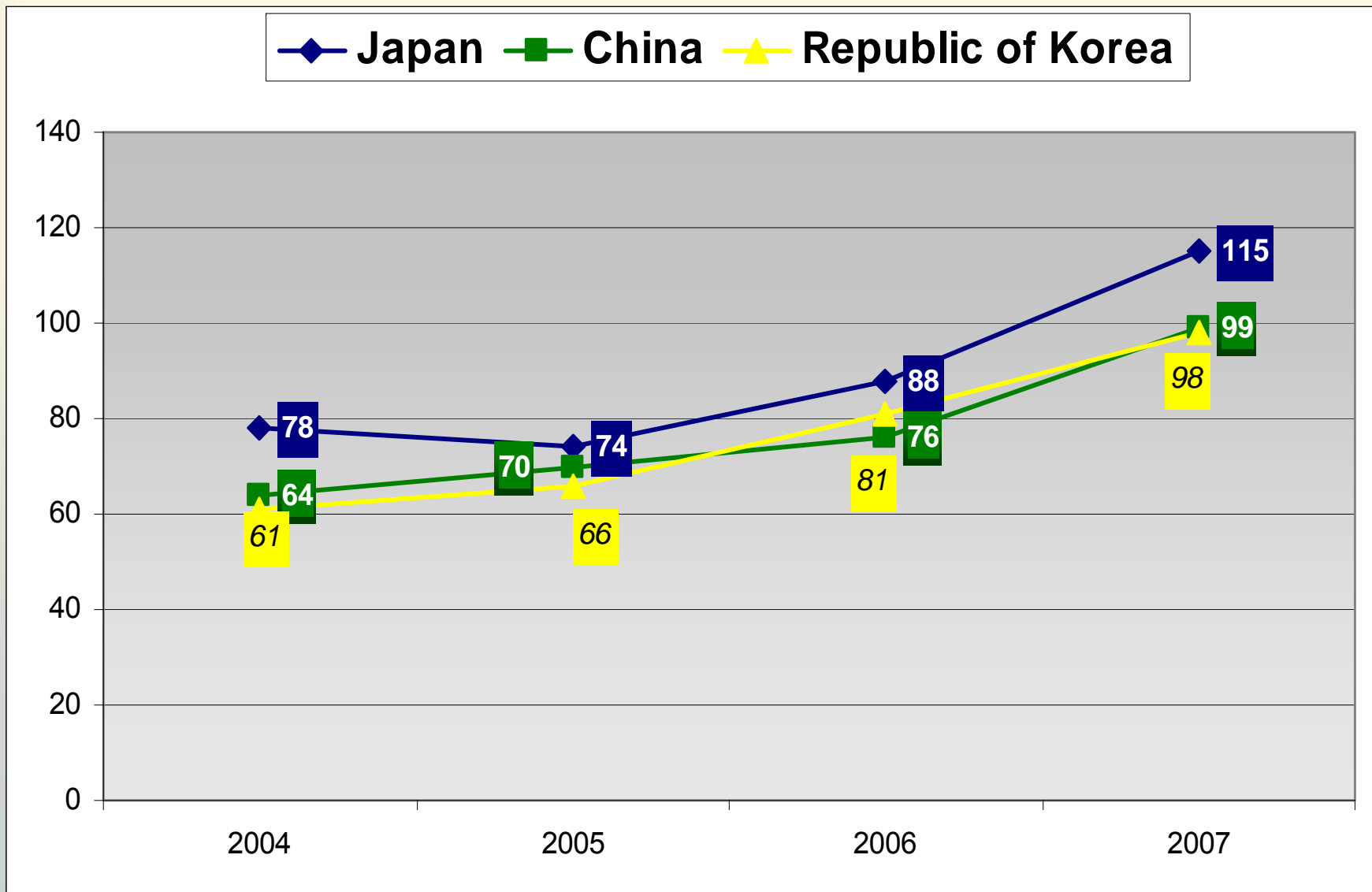
- The Japanese market for many years (since 1950-s) was most attractive to the Russian Far East wood.
- After the 2000s quickly growing and less exacting to quality, the Chinese market became more attractive for timber exporters from the Khabarovskii Krai.
- Japan imports a larch of average and large diameters for needs of wooden housing construction; South Korea - a fur-tree of large and average diameters, the Peoples Republic of China - all assortments, including balance raw materials.
- A demand for timber at domestic market remains narrow.

Dynamics of Export Prices on Timber from Khabarovskii Krai

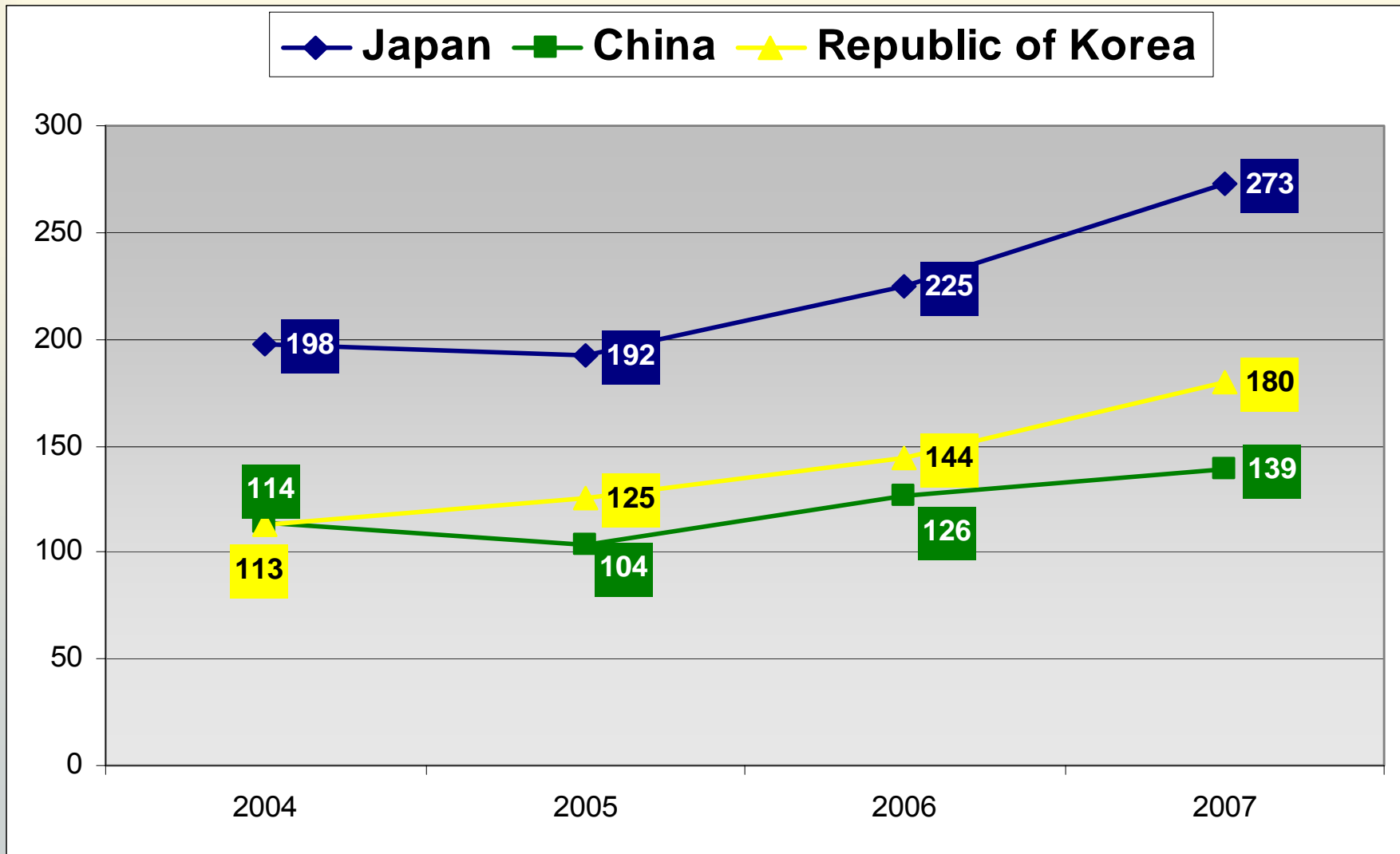


- The Asian market as whole has swallowed 20 % increase in protective logs export duties with small decrease in exported volumes to Japan and Republic of Korea, and nearly with no changes on the Chinese direction.

Dynamics of Export Prices on Round Wood, US\$/m³



Dynamics of Export Prices on Sawnwood, US\$/m³



- There are not big differences in prices for RFE round wood in Japan, China and Republic of Korea.
- The prices for RFE round wood fell a bit in the Japanese market in 2005, and in the Chinese market the prices have risen almost to the Japanese level that promoted a moving of a part of the Russian timber exporters to the Chinese market.
- A gap between the prices for RFE round wood and sawn wood exported to Japan is 158 US dollars, to Republic of Korea is 82 US dollars, but to China is only 40 US dollars. That testifies about very low level processing of production exported to China.
- Even though the price of sawn wood in the Japanese market exceeded 2.5 times the prices of round wood but the requirements of this market to quality of lumber are very high and it is difficult for Russian enterprises to sustain qualitative parameters and be competitive.
- It is clear that the wood market of Republic of Korea has original intermediate character between Japan and the People's Republic of China

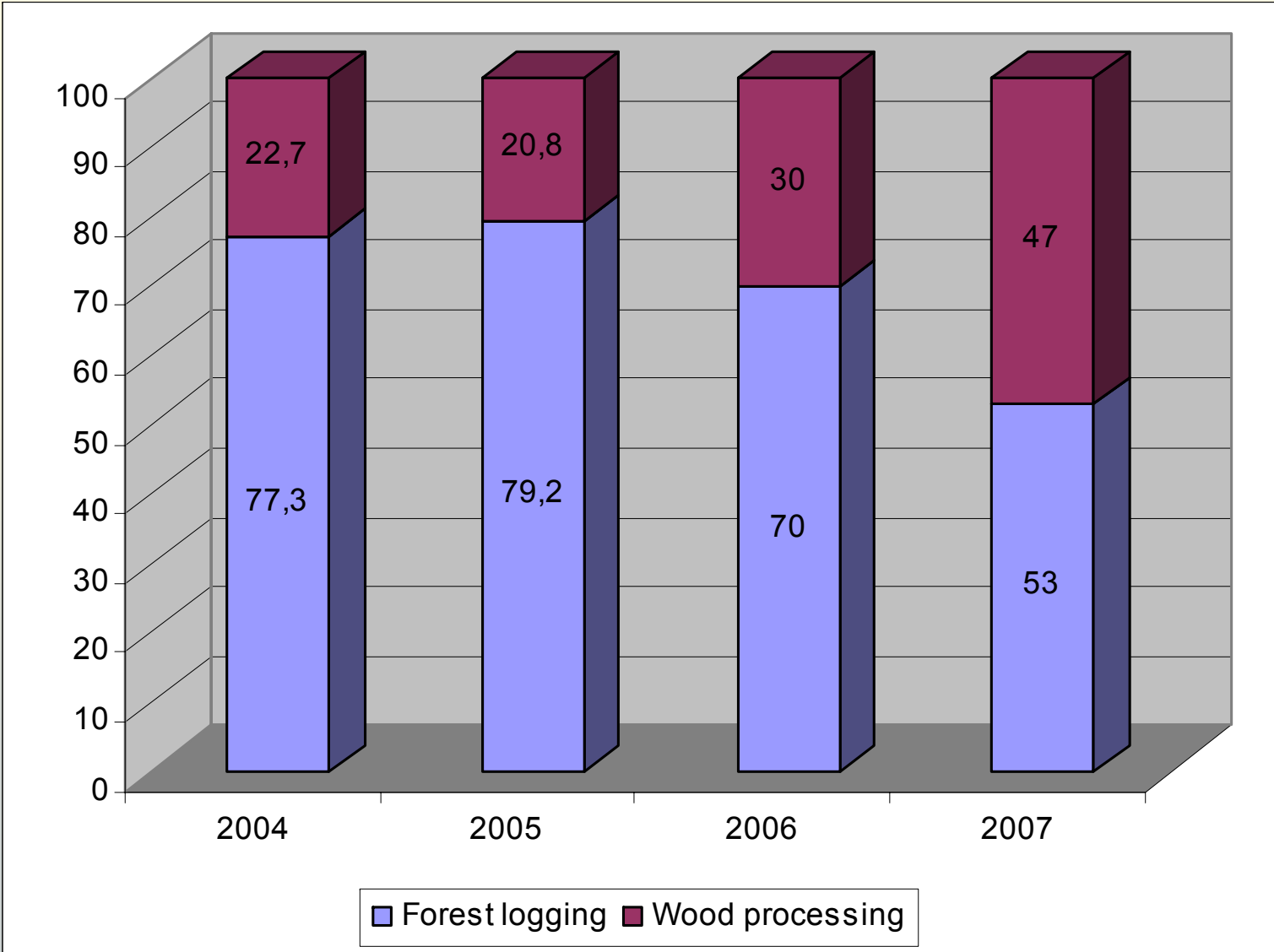
Forest Sector in Khabarovskii Krai's Investments

	2004	2005	2006	2007
Investments in fixed capital in the Krai as a whole, billion rubles / USD	<u>34,6</u> 1,2	<u>39,2</u> 1,4	<u>45,6</u> 1,7	<u>52,0</u> 2,0
Including investments in forest sector, billion rubles / USD	<u>1,4</u> 0,05	<u>1,6</u> 0,06	<u>1,6</u> 0,06	<u>2,4</u> 0,09
Share of forest sector investments in the Krai's total investments, %	4,0	4,1	3,5	4,5

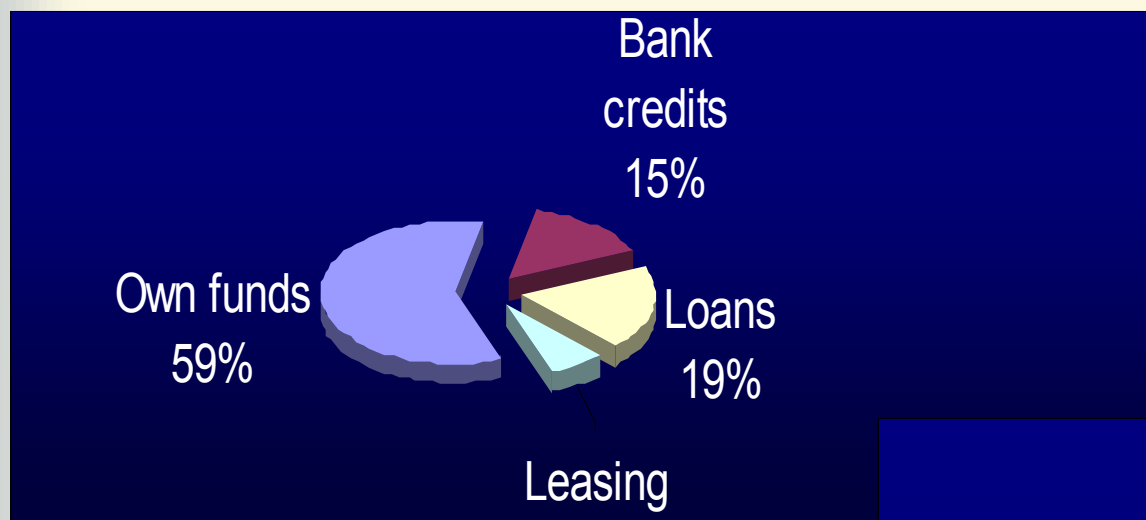
Forest Sector in Khabarovskii Krai's Investments

- In comparison with trade a share of investments into the fixed capital in forest sector remains insignificant, less than 5 % of total investments into the Krai's economy though it has grown over last year by 1,5 times.
- Before 2007 $\frac{3}{4}$ of all investments came to timber logging branch. It means that the raw orientation of timber exports of the Krai remains a dominating tendency so far.
- Investments into the processing start growing only after a adoption of enactment on increase in logs export duties.

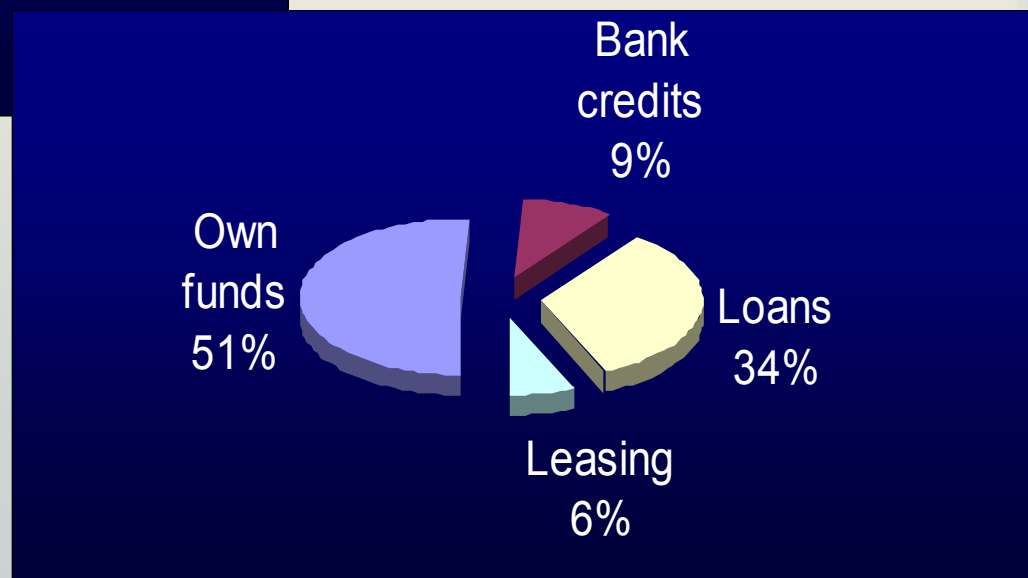
Structure Of Investments Into the Krai's Forest Complex By Main Activities



Sources of Investments into the Khabarovskii Krai's Forest Sector



2004



2007

Sources of Investments into the Khabarovskii Krai's Forest: some findings

- Due to low degree of the RFE forest sector manufacture concentration, the possibilities to use own sources for investments are very limited. However, own funds of the timber enterprises dominate in sources of investments for creation of processing capacities.
- In 2007 a share of loans, which new proprietors of wood enterprises could attract, has increased. The share of the banks is decreasing, because they reduce crediting wood enterprises, doubting in their economic stability because of increasing export duties.

Foreign Investments In Forest Sector

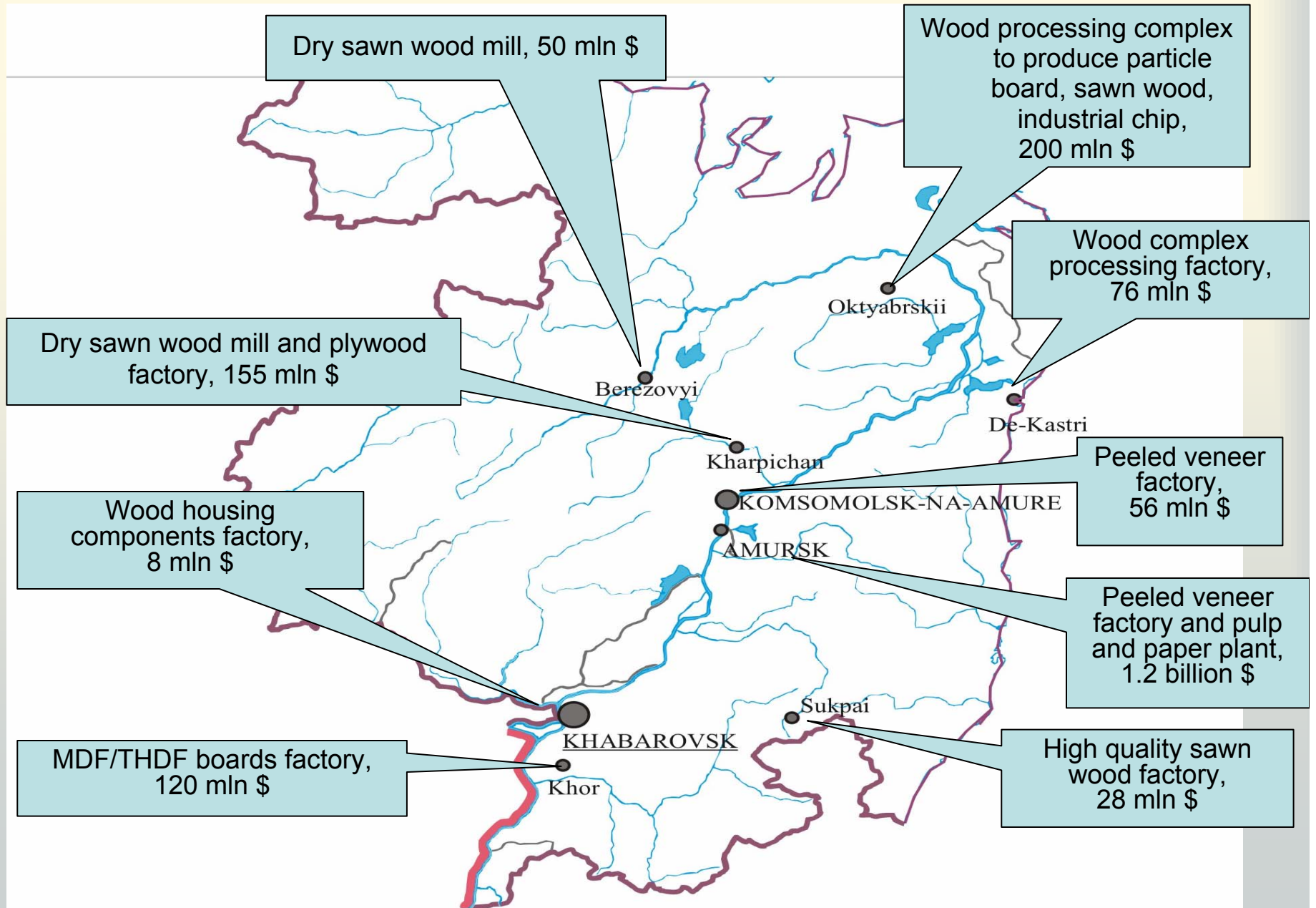
- 2004 г. – 7,1 %
- 2005 г. – 4,4 %
- 2006 г. – 0,5 %
- 2007 г. – 5,7 %

Share of foreign investments in general volume of investments into the Khabarovskii Krai's forest sector is too small still

Key Investments Projects In The Krai's Forest Sector

- The next scheme shows the main perspective investment projects in the field of wood processing in Khabarovskii Krai.
- In notes, there are specified the name of production planned to output and projected volume of investments.
- Practically all the projects are designed to export made production to the countries of Northeast Asia and Europe.
- The projects have different terms of implementation, basically after 2009. Thus, at the moment of 80 % of export duties they will not reached their designed capacity.

Key Investments Projects In The Krai's Forest Sector



Prospects for Development of The Krai's Forest Sector: Opportunities

- Abundant wood resources
- Steady growing external demand for Russian wood especially in North East Asia.
- Big investing companies show interest to the Krai's forest sector and are able to involve investors for co-funding investment projects in the field of wood processing.
- Working out and adoption of the Concept of the RF Forest Sector Development in 2008-2020.
- Development of a priority investment projects mechanism for the forest sector with granting a number of preferences, including funds from The Investment Fund of the Russian Federation to develop forest infrastructure.

Plans for Development of the Khabarovskii Krai's Forest Sector

Activity	2004	2007	2010	2012
Produce of commercial timber, thousand m ³	7045	7600	6683	8200
Processing of commercial timber, thousand m ³	1160	2333	6343	8200
Share of total produced commercial timber	16,5	30	95	100

- The government of the Khabarovskii Krai expects that implementation of the main investment projects will provide by 2012 a growth of wood processing up to 100 % of harvested timber volumes and will ensure over 3 thousand new workplaces at the wood processing enterprises.
- At the same time it is expected that introduction of 80 % export duties will lead to reduction of harvesting volumes in the Krai by 12 % as minimum.
- But most likely the reduction will occur much more that is determined by a number of difficulties which will especially reveal itself in the next 2008-2010 years.

Prospects for Development of The Krai's Forest Sector: Constraints

- **Weak development of wood processing which is characterized by low share of processing of harvested timber; primitive level of processing; poor quality of manufactured products; absence of capacities on deep processing of wood as far.**
- **Period of reforms following after adoption of new Forest Code 2007. Transfer of forest governance mainly to the regional level. It creates an additional source of instability to working conditions for business, makes uncertain rules for getting forest resource to harvest.**
- **Adoption of strict customs duties on export of round wood. It will lead to rush falling of own funds of timber logging enterprises that will limit possibilities for finalizing the investment projects.**
- **Limited domestic demand for wood processed products in the Russian Far East.**
- **Limited domestic highly-skilled labor resources to develop wood processing in RFE. Plus, the general problem of labor resources deficiency in the Russian Far East and in the Khabarovskii Krai.**

Development of processing manufacture in the Russian Far East will run across the following issues:

1. Forcing out of small and medium business in the course of restructuring.

At present, nearly the whole timber logging base in the southern Russian Far East is distributed between tenants, and available perspective logging sites in remote areas demand for considerable preliminary investments into infrastructure development.

Process of concentration of large business in forest sector can provoke further "re-distribution" of concessions at the expense of small and medium business.

That can cause a growth of unemployment and social intensity in forest settlements where the small business works.

2. Lack of brands of RFE wood processed products on external markets.

Round wood from the Russian Far East takes now a strong niche in the market of North East Asia.

Selling of new Russian wood processed products will demand to implement a competent marketing policy on the world markets where is a tough competition that will require from 2-3 to 5-7 years.

There is a risk that during this period the forest sector of the Khabarovskii Krai and the Russian Far East will have heavy times.

3. Trade vs. Integration

Cooperation on the basis of trade only is a one-side game, when the Russian Far East acts as supplier of only raw materials, creating itself social, economic and environmental problems.

It is necessary to come to the following step of cooperation - to integration, which one of initial stages is investment cooperation.

Investment cooperation with China as potential great economic partner and investor with integration of the Russian forest resources and Chinese technologies and market niches could play a considerable role.

The main problems for integration there are:

- (1) guarantees for investors / foreign partners through granting large logging sites in long-term concessions
- (2) attraction of a foreign labor (especially for the Chinese investment projects)

Nevertheless, it is necessary to search for the new ways to optimize benefits of all the concerned parties.