

*Pellervo Economic Research Institute
Working Papers
Pellervon taloudellisen tutkimuslaitoksen
työpapereita*

N:o 99 (September 2007)

**NORTHWEST RUSSIA: DEVELOPMENT OF THE
WOODWORKING INDUSTRY AND OPPORTUNITIES
AS A POTENTIAL MARKET AREA FOR FINLAND**

**Allan Flink
Erno Järvinen
Ritva Toivonen**



Pellervon taloudellinen tutkimuslaitos PTT

Pellervo Ekonomiska Forskningsinstitut

Pellervo Economic Research Institute

Eerikinkatu 28 A, 00180 Helsinki

Puh. (09) 348 8844, fax (09) 3488 8500

Sähköposti: econ.res@ptt.fi

www.ptt.fi

*Pellervo Economic Research Institute
Working Papers
Pellervon taloudellisen tutkimuslaitoksen
työpapereita*

No. 99 (September 2007)

**NORTHWEST RUSSIA: DEVELOPMENT OF THE
WOODWORKING INDUSTRY AND OPPORTUNITIES
AS A POTENTIAL MARKET AREA FOR FINLAND**

**Allan Flink
Erno Järvinen
Ritva Toivonen**

Helsinki, September 2007

ISBN 978-952-5594-62-1 (PAP)
ISBN 978-952-5594-63-8 (PDF)
ISSN 1455-4623 (PAP)
ISSN 1796-4784 (PDF)

Pellervon taloudellinen tutkimuslaitos PTT
Pellervo Economic Research Institute PTT
Eerikinkatu 28 A
00180 Helsinki

Helsinki 2007

FLINK, Allan - JÄRVINEN, Erno – TOIVONEN, Ritva. 2007. NORTHWEST RUSSIA: DEVELOPMENT OF THE WOODWORKING INDUSTRY AND OPPORTUNITIES AS A POTENTIAL MARKET AREA FOR FINLAND.

Pellervo Economic Research Institute Working Papers No.99. p. 62. ISBN 978-952-5594-62-1 (PAP), ISBN 978-952-5594-63-8 (PDF), ISSN 1455-4623 (PAP), ISSN 1796-4784 (PDF)

ABSTRACT: This study examines the export possibilities of the Finnish woodworking industry in Northwest Russia. In addition, among other issues, the development of Northwest Russia's economy and woodworking industry, the potential for market development and obstacles to market entry are examined. The study is based on statistics, literature and interviews of Finnish experts both in industry and in expert organisations. Northwest Russia is a very lucrative market area for the Finnish woodworking industry due to its proximity and economic growth. However, the buildings, which were mainly constructed during the Soviet era, have huge repair and maintenance needs. Similarly, due to the growth of the population in the biggest cities (e.g. in St. Petersburg), there is an increasing demand for new dwellings. Growth of the economy and increasing prosperity set higher requirements for construction and also for the use of wood products. Northwest Russia's own woodworking industry is also improving and hence a significant competitor for foreign companies exporting wood products to Northwest Russia. According to the expert interviews, there is large growth potential in markets for further processed wood products such as joinery products. In commodities (e.g. sawn timber and wood-based panels), Northwest Russia's own production is very competitive. The main strengths of Northwest Russia as a market area for the Finnish woodworking industry are related to the growth of the economy, the large market size and high quality of Finnish wood products. The main weaknesses, however, are related to fierce competition in the wood product markets, the lack of market information and the bureaucracy of Russian society.

Key words: *Northwest Russia, woodworking industry, Finland, export possibilities*

FLINK, Allan - JÄRVINEN, Erno – TOIVONEN, Ritva. 2007. LUOTEIS-VENÄJÄN PUUTUOTETEOLLISUUDEN KEHITYS JA MAHDOLLISUUDET POTENTIAALISENA MARKKINA-ALUEENA SUOMELLE. Pellervon taloudellisen tutkimuslaitoksen työpapereita nro. 99. 62 s. ISBN 978-952-5594-62-1 (PAP), ISBN 978-952-5594-63-8 (PDF), ISSN 1455-4623 (PAP), ISSN 1796-4784 (PDF).

TIIVISTELMÄ: Selvityksessä tarkastellaan suomalaisen puutuoteteollisuuden vientimahdollisuuksia Luoteis-Venäjälle. Lisäksi tarkastellaan muun muassa alueen talouden ja puutuoteteollisuuden kehitysnäkymiä, millä puutuotteilla on parhaat menestymisen mahdollisuudet ja mitkä ovat suurimmat ongelmat markkinoille pääsyssä. Tutkimuksen aineistona käytetään tilastoja, kirjallisuutta ja suomalaisten, teollisuudessa ja tutkimusorganisaatioissa toimivien asiantuntijoiden haastatteluja. Luoteis-Venäjä on suomalaiselle puutuoteteollisuudelle houkutteleva markkina-alue läheisyytensä ja nopean talouskasvun vuoksi. Valtaosin neuvostoajalta peräisin olevissa rakennuksissa on suuria peruskorjaustarpeita, myös uudisrakentamisen odotetaan olevan vilkasta, kun väestö keskittyy suurimpiin kaupunkeihin. Talouskasvu ja varallisuuden lisääntyminen asettavat rakentamiselle ja sitä kautta myös puutuotteiden käytölle korkeampia laatuvaatimuksia. Luoteis-Venäjän oma puutuoteteollisuus on kehittymässä ja merkittävä kilpailija puutuotteita alueelle vieville suomalaisyrityksille. Merkittävimmät puutuotteiden kasvumahdollisuudet asiantuntijahaastatteluiden perusteella ovat pitkälle jalostetuissa puutuotteissa kuten puusepäntuotteissa. Perustuotteissa kuten sahatavarassa ja puulevyissä Luoteis-Venäjän omaa tuotantoa pidetään kilpailukykyisenä. Asiantuntijahaastatteluiden perusteella Luoteis-Venäjän alueen merkittävimmät vahvuudet suomalaisten puutuotteita vievien yritysten näkökulmasta liittyvät nopeaan talouskasvuun ja markkinoiden suureen kokoon sekä suomalaisten puutuotteiden korkeaan laatuun. Suurimpia ongelmia viennin kannalta sen sijaan ovat kova kilpailu puutuotemarkkinoilla, markkinatiedon puute ja Venäjän markkinoilla toimimiseen liittyvä byrokraattisuus.

Avainsanat: *Luoteis-Venäjä, puutuoteteollisuus, Suomi, vientimahdollisuudet*

TABLE OF CONTENTS:

EXECUTIVE SUMMARY	1
TIIVISTELMÄ	3
1. INTRODUCTION	4
1.1. Background	4
1.2. Objectives.....	5
1.3. Data of the study	5
2. NORTHWEST RUSSIAN ECONOMY	7
2.1. Overall economic development	7
2.2. Business environment	9
2.3. Demographics	12
2.4. Real estate market	13
3. NWR'S FOREST RESOURCES AND FOREST INDUSTRY	14
3.1. Forest resources.....	14
3.2. Forest ownership and forest policies	15
3.3. Roundwood supply	18
3.4. Roundwood Exports from Russia to Finland	19
4. WOODWORKING INDUSTRY IN NWR	21
4.1. General information	21
4.2. Development of the forest industry since 1990	21
4.2.1. Russia	21
4.2.2. NWR.....	22
4.3. Russia's domestic demand 1990-2005	24
4.4. Foreign trade of forest products in NWR and Russian Federation.....	27
4.5. WTO impacts.....	29
4.6. Use of wood.....	30
4.6.1. In construction	30
4.6.2. In interior design.....	31
4.7. Wood product groups	31
4.7.1. Sawn timber	31
4.7.2. Wood-based panels	32
4.7.3. Joinery	36
4.8. Forest product markets in NWR	39
4.8.1. Production and consumption.....	39
4.8.2. Distribution	41
4.8.3. Customers and suppliers	42
5. EXPORT AND PRODUCTION POSSIBILITIES FOR THE FINNISH WOODWORKING INDUSTRY IN NWR	45
5.1. Northwest Russian wood products market.....	45
5.2. Finnish exports of wood products to Russia 1990-2006.....	45
5.3. Finnish producers in NWR.....	46
5.4. Results of the expert survey	48
5.4.1. Opportunities and threats related to the export of wood products from Finland to NWR.....	48
5.4.2. SWOT related to production possibilities in NWR.....	50
5.4.3. Position of Finnish wood products on the markets of NWR.....	50
6. CONCLUSIONS	52
REFERENCES	54
ANNEX 1 QUESTIONNAIRE: PRODUCERS	56
ANNEX 2 QUESTIONNAIRE: EXPERT ORGANIZATIONS	59

LIST OF FIGURES:

Figure 1.	The Northwest Russian Federal District	7
Figure 2.	Gross Regional Product of Russian Federal Districts in 2004	8
Figure 3.	Structure of industrial production in the NWFD in 2005	9
Figure 4.	Average industrial price of electricity	10
Figure 5.	Breakdown of venture investments according to Federal District in 1999-2004, % (USD bn)	11
Figure 6.	Monthly income per person according to Federal District in 2005	13
Figure 7.	Forest area available for wood supply in the Baltic Sea area	14
Figure 8.	Consumption of roundwood in Russia in 2002.....	19
Figure 9.	Industrial roundwood imports from Russia to Finland	20
Figure 10.	Production, export and apparent consumption of sawn wood in Russia 1992-2007	22
Figure 11.	Development of the profitability of the wood product industry in NWR	24
Figure 12.	Russian Federation's consumption of roundwood and sawn wood	26
Figure 13.	Russian Federation's consumption of wood-based panels	26
Figure 14.	Value of foreign trade of the NWR forest industry.....	27
Figure 15.	Structure of Russian forest product exports, 2003.....	28
Figure 16.	Product distribution of the Northwest Russian Forest Industry in 1999*	28
Figure 17.	Structure of forest products export value in Russia	29
Figure 18.	Development of plywood production 1993-2007	33
Figure 19.	Development of fibreboard production 1993-2007	35
Figure 20.	Development of particle board production 1993-2003	36
Figure 21.	Estimated trade flows of wood products in NWR in 2005	39
Figure 22.	Structure of forest product sales in Russia in 2001.....	40
Figure 23.	Share of imported components in furniture production, % of total consumption	44
Figure 24.	Development of exports of Finnish wood products to Russia from 1992-2006	46

LIST OF TABLES:

Table 1.	Macroeconomic indicators of Russia 1992-2008	8
Table 2.	Change in socio-economic indicators in Russia and the NWFD from 2004 to 2005	8
Table 3.	Price development of the Russian economy in various sectors	9
Table 4.	Investment ratings of the Northwest Russian regions in 2001-2002	12
Table 5.	Development of apartment buildings	13
Table 6.	Most common tree species in NWR.....	15
Table 7.	Import tariffs for major wood products exported from Finland to Russia in 2005	18
Table 8.	Harvesting volumes in NWR in 1994-2005	18
Table 9.	Export and import distribution of the NWFD and Russian Federation.....	19
Table 10.	Production volumes of NWR's woodworking industry	23
Table 11.	Production of the main wood products in NWR in 2003-2004.....	23
Table 12.	Main spheres of forest product consumption in Russia in 2000.....	25
Table 13.	Apparent consumption of sawn wood and wood-based panels, 1000 m ³	25
Table 14.	WTO impact on import tariffs of wood products produced in the Republic of Karelia	29
Table 15.	Largest sawn timber producers in NWR	32
Table 16.	Largest plywood producers in NWR	33
Table 17.	Fibreboard production and capacity utilisation rate in 2003.....	34
Table 18.	Largest fibreboard producers in NWR	35
Table 19.	Particle board production and capacity utilisation rate in 2003	36
Table 20.	Largest particle board producers in NWR	36
Table 21.	Largest furniture producers in NWR	38
Table 22.	Production and apparent consumption of the main wood products in NWR in 2003	41
Table 23.	Price indices of the main wood products in NWR	44
Table 24.	Average prices for selected wood products in NWR.....	44
Table 25.	The major Finnish investment projects in Russia's woodworking industry.....	47

Table 26.	Opinions of experts on the export possibilities of wood products from Finland to NWR .	48
Table 27.	Opinions of large exporters and producers on the export possibilities of wood products from Finland to NWR	49
Table 28.	Opinions of SME exporters opinions on the export possibilities wood products from Finland to NWR	49
Table 29.	SWOT analysis of NWR markets concerning the Finnish woodworking industry's production possibilities in NWR	50
Table 30.	The main competitors of Finnish producers on the wood product markets of NWR	51
Table 31.	Recommendations for Finnish exporters to successfully penetrate the NWR wood product markets	52

EXECUTIVE SUMMARY

The economic and political situation in Russia is perceived to be rather stable compared to the 1990s. The region of Northwest Russia is one of the centres of economic growth and its proximity to western market also makes it an attractive area for foreign investment. The main aspects of the macro-environment are the decreased level of inflation and relatively fast growth of incomes, which has further increased private and public spending and construction.

The good quality of Finnish products is also a strength of the Finnish woodworking industry in Russia. On the other hand, bureaucracy, fierce and simultaneously regulated competition and the lack of market information are generally considered as the main weaknesses or threats in Russian markets according to several Finnish experts interviewed for this study.

Most of the difficulties in gaining entry to the Russian market are not dependent on the macro-level aspects (thus also possibly being a point of improvement for Finnish exporters). For instance, the availability of market information can be improved by Finnish exporters by taking their own measures. In addition, the poor availability of market information is a similar problem for all market players. Likewise, a sales office is essential in all other markets having a different business culture from that, for instance, in Western Europe.

In markets for wood-based panels in Northwest Russia the main competitors are Russian producers, who can effectively compete in prices with any foreign producer. The position of Finnish wood products and the market prospects of high added value wood products such as furniture, joinery and wooden flooring are relatively good. The Finnish exporters' position in other wood product markets, e.g. for sawn timber and wood-based panels, is more challenging. Competitiveness in these products requires a fully-utilized economy of scale in production, as well as effective marketing channels.

The demand for wood products, especially boards and joinery, will remain stable and most probably expand in Northwest Russia. By not concentrating on the bureaucracy issues and informal aspects of the customs regulations, one could conclude that Northwest Russia's GDP and market growth present good opportunities for Finnish exporters in all product groups.

By concentrating on the development of marketing channels, brands, personnel as well as market information issues, the possibilities of Finnish wood product exporters may significantly improve. The export of high value added wood products, such as furniture and joinery, will probably also give the highest yield. The market-based approach has

also shaped marketing channels in the wood products industry. According to Finnish experts operating in Northwest Russia, although marketing channel logistic systems could be quite developed in some supplier groups, the main problem remains the punctuality and reliability of the deliveries of raw materials.

TIIVISTELMÄ

Tässä tutkimuksessa haastateltujen suomalaisasiantuntijoiden mielestä Venäjän taloudellinen ja poliittinen tilanne on jo kohtalaisen vakaa verrattuna esimerkiksi 1990-luvun loppuvuosiin. Luoteis-Venäjän alue on Venäjän nopeimmin kasvavia alueita. Läheisyytensä, raaka-aine resurssien ja markkinoiden koon vuoksi se on houkutteleva markkina-alue niin puutuotteita vieville yrityksille kuin investoijille. Talouskasvun odotetaan jatkuvan vilkkaana myös 2000-luvun jälkimmäisellä puoliskolla, inflaation odotetaan hidastuvan ja tulotason nousevan edelleen.

Suomalaisia puutuotteita pidetään asiantuntija-arvioiden perusteella Venäjällä laadukaina. Toisaalta byrokrania, tiukka ja säännelty kilpailu sekä markkinatiedon puute ovat venäläisen markkinan suurimpia ongelmia. Venäläiseen markkinaan liittyviin ongelmiin suomalaiset yritykset voivat omilla toimillaan vaikuttaa. Esimerkiksi markkinatiedon systemaattista keruuta voi tehokkaasti kehittää. Suomalaiset yritykset eivät myöskään ole ainoita, joilla ei ole markkinoista riittävästi tietoa. Sama koskee kaikkia muitakin Venäjälle puutuotteita vieviä maita ja yrityksiä. Ensinnäkin oma myyntikonttori on perustettava usein muillekin uusille markkina-alueille, joissa toimitaan eri tavalla kuin esimerkiksi Länsi-Euroopassa ja missä halutaan laaja markkinaosuus.

Puulevyissä venäläisten oma tuotanto on vientiyrityksiin verrattuna hinnaltaan hyvin kilpailukykyistä. Suomalaisten puutuotealan yritysten asema ja pitkälle jalostettujen puutuotteiden (esimerkiksi huonekalujen, lattiamateriaalien ja puusepäntuotteiden) kysyntänäkymät ovat asiantuntija-arvioiden mukaan hyvät. Sahatavarassa, puulevyjen tapaan, kilpailutilanne on huomattavasti haasteellisempi. Kilpailukyky venäläisen saha- ja puulevyteollisuuden kanssa edellyttäisi tehokkaimpia markkinointikanavia ja hinnaltaan nykyistä kilpailukykyisempää tuotantoa.

Puutuotteiden kysyntä Venäjällä jatkaa kasvuaan erityisesti puusepän- ja levyteollisuuden tuotteissa. Huolimatta venäläisen yhteiskunnan byrokraattisuudesta ja tiukasti säädellyistä markkinoista, Venäjä on suomalaiselle puutuoteteollisuudelle kasvava markkina-alue. Keskittymällä markkinointikanaviin, brändiin, henkilöstöön ja markkinatiedon saamisen tehostamiseen voidaan parantaa suomalaisen puutuoteteollisuuden kilpailukykyä Venäjällä. Parhaan kannattavuuden Venäjän viennistä suomalaiset yritykset todennäköisesti saisivat keskittymällä pitkälle jalostettuihin tuotteisiin.

1. INTRODUCTION

1.1. Background

Developed economies such as the USA, Western Europe and Japan suffered from slow economic growth at the beginning of the 2000s. Uncertainty over recovery encouraged many export-oriented forest industry companies to find new markets outside Europe.

Finding new market areas has also been the path of the Finnish woodworking industry, although the economic situation is likely to improve in our main market area in Europe. During 2006, round wood prices of saw logs in Scandinavia clearly rose. The prices of sawn softwood in Germany also significantly increased (over 10% from mid-June 2005 to mid-June 2006) (EUWID 2006). Prices rose further in the latter part of 2006.

The proximity of wood product markets in Northwest Russian (hereafter referred to as NWR) makes it attractive to the Finnish woodworking industry. When talking of proximity to markets one usually refers to faster delivery times and lower transportation costs, which can be considerable in certain product groups. The overall growth of the Russian economy has stimulated Finnish exports to Russia, as well as some significant investments. There was a severe economic collapse in Russia in August 1998 following a long recession. The Russian economy has also almost recovered from the slowdown in 2004-2005. Domestic demand has accelerated, propelled by further large terms-of-trade gains and a fiscal easing that entails saving less of such gains (IMF 2006).

The value of Russian imports doubled to USD 96 billion between 1999 and 2004, and in 2004 surpassed the pre-1998 level. The growth of imports also increased in 2005. Imports to Russia, measured by volume, grew by 15-30% during the first years of 2000. This is a clearly faster pace than the growth of domestic production, which has grown 4-12% during the same period. Strengthening of the rouble as well as the high demand for imports has placed Russia's own production in a challenging situation (BOFIT 2005).

The recovery in demand has been led by investments. While potential Gross Domestic Product (hereafter referred as GDP) growth in the IMF mission's assessment has edged up to 6-6.5 percent per year, resource constraints are tightening in both products and labour markets. Domestic demand continues to significantly outpace potential GDP growth, causing increasing leakage through imports. Exports are also hampered by emerging capacity constraints and now contribute little to growth, following a precipitous slowdown in oil extraction in 2004-05. Looking forward, the large terms-of-trade gains already in store and the fiscal relaxation entailed by the 2006 budget mean that domestic demand is set to continue to grow significantly faster than the potential GDP during 2006. The same pace is expected to continue in 2007. IMF forecasted real GDP

growth to amount to 6.5 percent in 2006 and to remain at or above the potential in 2007 (IMF 2006).

1.2. Objectives

The aim of the study is to explore the export possibilities for Finnish sawn wood and other wood products in NWR. The study addresses the following questions:

- What is the demand perspective for wood products in NWR regions?
- What kinds of wood products should be exported to NWR from Finland?
- What kind of problems and risks may Finnish wood product exporters face in NWR?

The objectives of this study are met by:

- presenting NWR's general economic characteristics as well as by presenting the wood product industry;
- describing NWR's wood products market;
- analysing the reasons for the growth/decline in production, changes in international trade and changes in prices and tariffs, and identifying systematic changes in production structures, sales and distribution channels;
- producing an opportunities and threats analysis of the Finnish wood products on NWR's wood products market;
- generating recommendations or appropriate measures from an analysis of opportunities and threats for Finnish exporters of wood products.

The study is conducted using literature and expert interviews, which cover NWR's economic outlook, forest resources and forest industry. These issues are addressed in Chapters 1 to 4. Chapter 5 will, by using an opportunities and threats analysis, concentrate on an examination of the export possibilities of Finnish wood products. Furthermore, based on the results of expert interviews, the Finnish wood working industry's investment environment and possibilities in NWR using SWOT analysis are also examined in Chapter 5. Finally, based on opportunities and threats analysis, recommendations for Finnish wood working industry will be presented in Chapter 6.

1.3. Data of the study

The primary data collected for this study consisted of interviews within Finnish private and public expert organizations involved in research on NWR's forest industry and forest product markets as well as its forest industry. The observation units of the study were chosen using convenience sampling. The use of convenience sampling was moti-

vated by the possibilities to choose the leading experts in the field as well as ensure a high response rate and insightful answers.

The primary data were collected using unstructured questionnaires, which are presented in Annexes 1 and 2. The total sample was 21, out of which 10 respondents returned the questionnaire. Thus, the response rate of the survey was 43%. The data were collected by mail survey between 1 June 2006 and 25 September 2006. The questionnaire contained four pages with an introductory letter. The respondents were contacted by telephone before sending the questionnaire in order explain the purpose of the survey as well as motivate them. The data from the mail survey were only analysed qualitatively. Due to the small number of observations no statistical analysis was carried out. In addition, no statistical comparisons were made between respondent groups.

The data describing the macro-environment were collected from official Russian statistical sources, primarily from the Russian Statistical Year Books 2004 and 2005, as well as OECD Economic Surveys from 2001-2002 and UNECE Timber Committee discussion papers. The micro-environment was mainly assessed using publications of the Research Institute of the Finnish Economy (ETLA) and the Finnish Forest Research Institute (METLA), which also covered the Russian and NWR forest sector. Russian domestic trade information was gathered from Russian Internet pages and printed sources from the Russian Federal State Statistics Service. International trade information was obtained from the United Nations Commodity Trade Statistics (UN COMTRADE) database. A great majority of the secondary sources were published after the year 2000.

Information about the economy of Russia and NWR is nowadays abundantly available, although data gathering can be laborious and reliability can be debatable. Furthermore, macro-economic data are usually heavily aggregated. Information about wood products trade on the industry level is seldom available from public sources, although Russian statistics covering these issues have been constantly improving.

2. NORTHWEST RUSSIAN ECONOMY

2.1. Overall economic development

NWR is officially recognised as the Northwest Federal District (hereafter referred as NWFD) of the Russian Federation. A map of the region is presented in Figure 1. NWR will be examined as an economic entity. The NWFD consists of 11 subjects of the Russian Federation: the Republic of Karelia, Republic of Komi, Archangelsk Region, Vologda Region, Kaliningrad Region, Leningrad Region, Murmansk Region, Novgorod Region, Pskov Region, the City of St. Petersburg and Nenets District (Figure 1). The administrative centre of NWFD is St. Petersburg. The total area of the NWFD is approximately 1.7 million square kilometres and it accounts for 9.8% of the area of the Russian Federation.

Figure 1. *The Northwest Russian Federal District*



Source: Dudarev G. et al. 2002

The NWFD accounts for 10% of Russia's GDP and holds fifth position among the Federal Districts in GDP formation (Figure 2). The NWFD also holds third position in GRP (Gross Regional Product) per capita among Federal Districts. All indicators of the Russian economy have developed favourably both in the Russian Federation and in the NWFD (Table 1 and Table 2). At the end of 2005 there were 132 000 unemployed in Russia, which corresponds to an unemployment rate of 7.2%.

Figure 2. *Gross Regional Product of Russian Federal Districts in 2004*

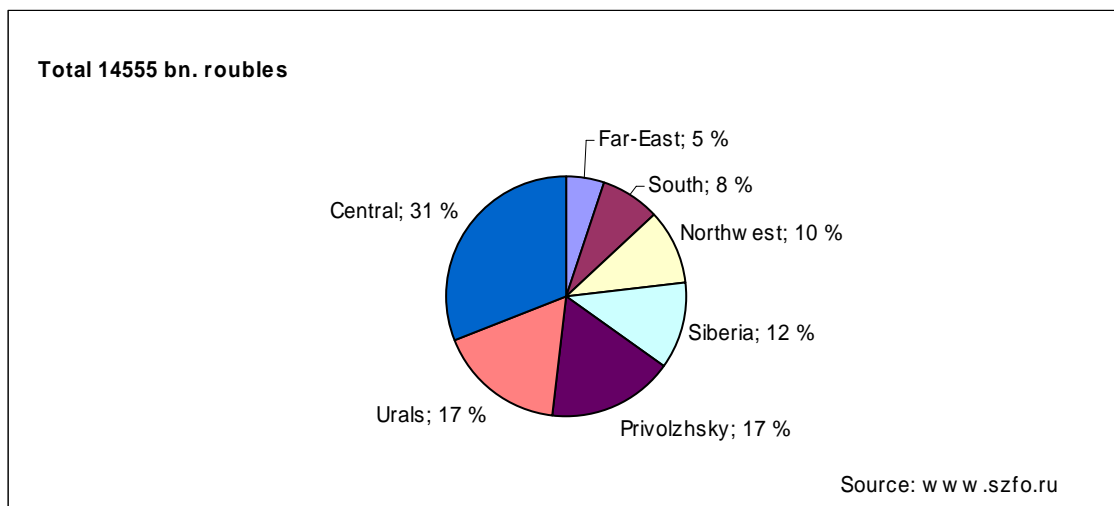


Table 1. *Macroeconomic indicators of Russia 1992-2008*

Indicator	1992	1996	1998	2000	2003	2004	2005	2006	2007	2008
GDP, % change	-14.5	-3.6	-5.3	10.0	7.3	7.2	6.4	6.7	6.3 f	6.0 f
Lending interest rate, %		147	41.8	24.4	13.0	11.4	10.7	10.5	9.9 (Q1)	
Construction, % change			-6.3	17.4	12.5	11.7	10.7	13.5	20.2 (Q1)	
RUB/USD ¹⁾	1247	5560	20.65	28.2	29.5	27.8	28.8	26.3	26.1 (Q1)	

Sources: Mutanen et al. 2005, Bank of Finland 2007, www.arqe.de 2007, www.uni-kiel.de 2007

¹⁾ At the end of the period

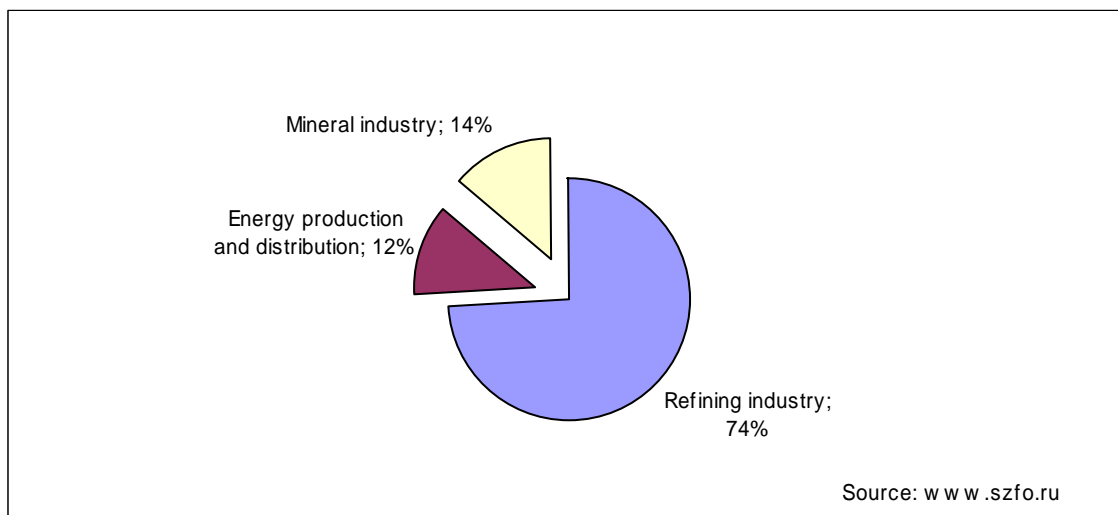
Table 2. *Change in socio-economic indicators in Russia and the NWFD from 2004 to 2005*

INDICATOR	2004=100	
	RUSSIAN FEDERATION	NWFD
Industry output index	104.0	105.9
Dwellings	106.3	106.2
Investments	110.7	110.8
Retail volume index	112.0	111.9
Real income	108.9	109.5
CPI	110.9	111.2
Registered unemployment	95.3	90.0

Source: www.szfo.ru

Industrial production plays a major role in the economics of the NWFD. It contributes almost 30% to the formation of the GRP (Figure 3). The refining industry accounts for three quarters of all industrial activities in the Northwest Russian region.

Figure 3. *Structure of industrial production in the NWF in 2005*



The price development in various sectors of the Russian economy continued to be rather rapid during the first years of 2000 (Table 3). However, the growth figures clearly slowed, for instance, between 1992 and 1995.

Table 3. *Price development of the Russian economy in various sectors*

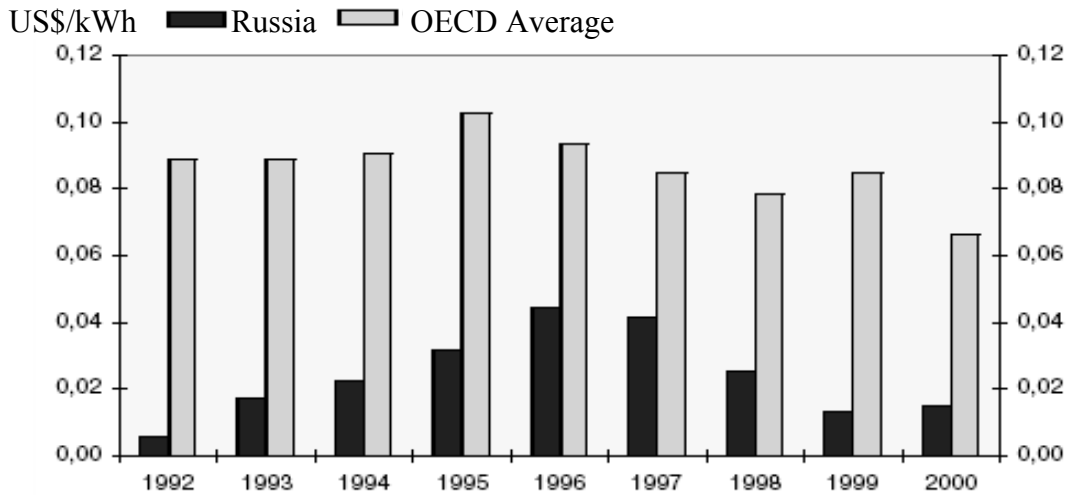
INDEX	1992	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
	¹⁾	¹⁾	%	%	%	%	%	%	%	%	%
Consumer price index (CPI)										7.5	7.0
	26.1	2.3	20.2	18.6	15.1	12.0	11.7	10.9	9.0	(Q1)	(est.)
Producers' price index for industrial output	33.8	2.7	31.6	10.7	17.1	13.1	28.8	13.4	nd	nd	
Producers' price index in construction	16.1 ²⁾	2.5	35.9	14.4	12.6	10.3	14.9	nd	nd	nd	

1) Relative increase from the previous year
 2) Average annual
 Sources: Federal State Statistic Service 2006, Bank of Finland 2007, www.arqe.de 2007, www.uni-kiel.de 2007

2.2. Business environment

Power consumption in NWR has fallen by 30% since 1990 as a result of reduced industrial output. However, industrial power consumption still represents approximately 50% of the total demand. Future power demand thereby depends on the fate of a few big industrial complexes. While traditional economic forecasts predict a 3% average growth in power demand in Russia, the situation in NWR is likely to be much higher than these figures. The demand for power is expected to fluctuate around the level of the mid-2000s, dependent on the world market for industrial goods and local power prices. Russian power prices fell dramatically after the devaluation of the rouble in 1998. Prices are steadily increasing and will reach pre-1998 levels, in proportion to US dollars, in 2006 or 2007. The fate of power demand in NWR is in the hands of the export-oriented power-consuming industries (The Power Market...2003). The average industrial price of electricity in Russia is still one third of the average in OECD countries (Figure 4).

Figure 4. *Average industrial price of electricity*



Source: OECD 2002

RAO “UES of Russia” (the Russian Stockholder Company “United Energy Systems of Russia”) is a vertical integrated holding company that combines most of the non-nuclear power generation, national transmission and dispatch infrastructure and distribution. RAO “UES of Russia” is the largest power company in Russia, with 155.1 GW of installed capacity. RAO UES directly manages the main national grid and the largest power stations. The rest of the high voltage grid and non-nuclear power generation is controlled through the regional “energors” (or regional energy companies such as “Leningroenergo”, “Kolenergo” and “Karelenergo”) in each Oblast (county) (The Power Market... 2003).

The investment climate in Russia was and remains the topic of numerous discussions and studies. The prevailing opinion is that the investment climate in NWR is essentially no different from that prevailing in the country as a whole, but there are significant differences among regions, connected both with the availability and various concentrations of basic factors of production (natural resources, workforce, etc.), and with the policies of local authorities.

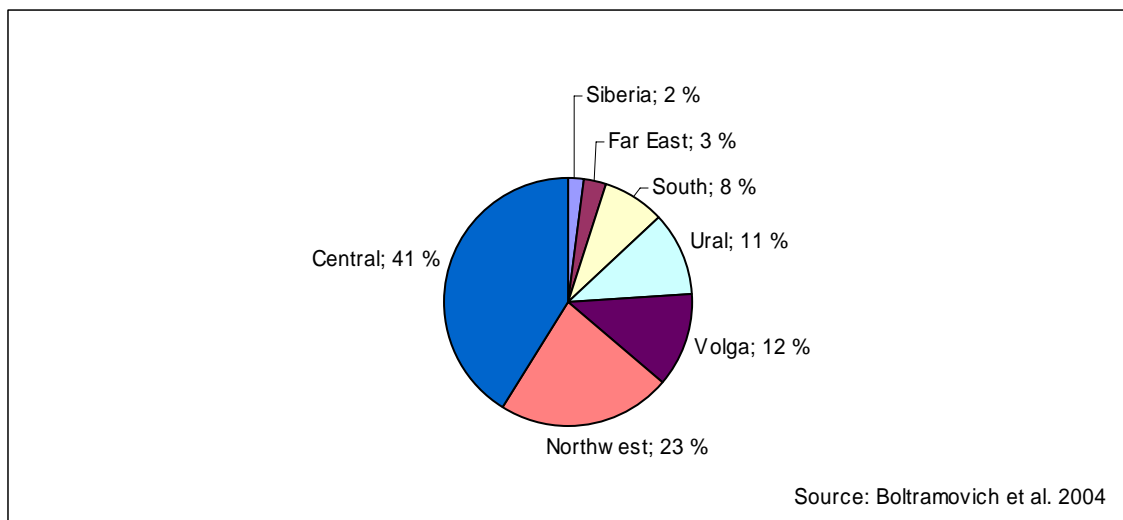
NWR can be described as an attractive business environment if measured by level of foreign investments and economic activity. In terms of foreign investments, the Central Federal District of Russia was the only region ahead of the NWFD (Figure 5). However, investments are distributed very unevenly inside the NWFD, with more than 86% allocated to St. Petersburg and the Leningrad Region. The food, tobacco and pulp and-paper industries, transport, communication, trade and catering are the most attractive sectors for foreign investments (Dudarev et al. 2002A).

The largest volume of foreign investment in NWR is found in St. Petersburg and the Leningrad Region. In the early years of the 2000s the share of these regions in the total

volume of foreign investment in NWR steadily grew, with the highest rates of investments being made in the tobacco industry, retail trade, communications and services.

The most attractive of the other regions for foreign investors have been the oil-rich Komi Republic and Nenets Autonomous District, and Novgorod Region. The latter does not possess vast natural resources, but its authorities have created highly favourable conditions for foreign investment within the framework of the unified federal legislation (Table 4). A different approach is demonstrated by the policy promoted by the government of the Republic of Karelia: this region has favourable prospects for international cooperation, primarily with Finland, but a number of unsuccessful investment projects initiated in the 1990s have resulted in a reserved approach to foreign businesses on the part of the local authorities (Boltramovich et al. 2004).

Figure 5. Breakdown of venture investments according to Federal District in 1999-2004, % (USD bn)



Despite the obvious interest displayed by Finnish businesses in the Russian economy, and the economy of NWR in particular, there have been no major investment projects led by Finnish companies, even though Finland is an active exporter of capital. In the mid-2000s, Russia was the destination of about 1% of Finnish foreign capital investment. Finland's share of the accumulated volume of foreign investment in Russia in 1996-2003 accounted for USD 1024 million, which was about 2% of the total accumulated foreign investments in Russia for that period. Finland's share in the accumulated FDI in Russia is higher and accounted for 3% of the total (seventh place among all countries investing in the Russian economy) (Boltramovich et al. 2004).

Current Finnish investment in the Russian economy is rather precisely located: NWR is the main playground for the investments, with about 80% of all investment being addressed here. Another 20% of investments are in Moscow and the Moscow Region, and

under 1% are in the rest of the country. In the early years of the 2000s Finland was the third largest investor in NWR (17% of the total) (Boltramovich et al. 2004).

Table 4. *Investment ratings of the Northwest Russian regions in 2001-2002*

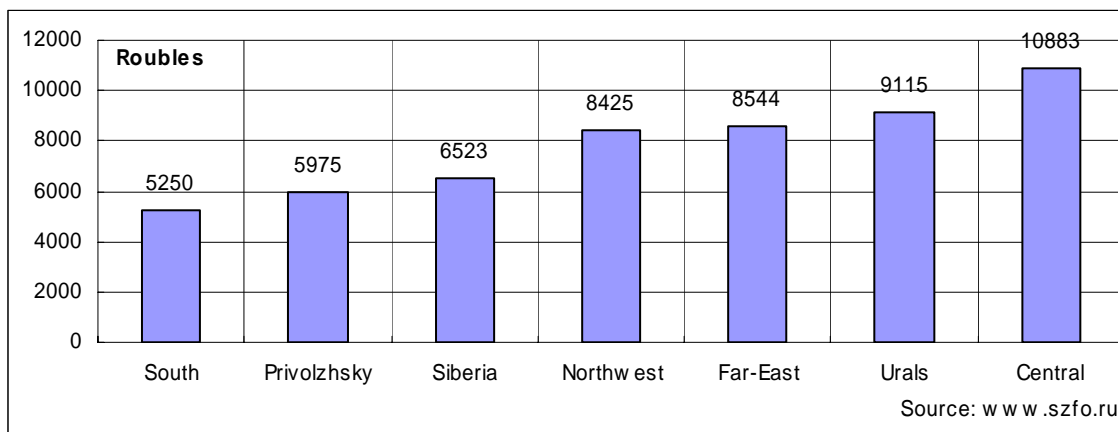
REGION	POTENTIAL RISKS	LOW MINIMAL	MIDDLE MODERATE	LOW MODERATE	INSIGNIFICANT MODERATE	LOW HIGH
St. Petersburg			X			
Republic of Karelia					X	
Republic of Komi						X
Archangelsk				X		
Vologda				X		
Kaliningrad				X		
Leningrad			X			
Murmansk				X		
Novgorod				X		
Pskov					X	
Nenetsk District					X	

Source: Boltramovich et al. 2004; original source: Expert RA 2003

2.3. Demographics

According to a recent All-Russia population census, there were 13.9 million residents in the NWFD in 2002. The urban population was 11.5 million persons (82% of the total) and the rural population 2.4 million persons (18% of the total). The most populated areas were the city of St. Petersburg (4.7 million) and Leningrad Region (1.7 million) (Federal State Statistic Service, All-Russia population census 2002). NWR can be classed as a successful region if measured by incomes (Figure 6). Only the Central Federal District, Urals Federal District and Far-Eastern Federal District precede the NWFD in income levels. However, those Federal Districts are either abundant in natural resources such as natural gas and oil or accumulate financial and other economic activities such as banking (www.szfo.ru). The average monthly income in Russia was about US\$408 (about 11090 roubles) in 2006. During the first three months of 2007 the average income reached US\$482. The World Bank forecasted in May 2007 that the average monthly income would exceed US\$500 in the Russian Federation in 2007. In 2005, the nominal income in the NWFD was 8425 roubles, which ranks fourth among federal districts.

Figure 6. *Monthly income per person according to Federal District in 2005*



2.4. Real estate market

The NWFD accounts for almost one tenth of household construction in Russia. Despite the influence of St. Petersburg the real estate prices remain under the Russian average (24 224 roubles per square metre in NWR, 25 394 roubles per square metre on average)

The Russian building and construction industry is booming. In 2005, the construction sector showed a 10% growth compared to 2004. Construction and building accumulated 7.2% of Russia's GDP in 2005. According to many indicators, construction is expected to grow strongly in the near future (Spiridovitch 2006).

In NWR, apartment building is proceeding as fast as in other regions of Russia, although the prices have not increased as rapidly as in Moscow. The average size of Russian apartments is constantly growing, reaching 86 square metres in 2004. The total number of new dwellings is presented in Table 5. Basic calculations show that approximately 41 000 new apartments were built in NWR in 2004.

Table 5. *Development of apartment buildings*

	1999	2000	2001	2002	2003	2004
Average size of apartment in Russia (m ²)	82.1	81.1	83.1	85.3	85.4	86.0
New dwellings in NWR (thousands m ²)	2531	2453	2436	2612	3255	3696

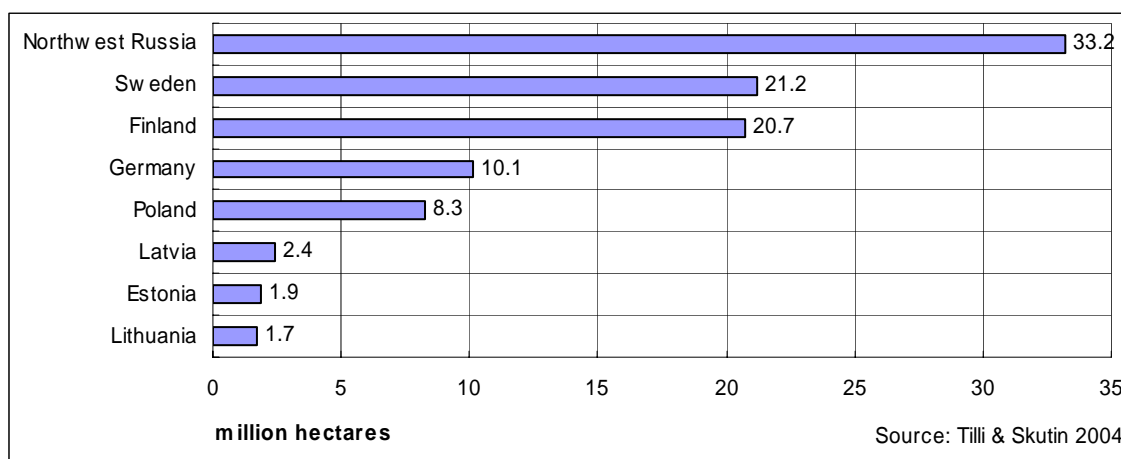
Source: Federal State Statistics Service 2005

3. NWR'S FOREST RESOURCES AND FOREST INDUSTRY

3.1. Forest resources

Russia possesses the largest forest stock in the world. The huge forest stock is usually considered as a competitive advantage of Russian forest industries as well as one of the main factors stimulating foreign interest in Russian forestry. *Russia's forest stock was ca. 81.9 billion m³ in 2001. More than a half (54%) of the total forested area of the European part of Russia (about 11% of the total Russian forest stock) and two thirds (67%) of boreal coniferous forests are located in NWR.* This region is of primary interest to forestry companies owing to its proximity to the markets of the EU (in comparison with other Russian regions). The Arkhangelsk Region and the Republic of Komi possess the largest forest stock in Northwest Russia. The Republic of Karelia as well as the Vologda and Leningrad regions also have considerable forest resources. The territories in which agriculture began to develop long ago (the Pskov and Kaliningrad regions), and also the areas far northern (the Murmansk Region and the Nenetsk district), do not have significant forest stocks. There are practically no forests in the Nenetsk district (Dudarev et al. 2002). The forest area covers 45.5 million hectares of NWR, but the ecologically and economically available forest area is about 33 million hectares. This is far more than in any other country in the Baltic Sea area (Figure 7).

Figure 7. Forest area available for wood supply in the Baltic Sea area



The growing stock volume in NWR is about 4 billion cubic metres, although the growing stock volume available for wood supply is 72% of the Northwest Russian total growing stock volume. The net annual increment in the forest available for wood supply in NWR is about 63 million cubic metres. The difference between the gross and net annual increment in NWR is clear. One reason for the high proportion of natural losses is the age structure of Russian forests. The proportion of mature and overmature forests is clearly higher than in Finland or Sweden. Another reason is the forest management,

which includes very little or no thinning or other intermediate cuttings (Tilli & Skutin 2004). The most common tree species are presented in Table 6.

Table 6. *Most common tree species in NWR*

	Area 1000 ha	%	Volume m. m3	%
Pine	2272	34	382	32
Spruce	1578	23	288	24
Larch	2.2	0	0.2	0
Cedar	0.1	0	0.0	0
Birch	2117	31	370	30
Aspen	567	8	136	11
Alder	237	4	33	3
TOTAL	6773	100	1209	100

Source: Karvinen et al. 2005

The forests of NWR are typically overmature and dominated by coniferous tree species. Coniferous forests occupy 57% of the forest area of NWR. Birch and aspen dominate in 39% of the forests (Karvinen et al. 2005). The total length of forest roads in the NWFD is approximately 235 000 km (www.drevesina.ru).

3.2. Forest ownership and forest policies

FOREST CODE OF 1997

The ownership and management of forest areas is regulated by the Forest Code of 1997. According to the legislation, all forest areas belong to the Federal State, although the management of the forests is dispersed between the Federal centre and the local authorities. The right of possession can be obtained through a lease or concession agreement between the leaseholder and the local authority. The use of forests is divided into either long-term lease and concession agreements or to short-term leases. Long term agreements are granted for 10-99 years through open tender. In practice, lease agreements are quite short, 5 years at most. Short-term lease agreements are in practice timber auctions. A short-term agreement does not include obligations for reforestation. The short-term leaseholder carries out harvesting in accordance with an authorized harvesting plan.

NEW FOREST CODE

The Forest Code of 1997 was updated for many years. Hundreds of amendments were added to the previous forest code. The work to develop a new forest code was implemented by the State Duma in 1997. The main objectives of the new forest code were to increase the economic value of forests by intensifying forest management measures and to increase the stumpage price of timber. A significant issue of the new code was also

the reallocation of management and control functions of the state. Additionally, the new code pursued the transfer of forest management responsibilities (such as reforestation and forest roads) from the state to private leaseholders. Furthermore, in the new Forest Code, the long-term lease is the main form of possession right and includes compulsory reforestation and forest management obligations (Petrov 2005).

The new version of the Forest Code was approved by Russian parliament, the state Duma, in November 2006 and it came into force on 1 January 2007 after having been approved by Federation Council and signed by the president. Forest management, monitoring, and use supervision will be formally decentralized. In other words, governments of the Russian administrative units (oblasts, krai, republics, or okrugs) will be responsible for managing, protecting, using, and regenerating forests in their jurisdictions. At the same time, most of the forests will remain under federal ownership, and laws and regulations regarding forest management will be established at the federal level. Similarly, income from forest use will flow into the federal budget and will subsequently be distributed to the regions through task-specific subventions.

The maximum leasing period for commercial forests has been reduced from 99 years in the original draft to 49 years. However, the minimum leasing period for new concessions will increase from 13 months to 10 years. Private ownership of forests that are not part of the forest fund has become possible. This includes forests within human settlements. Private construction without land category change is also possible in forests under the jurisdiction of the hunting management agency, recreational and religious activities, and several other instances.

Forest lessees will have new responsibilities for forest management. However, the Code does not presume any concrete requirements. Forest inventory and other management work will have to be assigned based on a tender, in which anyone can participate independently of license and accreditation. Concessions and areas for leasing will be given based on an auction system, not on tender. Forest management planning and government inventory of forests (over which the government has a monopoly) will be divided. The government will hold control over forest monitoring, forest registry, cadastre, forest land development plans (which will substitute logging plans), and management regulations (which will substitute organization and forest management projects). It will take a long period of time to develop the regulatory documents that will interpret law as practical instructions. (www.forest.ru/eng/news)

EXPORT DUTY DEVELOPMENT

The Russian Government is looking to shift the timber industry away from raw material exports and increase the local production of value-added wood products. To achieve this goal, the Government is looking to apply a selective tariff policy that gives preferential

rates to exports of value-added forestry products. In the past several years, the Government has approved a number of resolutions lowering export duties for several categories of value-added forestry products, while raising duties on unprocessed forestry products. Some increases are being made in multiple steps to help buffer the impact on the local industry, particularly on employment levels. Beginning on 1 January 2006, a single export duty for unprocessed forestry products was established at the rate of 6.5%, but not less than 4 euros per cubic metre. This represented an increase of around 1.55 euros per cubic metre.

The Government Commission on Foreign Trade Protection and Customs Tariff Regulations is working to adjust the remaining export duties for unprocessed wood and finished products. Beginning in January 2007, export tariff rates for unprocessed wood, except for coniferous species, were set at 10% of the customs value, but not less than 6 euros per cubic metre. In the first phase, the biggest impact is likely to be on exports of coniferous pulpwood. In addition, the export duty for sulphate pulp, the main export category, was set to zero beginning on 21 January 2006. This follows on from several changes to pulp duties in 2002-2003 and is aimed at stimulating pulp exports. Export duties have been reduced to zero on sulphate pulp and increased on unprocessed wood as part of a programme to redress the current imbalance in industry trade patterns.

As earlier mentioned, Russia uses export regulation in timber trade. As long as Russia is not a WTO member, there is little chance of affecting such measures. The Russian government decided to increase the export duty levied on roundwood timber – excepting birch and aspen timber with a diameter of less than 15 cm (until 2011) – from 6 euros to at least 10 euros per cubic metre. These changes took effect on 1 July 2007. From the beginning of April 2008, the export duty on roundwood will increase by 25% of the customs value, but not less than 15 euros per cubic metre. A further increase of 80% of the customs value or 50 euros per cubic metre (excluding birch pulpwood) is scheduled for the beginning of 2009.

The new import tariffs will increase the costs of wood imported by Finnish producers by 15-20 million euros annually. The rising price of round wood will complicate long-term procurement planning and increase uncertainty in roundwood procurement, especially in the case of the sawmilling industry (FFIF).

Russia also imposes tariffs on wood product imports varying from 5% for cork products to 20% for wooden furniture. The import tariffs on major Finnish wood products are presented in the following Table 7.

Table 7. *Import tariffs for major wood products exported from Finland to Russia in 2005*

	CN Group Code	Product description	Rate of duty in €	Rate of duty in % of customs value
1	4407	Planed timber		15%
2	4410	Particle board		15%
3	4411	Particle board		15%
4	4412	Plywood		15%
5	4415	Wooden Packages		15%
6	4418	Joinery		15%
7	4421	Others		15%
8	940(330)	Furniture	not less than € 0.6/kg	20%
9	940(340)	Furniture	not less than € 0.8/kg	20%
10	940(360)	Furniture	from €0.75/kg to € 1.8/kg	20%

Source: Russian Federal Customs Service 2006

3.3. Roundwood supply

The level of roundwood supply did not dramatically change between 1995 and 2001 (Tilli & Skutin 2004). The annual allowable cut (AAC) in NWR has been about 100 million cubic metres (under bark), while the actual harvesting volumes in the 1990s were about half of the AAC (Table 8). The actual harvesting volumes only exceed two thirds of the AAC in the Republic of Karelia, owing to its proximity to the Finnish market and developed forest road network. (Dudarev et al. 2002B).

Table 8. *Harvesting volumes in NWR in 1994-2005*

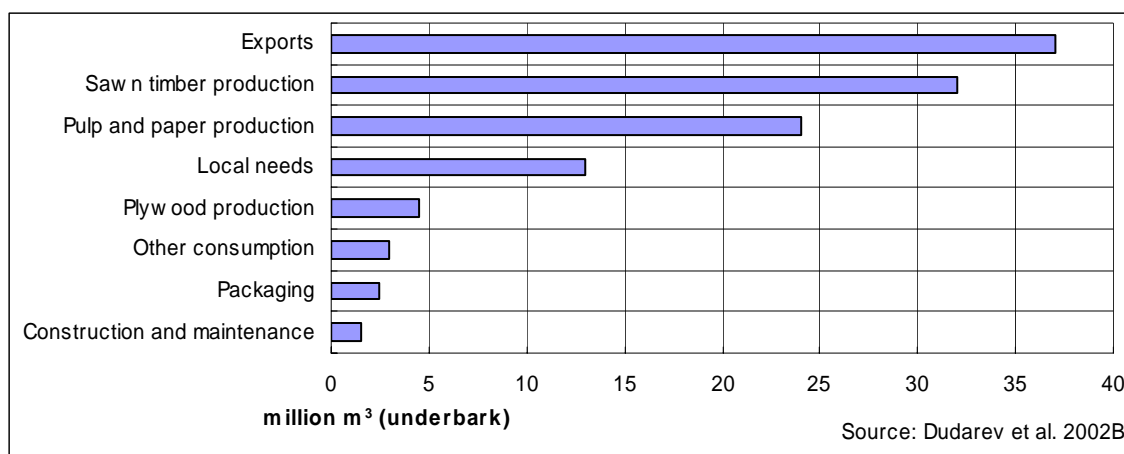
DISTRICT	1994	1995	1996	1997	1998	1999	2004	2005
	of allowable cut						m. m³	m. m³
	%	%	%	%	%	%	Excl. thinnings	
NWFD Total	37.4	40.1	32.5	31.5	33.8	42.3	36.79	43.6
Republic of Karelia	64.6	66.3	60.3	60.3	65.3	71.6	6.07	5.9
Republic of Komi	27.6	31.9	21.8	17.8	19.5	25.9	6.32	6.5
Arkhangelsk Region	40.6	41.0	36.4	36.7	36.4	47.1	9.37	10.6
Vologda Region	40.0	40.6	29.9	30.1	32.3	42.0	6.75	10.3
Kaliningrad Region	34.7	49.8	36.6	24.1	26.3	51.4	0.11	0.2
Leningrad Region	36.5	46.1	36.8	36.8	38.8	49.5	4.1	5.5
Murmansk Region	25.0	24.3	26.5	17.5	14.1	23.2	0.13	0.1
Novgorod Region	36.2	37.9	32.8	32.8	40.7	44.9	3.27	3.4
Pskov Region	21.2	25.0	19.4	22.2	25.7	33.5	0.71	1.1

Source: Dudarev et al. 2002B, www.idanmetsatiето.fi

Roundwood production in 2002 in Russia totalled 162 million cubic metres and apparent consumption 124 million cubic metres (Figure 8). About one third of the harvested

timber is exported. The largest domestic roundwood consumers are sawmills and pulp and paper mills.

Figure 8. Consumption of roundwood in Russia in 2002



NWR's share of Russian wood and paper exports is approximately 43%, of which circa 93% is exported to non-CIS countries. The Table 9 shows the export and import distribution for wood and pulp-and-paper products of the NWFD and the Russian Federation with non-CIS countries in 2003.

Table 9. Export and import distribution of the NWFD and Russian Federation

9 months of 2003, million \$	Export (CN Codes 44,47, 48*) non-CIS countries	Export value all products	Import (CN Codes 44,47,48*) non-CIS countries	Import value all products	Development of imports from non-CIS countries in 2003, % (2002=100)
Russian Federation	3 464	51 923	1 068	22 874	118.4
NWFD	1 495	5 327	348	4 553	123.0

*CN Codes 44 (wood and products from wood), 47 (pulp), 48 (paper)
Source: Russian Federal Customs Service 2004

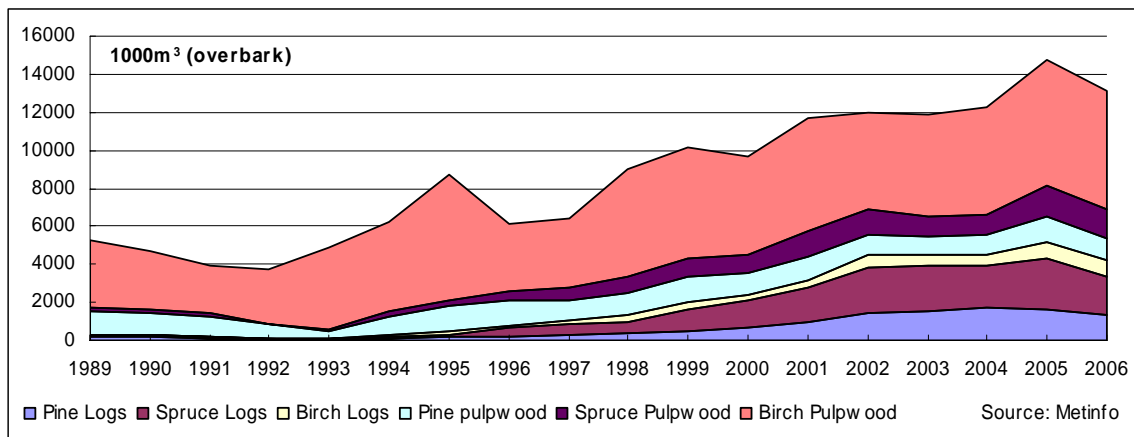
3.4. Roundwood Exports from Russia to Finland

Most of the roundwood exports from the western part of Russia are directed to the current area of the European Union (EU 25). Finland is the most important European importer of Russian coniferous roundwood, accounting for about 20 per cent of the total Russian coniferous round wood exports during 1997 to 2002.

Most of the Russian roundwood exports to the EU area originate from NWR. Although no reliable or detailed statistics on roundwood exports or the distribution of assortments from NWR exist, the export volumes to Finland provide a good approximation of the evolution of the total roundwood exports to the European Union.

The total roundwood imports from Russia to Finland more than tripled from the early 1990s to 2005, amounting to almost 15 million m³ in 2005. In 2005 an exceptional amount of roundwood was available. Due to a storm in Sweden and the Baltic Sea Region in January 2005, the Swedish forest industry had no need for roundwood imports. In addition, the transition period in the Finnish forest taxation expired and the Finnish forest industry wanted to guarantee roundwood availability by importing more roundwood than in earlier years. Therefore, roundwood imports slightly decreased in 2006 (Figure 9). Russia's share has been approximately 80% of the total roundwood import to Finland. About 20% of the total industrial use of roundwood in Finland is covered by Russian wood (Mutanen et al. 2005).

Figure 9. Industrial roundwood imports from Russia to Finland



4. WOODWORKING INDUSTRY IN NWR

4.1. General information

Timber processing is concentrated in the western part of European Russia, although the main forest resources are in Siberia and the Russian far-east. This concentration is due to the relatively good transport network as well as the proximity to European markets. The enterprises of the forest industry are mainly private or have joint ownership (private and public). There were quite many purely state- or commune-owned enterprises in the mid-2000s. The proportion of state-owned enterprises in the forest industry was 4% in 2002. During recent years the Russian forest industry has concentrated on bigger industrial groups by forming vertical integrates. They are not only able to conduct refinement, but also to take care of harvesting and forest management measures (such as reforestation) (Karvinen et al. 2005).

4.2. Development of the forest industry since 1990

4.2.1. *Russia*

In 1989, Russia was ranked second in the world (after the USA) in wood removals, the production of sawn wood and wood-based panels. Russia also took one of the leading places in the world's production of pulp, paper and paperboard. Over the period from 1980 to 1990, wood removals grew by 7.9%, production of sawn wood 5.7%, plywood 18.4%, particle board 57.3%, fibreboard 29.7%, pulp 23.3%, and paper and paperboard – 12.6%. High volumes of forest industry production in the 1980s were secured by State-supported modernization of facilities and the construction of new logging, wood-working and pulp and paper enterprises, as well as by the heavy demand for forest and paper products on domestic and foreign markets (UNECE 2003).

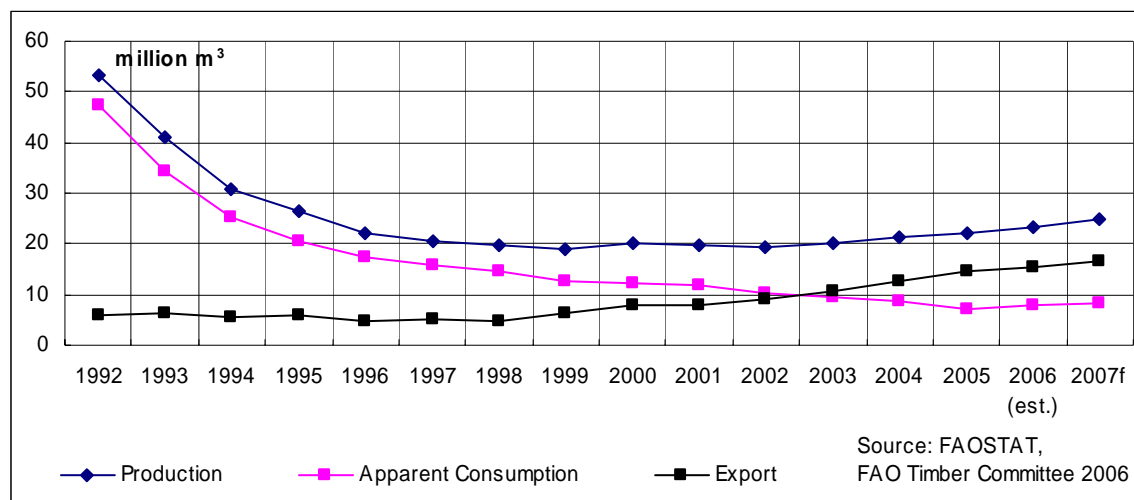
In the 1990s, as a result of radical economic and institutional reforms, the production volume of the forest industries in Russia markedly decreased. The decline in the forest industries, for instance in the sawmilling industry, reached its lowest point in the latter part of the 1990s (Figure 10). After the economic crisis in August 1998, production volumes grew due to favourable world market prices and the devaluation of the rouble, which made domestic manufacturing profitable. The production volumes, however, are still much lower than in the pre-reform period (Dudarev et al. 2002B). Since 1999 the situation has stabilized and many branches of the forest industry have shown significant growth, although the profitability of these has not developed at the same speed (Karvinen et al. 2005) (Figure 11 and Table 11).

The economic crisis, which reached its peak in August 1998, forced the Government to make alterations to the budget-and-monetary system, tax, credit and tariff policy. The measures that were taken made it possible to improve the economic and financial situation in the country in 1999 and 2000. GDP growth amounted to 3.5% in 1999 and 7.7% in 2000, while the respective growth of industrial output was 8.1% and 9.1%, and that of investments in fixed capital 5.3% and 1.4%. The situation in the forest and forest industry sector also improved.

In 1999 and 2000, there was clear increase in the production of all types of forest products. The highest growth rates were observed in the production of plywood (20.1 and 11.8%), particle board (26.7 and 19.2%), fibreboard (25.8 and 14.2%), and paper and paperboard (26.1 and 15.5%) (UNECE 2003).

The development of Russia's export and apparent domestic consumption of sawn wood in 1992 to 2007 is also presented in Figure 10. The form of the apparent consumption figure was rather identical to production figure until 2001, but since then it seems that consumption has slightly decreased. The apparent consumption figure should, however, be interpreted with caution as during the years 2000-2005 the Russian economy grew very rapidly. This means that sawn timber consumption should also have increased.

Figure 10. *Production, export and apparent consumption of sawn wood in Russia 1992-2007*



4.2.2. NWR

NWR has the most developed forest industry in Russia. More than 50% of Russian forest products have been produced in NWR (Dudarev et al. 2002B). The major products of the mechanical woodworking industry of NWR are sawn timber, plywood, fibre- and particle board, and furniture (Table 10).

Table 10. *Production volumes of NWR's woodworking industry*

DISTRICT	1995	1996	1997	1998	1999
Sawn timber, million m ³	5.6	4.4	4.2	3.8	4.8
Plywood, thousand m ³	255.6	265.5	322.8	408.8	513.5
Particle board, thousand m ³	408.7	204.2	238.9	322.1	404.1
Fibreboard, million m ²	51.3	41.7	53.2	41.8	51.3
Pulp chips, thousand m ³	1332	931.7	928.9	1011	1437
Wooden railroad ties, thousand	1124	1013	903	693.2	569.2

Source: Dudarev et al. 2002B

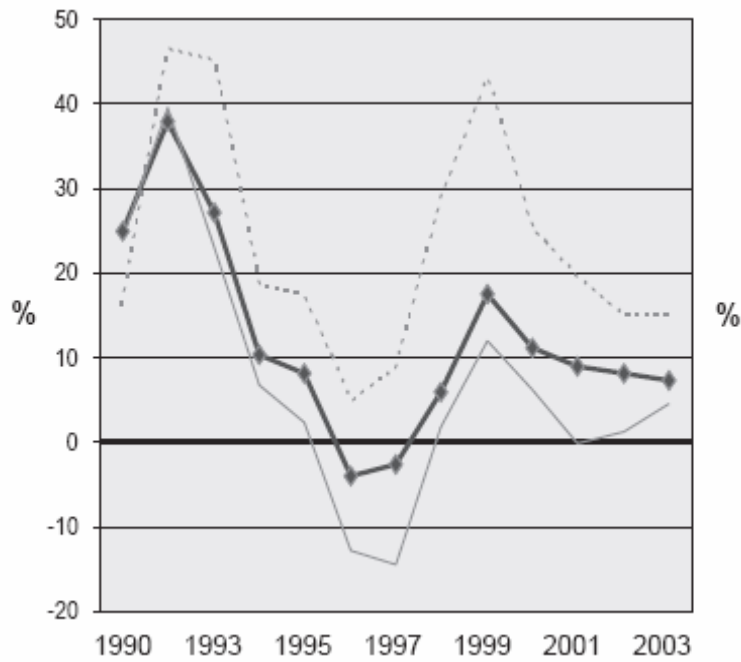
The NWFD's share of Russia's total sawn wood output was 27% in 2003 (Table 11) (Dudarev et al. 2002B). There is a high concentration of forest companies in NWR as compared with other Russian regions. More than one in three Russian harvesting and woodworking companies operate in NWR.

Table 11. *Production of the main wood products in NWR in 2003-2004*

	Production Russia		Change of production in 2003 compared to previous year,%		Share of NWR in the production of Russian Federation in 2003, %
	2003	2004	Russia	NWR	
Sawn timber m. m ³	20.2	21.4	+6	+10	27
Particle board m. m ³	3.2	3.6	+13	+20	26
Plywood m. m ³	2.0	2.2	+9	+7	39
Fibreboard m. m ²	321.0	342	+4	+1	19

Source: Karvinen et al. 2005

Figure 11. *Development of the profitability of the wood product industry in NWR*



Source: Karvinen et al. 2005

- ◆— Wood product industry
- Sawmilling industry
- - - Plywood industry

* profitability: profit before tax and interest depreciations divided by the sum of tangible and intangible assets.

4.3. Russia's domestic demand 1990-2005

An estimate of the total consumption of forest products in separate regions of the country shows that the European part, mainly Central, Privolzhsky and Southern regions, accounts for 70% of the consumption of industrial wood, products of wood processing and the pulp and paper industry. It should be stressed that technical progress contributes to expansion of the spheres of wood utilization. At the same time, the structure of forest products consumption is changing: consumption of unprocessed wood (round wood) is declining and that of products of high-degree chemical wood processing is growing (UNECE 2003).

During the years of economic reform, the per capita consumption of forest products also fell: sawn wood from 0.401 m³ in 1990 to 0.084 m³ in 2000, wood-based panels from 0.057 m³ to 0.025 m³, respectively, and paper and paperboard from 43.1 kg to 24.1 kg. In 2000, the per capita consumption of forest products was several times lower compared to other countries (e.g. USA, Canada, Finland, Sweden and others). For example, the per capita consumption of paper and paperboard in the USA is 351 kg, whereas in Russia it is 24.1 kg. The primary reasons for the fall in domestic consumption of forest

products in 1990-1998 are directly related to the economic and financial crisis in the country and in the branches of the industry during the transition period (UNECE 2003). The structure of forest products consumption is presented in Table 12 and Table 13.

Table 12. *Main spheres of forest product consumption in Russia in 2000*

SECTOR	INDUSTRIAL WOOD		SAWN WOOD		WOOD-BASED PANELS		PAPER AND PA- PERBOARD	
	million m ³	%	million m ³	%	1000m ⁴	%	1000 tons	%
Construction	0.9	1.2	5.8	47.2	395	10.8		
Repair / installations of buildings	0.7	1.0	2.83	23.0	271	7.4		
Furniture production			0.52	4.2	2204	60		
Mining industry	1.3	1.8	0.16	1.3				
Containers and packaging	0.5	0.7	2.19	17.8	52	1.4	1275	36.5
Machine building			0.7	5.7	106	2.9		
Printing							2215	63.5
Other needs	2.0	2.7	0.1	0.8	644	17.5		
Total	5.4	7.4	12.3	100	3672	100	3490	100
Wood processing, saw- milling, wood-based panels	40.7	55.6						
Pulp and paper production	27.1	37.0						
TOTAL	73.2	100	12.3	100	3672	100	3490	100

Source: UNECE 2003

Table 13. *Apparent consumption of sawn wood and wood-based panels, 1000 m³*

Europe	2000	2001	2002	2003	2004	2005	Change 2004-
							2005 in %
Sawn wood	111 378	107 386	107 807	110 692	114 233	117 806	3.1
Panels	55 552	54 676	54 255	56 526	63 637	65 843	3.5
Total	166 930	162 062	162 062	167 218	177 870	183 649	3.2
of which: EU25							
Sawn wood	98 084	94 992	93 905	96 471	99 249	101 812	2.6
Panels	50 023	49 772	48 660	49 981	55 873	56 516	1.2
Total	148 107	144 764	142 565	146 452	155 122	158 328	2.1
CIS							
Sawn wood	16 213	15 364	13 226	12 396	11 990	10 363	-13.6
Panels	5 133	5 998	6 702	8 165	9 104	10 713	17.7
Total	21 346	21 362	19 928	20 561	21 094	21 076	-0.1

Source: UNECE 2006

Over the period from 1990-2000, all spheres experienced a reduction in consumption. In construction, for instance, consumption decreased by more than 80%. This was related to a general decline in construction, including housing construction, which had always been the major consumer of forest products (UNECE 2003).

The consumption of forest products for building repairs and installations was reduced by more than 75%, although the number of houses and buildings grew slightly during that period. Such a situation cannot last long: the service life of wooden elements in construction does not exceed 50 years, and the buildings have not been repaired for many years. The consumption of forest products in container and package production was directly proportional to the decline in production: no product means no packaging. Shipping containers are mainly needed by light industry, as well as in electronics and machine building. While analysing the changes in the structure of consumption of forest products, one other phenomenon should be pointed out. Competition emerged between domestic and imported goods for some important items. Over recent years, the demand for high-quality imported furniture, wallpaper and joinery (windows, doors, linings, parquet) has grown (UNECE 2003). The development of Russia's domestic consumption of major forest products 1990-2005 is presented in Figure 12 and Figure 13.

Figure 12. *Russian Federation's consumption of roundwood and sawn wood*

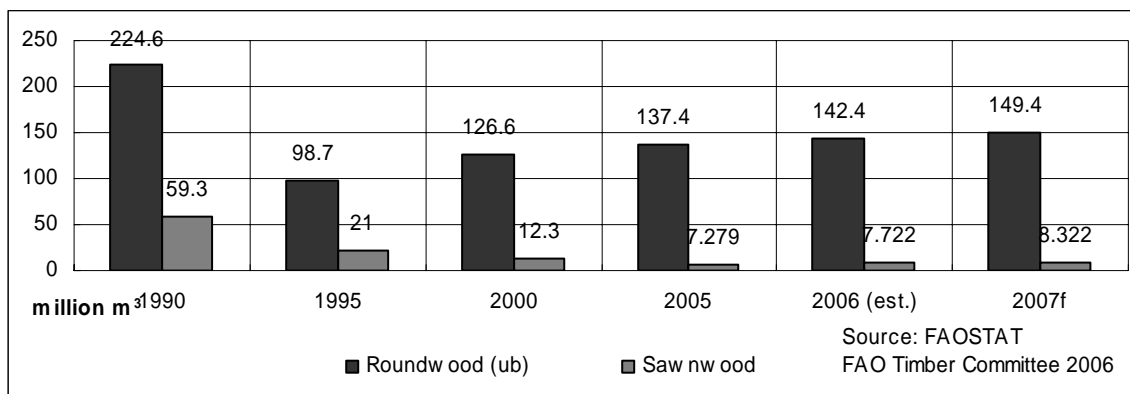
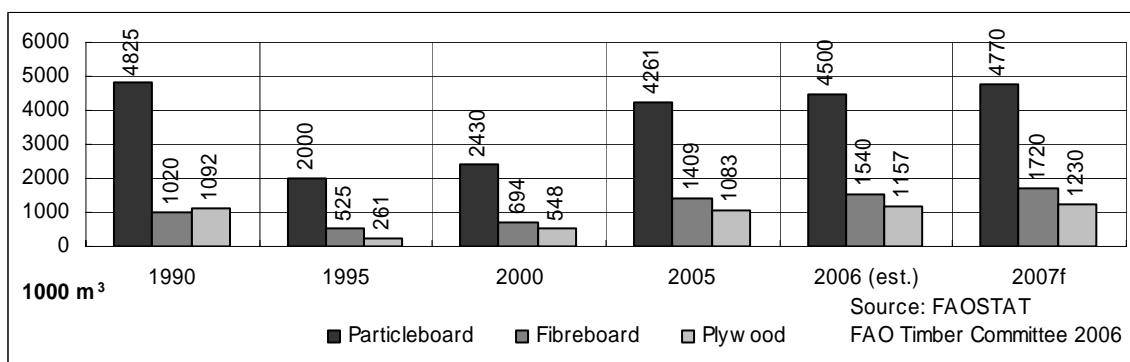


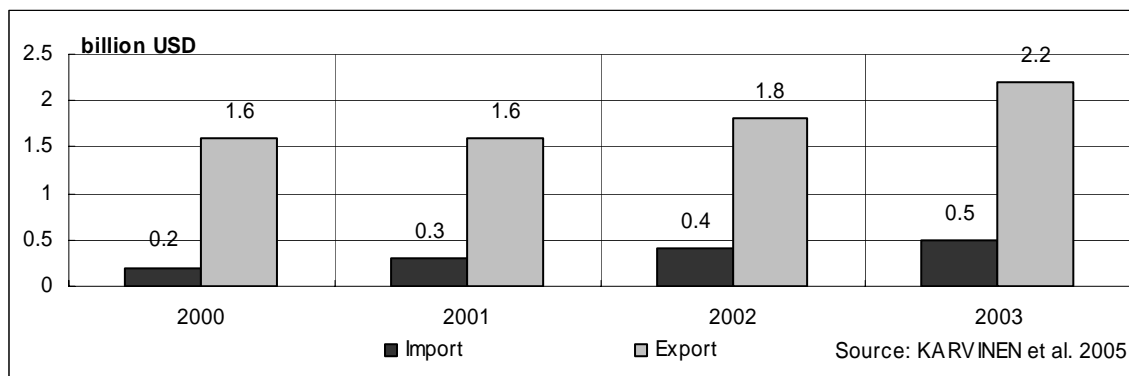
Figure 13. *Russian Federation's consumption of wood-based panels*



4.4. Foreign trade of forest products in NWR and Russian Federation

NWR's share of total Russian exports did not exceed 10% in the mid-2000s. The share of forest products exports, however, is substantially higher. In 1999, about 29% of Russian industrial wood exports, 35% of plywood exports and 40% of paper exports were supplied by NWR companies (Dudarev et al. 2002B).

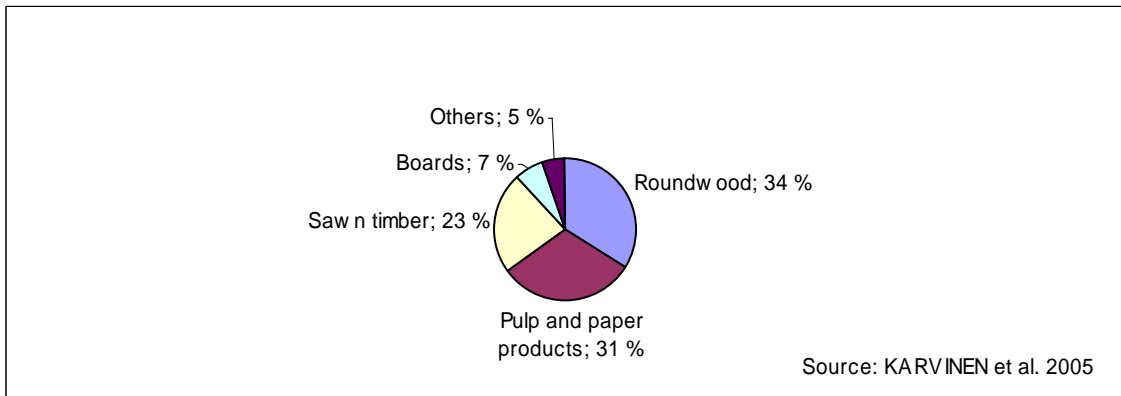
Figure 14. Value of foreign trade of the NWR forest industry



Industrial wood has for years been the most important export commodity of the Russian forest industry, and its exports have grown continuously. Russia is the biggest roundwood exporter in the world: in 2003 the volume of roundwood exports was 38 million cubic metres (underbark), which is one third of all roundwood exports in the world. The biggest roundwood exporters in NWR were the Republic of Karelia and Vologda Region. Some areas export up to 70-80% of all roundwood production. The significant export regions also import substantial amounts of roundwood from other regions for further export. For example, forest enterprises of the Republic of Karelia imported almost one million cubic metres (underbark) of roundwood, mainly from Archangelsk and Vologda regions. The biggest importers of Russian roundwood in 2003 were China (37%), Finland (32%), Japan (14%) and Sweden (6%) (Karvinen et al. 2005).

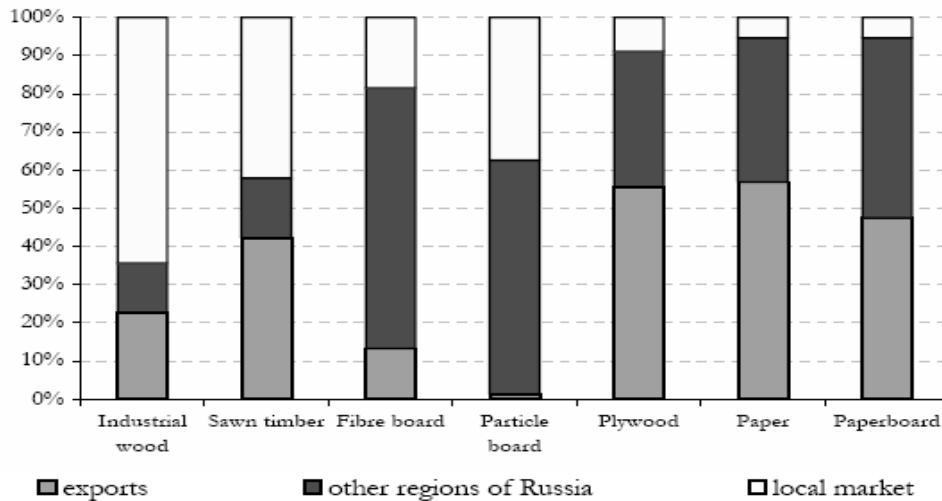
The value of forest product imports to Russia in 2003 was USD 2.4 billion. The share of pulp-and-paper products was roughly 60% of the import value. In 2002, Russia imported particle boards to the value of USD 65 million and fibreboard imports totalled USD 43 million. Wood products, such as joinery and construction materials, are mostly imported from Finland, Germany, Slovenia and Italy. Boards (particle board, fibreboard, MDF, OSB) are mainly imported from Belarus, Poland, France, Estonia and Finland. For the time being, the majority of MDF used in Russian furniture production is imported, but as domestic supplies increase and quality improves, imports are expected to decline. The level of wood product imports is connected to the development of the value of the Russian rouble: a strong Russian currency stimulates imports (Karvinen et al. 2005).

Figure 15. *Structure of Russian forest product exports, 2003*



The cost structure is one of the indices determining the efficiency of forest exports (Figure 16). High shares of roundwood in total currency earnings are characteristic of Russian forest exports. Over the last ten years the structure of Russian forest exports has undergone practically no changes. In 1990, roundwood accounted for 35% of currency earnings, while the figure in 2000 was 33%. In the pulp and paper industry the respective shares were 33 and 36%.

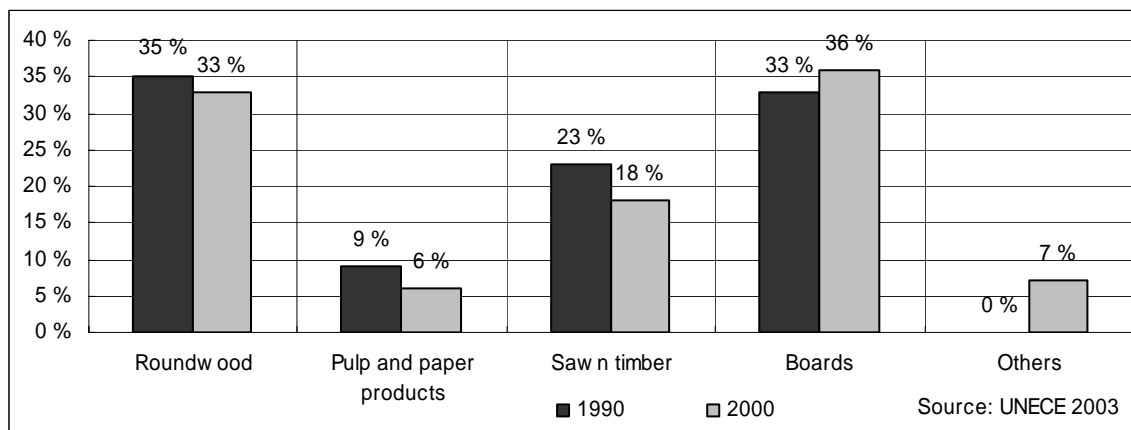
Figure 16. *Product distribution of the Northwest Russian Forest Industry in 1999**



*market pulp exports data are not available

Source: Dudarev et al. 2002B

Figure 17. *Structure of forest products export value in Russia*



4.5. WTO impacts

If Russia joins the WTO, the import tariff burden should gradually but steadily decrease. This is likely to improve the possibilities for Finnish exporters of wood products. However, the transition periods are rather long and a substantial reduction in tariffs is mostly expected for wooden furniture and particle boards. An example of the impact on tariffs is presented in Table 14.

Table 14. *WTO impact on import tariffs of wood products produced in the Republic of Karelia*

Product	Import duty rate in 2006	Initial rate of binding tariff	Final rate of binding tariff	Transition period, years
Chips (coniferous)	15	12	10	4
Sawn timber (spruce, pine, birch)	15	15	8	5
Pulpwood (spruce, pine, birch)	15	15	10	3
Planed timber (spruce, pine, other)	15	15	10	4
Plywood	15	15	11	3
Particle board	20	15	8	5
Particle board	20	15	8	5
Furniture, kitchen modular	20%, not less than €0.8/kg	20%, not less than €0.8/kg	12%, not less than €0.23/kg	6
Furniture, bedroom type	20%, not less than €0.75/kg	20%, not less than €0.75/kg	12%, not less than €0.23/kg	6
Furniture upholstered	20%, not less than €0.7/kg	20%	12.5%	6
Furniture, other wooden	20%, not less than €0.8/kg	42%, not less than €0.75/kg	12%, not less than €0.23/kg	6
Furniture, wooden for sitting	20%	20.5%	12.5%	6

Source: Ministry of Economic Development of Republic of Karelia

4.6. Use of wood

4.6.1. In construction

In the construction sector, demand is determined by the rates of investment. However, forest products are mainly used in housing, public utilities and country cottage construction, which should therefore be developed in the most active way. At the same time the stable tendency towards a reduction in the share of wooden construction resulting from the marked replacement of forest products by other construction materials (brick, steel etc.) is taken into account.

The total housing facilities of Russia account for 2,800 million m² of aggregate floor space or 19.4 m² per person. To reach the level of 21 m², which was forecast of Goss-troy in 2005, with allowances given for the removal from service of 520-550 million m² of dilapidated housing facilities, it will be necessary to increase the annual level of commissioning of new houses to 40-45 million m² against 30 million m² in 2000. One should bear in mind that in the late 1980s, the annual commissioning of new housing facilities amounted to 60 million m². In the mid-2000s, a clearly marked tendency took shape towards a sharp reduction in the share of “social” housing, that is, housing allotted to certain groups of the population (invalids, veterans, servicemen, etc.) in the budget.

The scope of housing construction will largely depend on the growth of income for the majority of the population and not only its richest section, although differentiation in this respect has grown swiftly. In the future, the quality standards of dwellings (norms, arrangement, finish) will undoubtedly rise. Taking these factors into account, an annual commissioning of 60 million m² of housing facilities can be projected for the period of 2010-2015. It is worth mentioning that the share of multi-storey houses out of the total housing units is 50%, while the share of single-story wooden houses is about 15% or 380-400 million m² (UNECE 2003).

Wooden houses are coming to NWR’s property market. In the mid-2000s, wooden houses were not a widespread phenomenon in Russia, although traditions in wooden construction exist. Wooden house building has accelerated due to a government programme aimed at improving affordable housing production. As a part of this program, wooden housing has been seen as an opportunity to provide ecological and affordable housing and also to stimulate the wood product industry. The main problems with wooden house building lie in the poor infrastructure and undeveloped banking structure, specifically the financing terms for developers (Nasibullin & Prudnikov 2005).

The demand for forest products for the repair of existing houses is high. In addition, renovations have been lagging in recent years for financial and economic reasons. Annual repair reserves in this sphere are estimated at 350-400 million m². In the mid-

2000s, the consumption of forest products for repair was 80% lower than to be expected under normal market conditions. The limited buying capacity in the sphere of construction and repair has on the whole determined the relatively low growth of demand so far observed for forest products, but demand in this sphere is expected to increase considerably. The demand for sawn timber, plywood and wood-based panels is projected to increase, compared with that in 2000, by at least 80% (UNECE 2003).

4.6.2. *In interior design*

Russia has long traditions in wooden architecture as well as in interior design. The use of modern fibreboard panelling and laminate flooring has started with the establishment of the market economy at the beginning of the 1990s. Foreign producers completely dominate the MDF-based panel and laminate flooring markets in NWR. Russian producers can only compete in wooden flooring, but by the mid-2000s the market was highly diversified. There are tens of small wooden flooring producers in NWR, which mainly use Russian production equipment. Parquet is mainly imported either from Western Europe or from other regions of Russia. The primary sales channels for MDF-based panels and laminated flooring are hardware stores and furniture shops, such as Stroymaster (owned by KESKO, Finland), OBI (Germany) and Starik Hottabych, Castorama (owned by Kingfisher, UK).

4.7. Wood product groups

4.7.1. *Sawn timber*

During the 1990s, the Russian sawmilling industry together with other branches of the forest sector was in economic crisis, suffering from a low level of investments and innovations, a low technical level of production and poor labour productivity. Furthermore, the consumption of sawn timber simultaneously decreased.

An important reason for the decreasing consumption as well as production was the sharp drop in the Russian economy during the transition period in the 1990s. For instance, GDP decreased during several years. Since the 1998 crisis, economic development has been improving and the GDP has shown higher rates of growth in comparison, for instance, to EU countries.

The improved economic situation also positively affected the production of forest products and furthermore halted the falling development of sawn wood production. The strongest positive effects were, however, in the production and consumption growth of wood-based panels. Because sawn wood consumption remained weak, the driving force of production was increasing exports. Export growth was supported by the devaluation

of the rouble, which improved the competitive ability of Russia in export markets (see also Table 1).

The Russian sawmill industry is highly export-oriented and has mainly concentrated on NWR and Siberia. In 2003, Russia produced ca. 20 million cubic metres of sawn timber, of which NWR produced ca. 5 million cubic metres. Most of the sawn timber was produced in Arkhangelsk Region (Karvinen et al. 2005).

The saw milling industry was the least profitable branch of the wood product industry in NWR in the early 2000s. The capacity utilisation rate seems to be the restrictive factor in production as well as outdated equipment and uncertainty concerning roundwood procurement. These problems formulate the improvement decisions for most sawn timber producers in NWR.

Table 15. *Largest sawn timber producers in NWR*

Area	Production volume in 2004		
	> 50 000 m ³ /a	>100 000 m ³ /a	>200 000 m ³ /a
Arkhangelsk Region	ZAO LDK Arhangelskles ZAO Ustjales	OAO Arhangelskij LDK No 3 OAO Lesozavod No 2	ZAO Lesozavod 25 OAO Solombalskij LDK OAO Onezhskij LDK OAO Lesozavod No 3
Republic of Karelia	ZAO Zapkareles OAO Ilijinskij lesozavod OOO Medvezhgorskij LPH	Segezhsckij LDK	
Republic of Komi	OOO SEvLesPil ZAO Leskom	OAO Syktyvkarskij LDK	
Novgorod Region	OOO Madok ZAO Pestovo Novo (UPM)		
Vologda Region	OOO Harovsklesprom AO Soldek	OAO Solokskij DOK	

Source: Mutanen et al. 2005

4.7.2. *Wood-based panels*

PLYWOOD

Plywood sales have been growing continually since 1995. Exports of plywood grew by 2.2 times in 1995-1999, and domestic consumption grew by 70%. Nearly 67% of all plywood produced was exported in 1999. As much as 517.2 thousand cubic metres of plywood were produced in NWR in 1999, which made up 39% of the total Russian plywood production. Twelve plywood producers operate in the region, but there is no obvious leader among them (Dudarev et al. 2002B). The production capacity of the plywood industry is almost 100% utilised in many areas of NWR (Karvinen et al. 2005).

The existing product range does not meet the demands of consumers. Whereas the majority of plywood producers in the developed countries have shifted to the production of large-sized plywood, Russian plywood mills continue making small-sized plywood, mostly of the size 1525x1525 mm, which makes up 70% of all production. The portion of specialized expensive sorts of plywood, which are in higher demand (laminated, non-flammable, waterproof, etc.), is a very small proportion of the total output of NWR's plywood industry (Dudarev et al. 2002B).

Figure 18. *Development of plywood production 1993-2007*

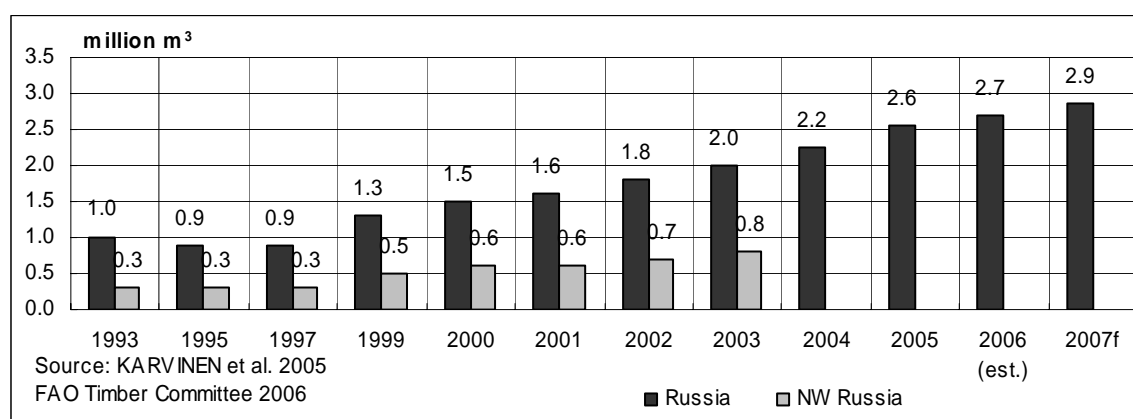


Table 16. *Largest plywood producers in NWR*

Company	Region	Turnover, million USD	Production in 2004, 1000 m3	Products			
				Standard	Laminated	Waterproof	Large-sized
Chudovo-RWC	Novgorod	23	72.9		+	+	
Ust-Izhora Plywood Mill	Leningrad	20	85.1	+			
Cherepovets Plywood and Frurniture Mill	Vologra	15	74.5	+			+
Zhesharski Plywood Mill	Republic of Komi	14	121.6	+			+
Syktvykar Plywood Mill	Republic of Komi	n/a	156.7		+	+	+
Arkhangelsk Plywood Mill	Arkhangelsk	n/a	84.6	+			
Parfino Plywood Mill	Novgorod	12.5	94.4	+			
Novator Plywood Mill	Vologda	8	76.4			+	
Lahdenpohja Plywood Mill	Republic of Karelia	n/a	19.2	+			

Sources: Dudarev et al. 2002B, Karvinen et al. 2005

In the early years of the 2000s there was no OSB production in Russia, although Kronostar (Swiss Krono Group) are planning to start OSB production at their Kostroma-based facility in 2007 (www.kronostar.com).

FIBREBOARD AND PARTICLE BOARD

The production of fibre- and particle board is not a core business of forest-based industries in NWR. The production volumes of both types of board were less than 25% of the Russian total in the early 2000s. The production technology of NW Russian fibre- and particle board industries is several steps behind the technology of West European companies.

Around one third of the particle board produced in NWR met the requirements of furniture companies with regard to surface quality and other characteristics in the early 2000s. As for fibreboard, one of the most promising products is MDF (Medium Density Fibreboard), which is widely used by furniture producers. The main MDF producer in the early 2000s in Russia was Sheksna Fibreboard Mill. Its output, however, does not exceed 50 000 cubic metres per year, which is not enough to meet the demands of the Russian furniture industry. The quality of Sheksna Fibreboard Mill products, however, does not satisfy the requirements of the leading domestic furniture producers (Dudarev et al. 2002). Fibreboard is mainly produced in the Vologda Region, the Republic of Komi and the Arkhangelsk Region (see Table 17).

The demand for MDF in Russia was about 300,000 cubic metres at the beginning of 2000 and it grew to roughly 500 000 cubic metres by 2005 (VNII Drev, Central R&D institution for the mechanical wood-processing industry, located in St. Petersburg). Following this trend, several new “greenfield” MDF production projects are being implemented in NWR (in Leningrad Region and the Republic of Komi) in 2007. These projects do not, however, match with the market demand in terms of quality and a temporary oversupply of lower quality MDF grades could be expected in the near term. (Dudarev et al. 2002B) The development of fibreboard production is presented in Figure 19. New production capacity is also planned by Kronospan in the Moscow Region and Kronostar in the Kostroma Region. The planned capacity of both project is estimated at 600 000 cubic metres/a (Karvinen et al. 2005).

Table 17. *Fibreboard production and capacity utilisation rate in 2003*

Area	million m²	Capacity utilisation rate, %
Russia	321.0	80
Northwest Russia	60.6	77
Vologda Region	25.4	57
Republic of Komi	20.0	91
Arkhangelsk Region	18.8	83

Source: Karvinen et al. 2005

Figure 19. *Development of fibreboard production 1993-2007*

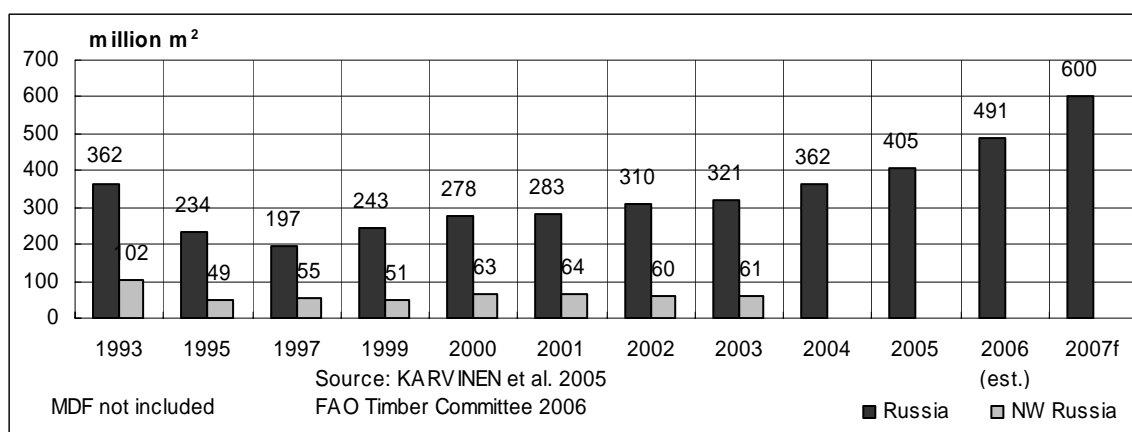


Table 18. *Largest fibreboard producers in NWR*

Company	Region	Turnover, million USD	Production in 2003, 1000 m2	Products			
				Hard fibre- board	Insulating fibreboard	MDF	Furnishing fibreboard
Knjazhpogost Fibreboard Mill	Republic of Komi	N/a	19 963	+			
Arkhangelsk PPM	Arkhangelsk	2138,9	8223	+	+		
Syas PPM	Leningrad	N/a	N/a		+		
Sokol PPM	Vologda	19	8000*	+	+		
Segezha LDK	Republic of Karelia	n/a	n/a			+	
Sheksna Fibreboard Mill	Vologda	n/a	n/a**			+	

* production in 2002

** ca. 50 000 cubic metres

Sources: Dudarev et al. 2002B, Karvinen et al. 2005

Russia produced 3.2 million cubic metres of particle board in 2003, which was less than 4% of the world particle board production. NWR's share of Russian particle board production was 26% in 2003. The production of particle board grew steadily in the early 2000s (see Figure 20). Several Russian and foreign producers have started to modernize production facilities or have initiated "greenfield" investment in the Novgorod Region.

Domestic demand for particle board has improved during recent years due to the growth of domestic furniture production. Particle board production is targeted mainly at the domestic market and only 6% of particle board production was exported in 2003 (Spiridovitch 2006).

Figure 20. *Development of particle board production 1993-2003*

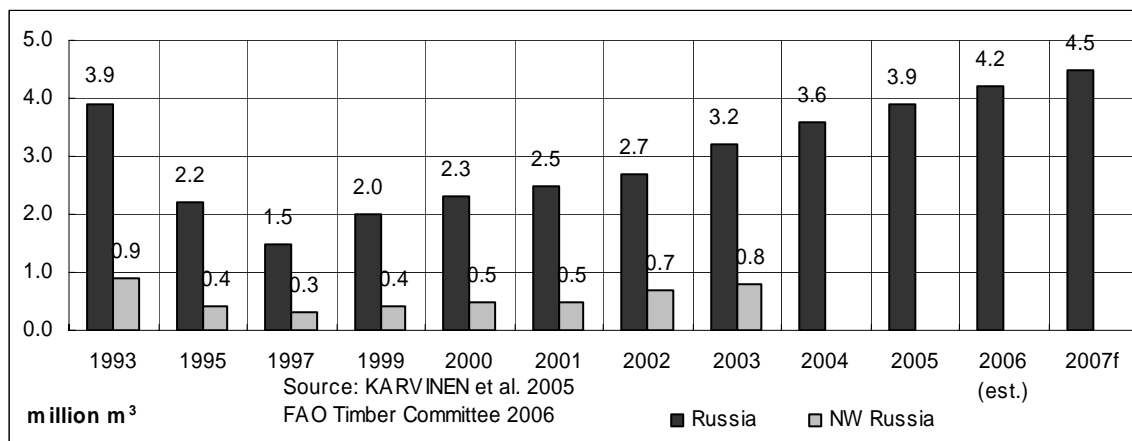


Table 19. *Particle board production and capacity utilisation rate in 2003*

Area	1000 cubic metres	Capacity utilisation rate, %
Russia	3181	84
Northwest Russia	840	n/a
Vologda Region	382	80
Republic of Komi	295	100
Republic of Karelia	106	n/a
Leningrad Region	104	n/a

Source: Karvinen et al. 2005

Table 20. *Largest particle board producers in NWR*

Company	Region	Turnover, million USD	Production in 2004, 1000 m ²
Syktvykar Plywood Mill	Republic of Komi	N/a	120
Karelia-Evroimex DSP	Republic of Karelia	N/a	110*
Cherepovets Plywood and Furniture Mill	Vologda	15	90
Zheshart Plywood Mill	Republic of Komi	14	61.2

Source: Dudarev et al. 2002B

4.7.3. Joinery

DOORS

In the mid-2000s the production of doors from massive wood and wood-based panels was dispersed, but the biggest producers were located in St. Petersburg, near the principal markets. Approximately ten relatively big producers in St. Petersburg have divided the market, and no clear market leader exists. In addition, there are also a number of smaller producers that have less market influence. The market leaders in wooden doors

are: “PTS”, “PROK”, “MASTER LES”, “ROTONDA” and “VIADUK”. In the mid-2000s, the door business mainly concentrated on renovation and rebuilding.

WINDOWS

The market for windows in NWR, as in Russia as a whole, has been rapidly invaded by PVC and aluminium windows. This has reduced the market share of wooden windows, but only in the cheapest segments of the market. PVC and aluminium-based windows dominated about 60% of all windows markets in Russia in the early 2000s (Chernenko 2003).

As with doors, the biggest producers of wooden windows in the mid-2000s were located in St. Petersburg. There are about 10 wooden window manufacturers and they have a market share of 90-95% in St. Petersburg. There are also other producers located in the less populated areas of NWR, such as Tiivi in the Murmansk Region, which is of Finnish origin. The biggest players in the Northwest Russian wooden window market are: “StroiImpex”, “Okna ot prirody”, “Aljans”, “Petrostrojtorg”, “PTS” and “Petro-Domus”.

The most prominent segment of the window business in NWR is in renovating and rebuilding. A major proportion of the building base in NWR was built during the Soviet era and is in great need of renovation. In 2000, almost 60% of all buildings in Russia needed immediate renovation or reconstruction. Therefore, the demand for windows is expected to remain stable (Chernenko 2003).

FURNITURE

In 2000, the total output of furniture production in NWR reached 2.5 billion roubles (about \$90 million). The furniture industry is represented by a significant number of large, medium and small companies that produce all kinds of furniture: e.g. cabinets, sofas, kitchen cabinets and children’s furniture. The largest producers are also located in St. Petersburg and the Leningrad Region (Table 21). The city of St. Petersburg is the main local furniture market of NWR (Dudarev et al. 2002B).

Demand for furniture will grow under the influence of enhancing the welfare of the country and the population. It will also depend on the dynamics of personal income and growth in the commissioning of dwellings intended for social purposes (public health services, culture, management, public utilities). Under the influence of these and many other factors, the furniture industry will form its own demand for forest products (UNECE 2003).

Russian furniture producers are constantly challenged by importers. The biggest importers of furniture to Russia in 2005 were Belarus and Italy, whose share of furniture com-

ponent and raw material imports was also considerable. During recent years, Russia has tried to protect domestic producers by imposing high tariffs on imported furniture.

Due to improvements in the purchasing power of Russian consumers, the furniture market has grown steadily, at the rate of 8-9% annually during the first years of the 2000s. The most significant growth has been observed in the office furniture market, which in 2005 totalled ca. 550 million USD. Enlargement of the domestic capacity has caused an increase in production of 10-15% annually. Although the quality of Russian office furniture has significantly improved during recent years, the demands of the most demanding customer segments cannot yet be satisfied. Imports of luxury furniture goods account for 80% of the demand (Spiridovitch 2006).

Table 21. *Largest furniture producers in NWR*

Company	Region	Personnel	Products					
			Kitchen furniture	Cabinetry	Soft furniture	Whole furniture	Furniture accessories	Office furniture
Sevzapmebel	St Petersburg	500	+	+	+	+		+
Lenraumamebel	St Petersburg	500	+	+	+	+		+
Nevskaja Dubrovska	Leningrad	750	+	+		+		
Pervaya Mebelnaya Fabrika	St Petersburg	165	+	+				+
Ninevija	Leningrad	100					+	
Jupiter-Holding	St Petersburg	80	+	+	+		+	+
Velikie Luki Mebel	Pskov	N/A	+	+		+		+

Source: Dudarev et al. 2002B

The demand for furniture and forest products for furniture production is affected by the growth of housing construction and the change in living standards. In the mid-2000s the demand for furniture was very high, which also caused growth in production. Thus, in Western European countries the annual per capita consumption of furniture amounts to \$120-230. By contrast, the annual consumption of furniture per capita in Russia is about \$9. Besides, in 1998 the market share of imported furniture in Russia was 46%. The reduction in the share of imports during the early 2000s illustrated the positive tendency in the development of the domestic furniture industry. For this industry to function properly, it will be necessary to improve the quality and competitiveness of domestic furniture and reduce the share of imported furniture to approximately 15-20% (UNECE 2003). The NWFD occupies third place amongst Russia's biggest furniture producing regions, although the share of NWR declined during 2003-2005 from 11.6% to 10.6% of all produced furniture (Expert RA 2006).

4.8. Forest product markets in NWR

4.8.1. Production and consumption

In 2001, the total sales of forest products in Russia amounted to \$5.6 billion, including about \$2 billion in imports. The structure of trade flows and value of sales are presented in Figure 21 and Figure 22. After the initial decline observed in the early 1990s at the start of reforms, the market for forest products started to grow. Some fragmentation of the market was also observed into groups of low and high value-added products, as well as regional concentration.

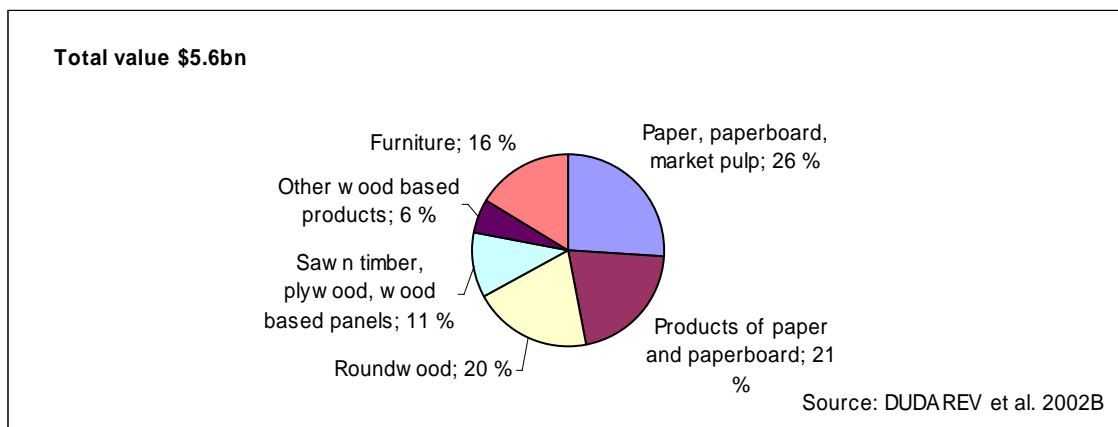


Figure 21. Estimated trade flows of wood products in NWR in 2005

Source: Federal State Statistics Service 2006

The consumption of end products in St. Petersburg, the main consumption market in NWR, differs significantly from other cities of the region in volumes, products and quality range. This fact, i.e. the concentration of demand for higher quality products in St. Petersburg, will continue. The market volume of low-cost and low-quality goods in the mid-2000s exceeded the market for high-quality products. The level of quality and associated services demanded by domestic consumers is still quite low in comparison to that in the developed markets (Dudarev et al. 2002B).

Figure 22. *Structure of forest product sales in Russia in 2001*



A major proportion of produced roundwood is exported, with Finland alone annually consuming about 12 million cubic metres (underbark) of roundwood produced in NWR. The remaining share (see Table 22) of industrial roundwood is divided between the biggest sawn timber producers in Arkhangelsk, Komi and Karelia regions. Plywood production also consumes a great deal of coniferous and birch roundwood, mainly in the Novgorod and Leningrad areas. The share of exports of plywood has been historically high, and was on the level of 70% in 2001 (Doronichev et al. 2005). The rest of the domestically produced plywood is traditionally used in vehicle, container and building industries.

Particle board is used mainly in furniture production as well as in building. In 2001, 80% of all consumed particle boards were used in furniture production. Due to the inability of the Russian particle board industry to satisfy the market demand for particle boards, imports exceeded exports by 2.5 times in the early 2000s. The main importers of particle board to Russia in 2001 were Poland (30% share of all imports), Germany (23%), Finland (10%) and Italy (9%). Almost all particle board produced in Russia is also consumed on the Russian market, and only 6% was exported in 2001.

Fibreboard is mainly used in building, accounting for 39% of all production. The production of fibreboard in 2000 had decreased by almost 50% in comparison to 1990. NWR produced around 60 million square metres of fibreboard. In 2006, MDF production was still insignificant and the existing production facilities were concentrated in the Vologda Region. Reasons contributing to the import substitution of fibre- and particle board include poor technical properties and a limited assortment.

Table 22. *Production and apparent consumption of the main wood products in NWR in 2003*

Product	Production	Export	Import	Apparent consumption
Round wood	29.7 m. m ³	12 m. m ³	n/a	17.7 m. m ³
Sawn timber	5.4 m. m ³	2.2 m. m ³	n/a	3.2 m. m ³
Plywood	0.8 m. m ³	0.3 m. m ³	0.05 m. m ³	0.55 m. m ³
Fibreboard	60 m. m ²	8 m. m ²	n/a	55 m. m ²
Particle Board	0.8 m. m ³	0.04 m. m ³	n/a	0.79 m. m ³

Sources: Federal State Statistics Service, Karvinen et al. 2005, Doronichev et al.2005

The total production of sawn timber in NWR was 5.35 million cubic metres in 2003, which accounted for over 26% of Russia's sawn timber production. The share of NWR's production is slowly growing. The share of exports has been significant for many years due to the high concentration of sawmills in the region. The volumes of sawn timber production in NWR are substantially lower than in other countries with comparable roundwood stocks (Finland, Sweden). Therefore, there is room for improvement, although in practice the level of infrastructure development and difficulties in ensuring safe raw wood supplies will limit the growth of production (Dudarev et al. 2002B).

As much as 517.2 thousand cubic metres of plywood were produced in NWR in 2000, which made up 39% of the total Russian plywood production. Twelve plywood producers operate in the region, but there is no obvious market leader among them (Dudarev et al. 2002B). The majority of plywood produced in NWR comes from the city of St. Petersburg and Leningrad Region.

4.8.2. Distribution

Half of the sawn timber produced in 2003 in Russia was exported. NWR's share of exports of sawn timber was almost 40% (Karvinen et al. 2005). The remaining sawn timber produced in NWR is distributed throughout NWR and other regions to industrial end-users such as furniture manufacturers and the building industry. The distribution channels of the vertically-integrated sawmills and small-scale production differ significantly. Large integrates are able to influence the channels of distribution due to the high volumes and possible experience in foreign trade (Kivelä 2006). Small sawmills have ineffective marketing as well as distribution channels and rely on sales techniques inherited from the Soviet era.

Plywood, particle- and fibreboards are mainly sold through distribution companies. In Russia, 65-75% of plywood and wood-based panels are sold via wholesale distributors. The rest of the production is sold for export. For example, Innovacia (ЗАО "ФПК "ИННОВАЦИЯ") is a wholesale dealer specializing in plywood trading. Innovacia is an

official dealer for Sveza (Novator plywood mill, Fanlit plywood mill) and Tjumen plywood mill (Siberia).

Domestic furniture is mainly sold to retailers, which include large specialist shopping centres, salon networks, individual retail outlets, furniture shops and furniture corners. For foreign producers the main marketing channels for furniture products are furniture fairs. Joinery products, especially windows and doors, are mainly sold to developers, which buy about 70-75% of all wooden windows and doors produced in NWR.

The transport infrastructure of NWR is relatively well developed compared to other Russian forest-rich regions such as Siberia and the Far East. There is a varied system of transportation routes in NWR. The main railroads are from St. Petersburg to Moscow, St. Petersburg to Helsinki, St. Petersburg to Murmansk, St. Petersburg to Vologda, Arkhangelsk to Moscow, and Konosha-Kotlas-Vorkuta. In the mid-2000s there were 8 railway border crossings with the Baltic States and Finland (these countries have the same gauge of railway as Russia) in the region. The largest seaports of NWR are St. Petersburg, Murmansk, Arkhangelsk and Kaliningrad. There are also some smaller seaport terminals. The density of transportation routes varies considerably between regions, but even in regions with the highest density of transportation networks this density is significantly lower than that of developed countries (Dudarev et al. 2002B).

The transition to the market economy in Russia has had a profound effect on the structure of the domestic forest products market. In the Soviet era, forest industry products were distributed through a centralized system of state-owned distributors, where products were assigned to consumers, and the producer rarely had any information about the user of its products, or preferences and demands.

The key forest companies operating in the mid-2000s were already established during the Soviet era. The problems of low value-added products integrated into their technologies therefore still to a large degree shape the most capital-intensive industries, such as pulp and paper and sawn timber. The old technologies start to be of lesser importance in the least capital-intensive industries, such as furniture and plywood manufacturing. Unfortunately, the general approach to marketing and management in all the forest industries still suffers greatly from the inherited ignorance of markets and consumers (Dudarev et al. 2002B).

4.8.3. *Customers and suppliers*

There are significant differences in forest product markets between the industries in the Russian Federation. The overall growth of industrial production (especially of all the wood processing industries) and the growth of domestic construction are of primary importance for the harvesting and sawn timber manufacturing companies.

Unfortunately, the prospects for rapid recovery and the further growth of overall industrial production and construction and, correspondingly, of roundwood and sawn timber production in Russia were doubtful in the mid-2000s. A further increase in roundwood exports is also highly unlikely, due to the protectionist approach of the Russian authorities. On the other hand, exports of sawn timber could grow substantially if domestic producers are able (in addition to their cost advantage) to provide competitive quality and delivery terms. This is highly dependent on developments in industrial policy, infrastructure and the training of skilled labour. Substantial growth in mechanical wood-processing and harvesting production in the latter part of the 2000s can only be achieved if new and large investments are made. This will only be possible when the investment climate has significantly improved (Dudarev et al. 2002B).

The key customers for wooden boards and plywood are the furniture and construction industries. Therefore, a driving force in the diversification and quality improvement of wood-based panels and plywood is the demand of final consumers and consequent diversification of the construction and furniture manufacturing industries. At the turn of the millennium, construction rapidly diversified although the total volume of construction output in the mid-2000s was much lower than in the Soviet era. In contrast to the Soviet period, the most dynamically growing market segments in the mid-2000s were high- and medium-quality housing and office space building and renovation. In these segments, a wide range of imported products is used. Thus, there is potential for growth and import substitution. It is also important to mention that in construction, the market, although diversified, is still heavily concentrated on mass housing that is built utilising old technologies and materials inherited from the Soviet era.

In the medium term, it is expected that demand for housing and finishing materials will shift to the higher quality segments, which will create a corresponding demand for forest products. Roughly the same situation can be observed in the furniture market as is prevailing in the plywood and wood-based panels markets. Diversification of production is also a major market trend in these industries, although the market volumes are heavily concentrated on the mass, low-cost segment. Product segmentation is driven by the wide gap in purchasing power between different customer groups. The trend is that the higher quality segment will grow much faster in the medium to long term.

The wealthy consumers are heavily concentrated in the cities and, primarily, in St. Petersburg. Therefore, the other trend is that further development of the manufacturers of high-quality products will also concentrate in St. Petersburg and the companies there will gradually shift to the manufacturing of their own brands and quality products. The leading furniture producers import components, accessories and equipment. There is also a further potential for import substitution in these product groups. The potential could be measured for furniture manufacturing by segments as presented in Figure 23 (Dudarev et al. 2002B).

Figure 23. *Share of imported components in furniture production, % of total consumption*

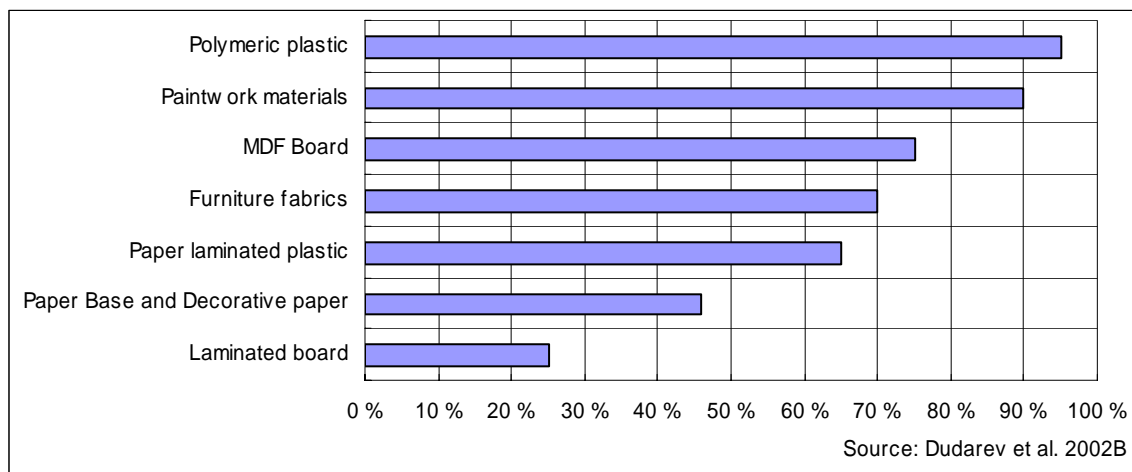


Table 23. *Price indices of the main wood products in NWR*

	% to previous year			
	2000	2001	2002	2003
Round wood	15.1	6.3	8.1	9.1
Sawn timber	21.3	20.1	12.3	9.8
Plywood	20.1	13.3	10.0	4.5
Particle board	73.8	27.5	6.5	14.9
Fibreboard	22.4	13.0	11.2	21.1

Source: Federal State Statistics Service 2004

Table 24. *Average prices for selected wood products in NWR*

	RUB/unit			
	2000	2001	2002	2003
Round wood (coniferous saw log) m ³	484	657	688	800
Round wood (peeler log birch) m ³	283	382	383	404
Sawn timber edged m ³	1213	1325	1355	1666
Sawn timber unedged m ³	867	849	949	1039
Door frames m ²	360	315	434	623
Window frames m ²	706	858	1079	1633
Particle board m ³	1856	2469	2622	2989

Source: Federal State Statistics Service 2004

5. EXPORT AND PRODUCTION POSSIBILITIES FOR THE FINNISH WOODWORKING INDUSTRY IN NWR

5.1. Northwest Russian wood products market

It is quite difficult to exactly determine the size of the Northwest Russian wood products market due to the lack of exact statistics. However, based on the primary data available for this study, some assumptions can be presented. Due to incomplete Russian statistics, figures related to the value of production rather than sales quantities can be considered more reliable in product groups such as furniture and joinery.

The market size was estimated using official production value figures published by the Federal State Statistics Service. The value figures were converted from roubles to euros using the Bank of Russia's yearly average currency exchange rates. The value of the industrial roundwood market in NWR in 2003 was USD 456 million. In addition, the value of area's sawn timber production in 2003 was USD 780 million and the value of the plywood production was USD 195 million during the same period. Furthermore, the value of the particle board production in NWR was USD 84 million and the value of fibreboard (excl. MDF) was USD 27 million in 2003. At the same time, the value of wood products (inc. paper) imported to the NWFD was USD 381 million.

The demand for wood products in general in the industrial customer segment as well as the private end-users segment is expected to grow (see also Chapter 4). Due to the wood building promotion programs carried out by authorities in St. Petersburg and Leningrad, consumption of wood products, especially wooden buildings, is likely to grow.

Competition in all wood product groups will remain intense, and will most probably tighten, when new production capacities in the woodworking industry are introduced. In addition, the consumer price index (CPI) is expected to rise. Trade restrictions will also affect competition for raw materials, as the log tax will affect the supply of industrial roundwood. In the latter half of the 2000s, if Russia joins the WTO, trade restriction measures will need to be abolished, thus providing more possibilities for foreign wood product exporters to Russia.

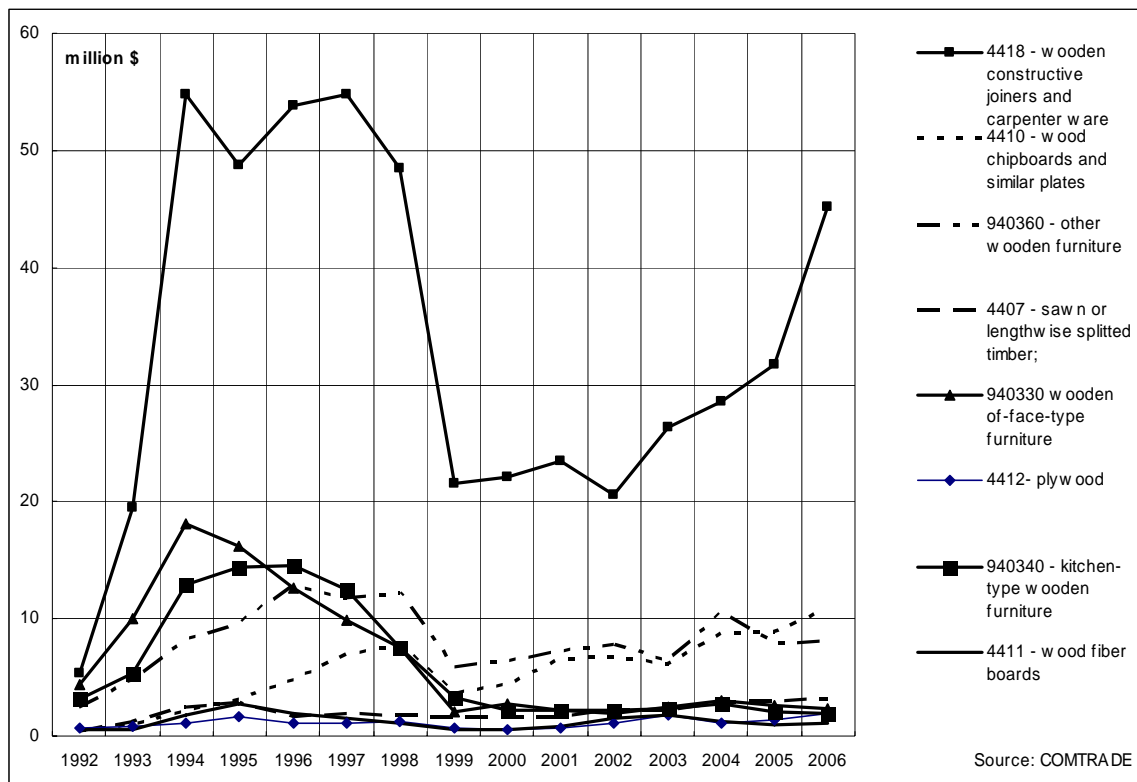
5.2. Finnish exports of wood products to Russia 1990-2006

Despite the huge forest resources, NWR is a net exporter in many wood product categories. Roundwood and plywood are the main net export commodities in NWR's wood product trade. Proximity to the EU and especially to Finnish market presents an opportunity to both NWR and Finnish producers and exporters. Finnish wood products are mainly high value added products in the higher price segment for almost all wood prod-

ucts. As domestic producers in NWR dominate in such product group categories as plywood and sawn timber, due to the more advantageous cost structure, Finnish wood products find their way to Russian consumers in product group categories such as wooden furniture, windows and doors and flooring. MDF and OSB are not produced in Finland.

Figure 24 illustrates the pattern of development of wood product exports from Finland to Russia from 1992-2006. The most traded products, measured by trade value, belong to CN group 4418, followed by CN groups 4410 and 940360, with other groups remaining rather insignificant. Exports from Finland to Russia clearly decreased in the latter part of the 1990s after the rouble was devalued. During the early years of the 2000s, Finnish exports to Russia again increased.

Figure 24. *Development of exports of Finnish wood products to Russia from 1992-2006*



5.3. Finnish producers in NWR

The prevailing opinion is that the investment climate in NWR is essentially no different from that prevailing in the Russian Federation as a whole. There are, however, significant differences between regions, connected both with the availability and concentrations of various basic factors of production (natural resources, workforce, etc.), and with the policies of local authorities.

Along with the roundwood trade to Finland, the Finnish forest industry has also focused on investments in the forest industry process capacity in NWR. Table 25 depicts the recent publicly-announced woodworking industry investment projects of Finnish origin. These investments can be seen so far more as pilot projects and tests for roundwood procurement by pulp and paper mills. The interest of Finnish firms in investing in NWR has also partly increased due to changes in the business infrastructure in Russia. The Federal Government of Russia has started to support development towards increased domestic use of roundwood and more value added production in NWR (Holopainen et al. 2006).

Table 25. *The major Finnish investment projects in Russia's woodworking industry*

PLANT LOCATION	CAPACITY, PER YEAR	YEAR	INVESTOR
Sawmills			
Impilahti	100 000 m ³	2003	StoraEnso
Nebolch	100 000 m ³	2004	StoraEnso
Pestovo	300 000 m ³	2004	UPM-Kymmene
Podporozhie	300 000 m ³	2006	Metsäbotnia
Suda	100 000 m ³	2007	Metsäbotnia
Kostroma	300 000 m ³	2008	Ruukki-Group
Vologda	20 000 m ³	2007	Koskinen
TOTAL	1 220 000 m³		
Plywood mills			
Tshudovsky	60 000 m ³	1988	UPM-Kymmene
Tshudovsky	100 000 m ³	2003	UPM-Kymmene
Tshudovsky	20 000 m ³	2006	UPM-Kymmene
Kostroma	nd	nd	Ruukki-Group
Vologda	40 000 m ³	2008-2010	Koskisen
TOTAL	220 000 m³		

Sources: Holopainen et al. 2006 and PTT's market follow-up

UPM and Stora Enso have been the most active, having four production facilities including Chudovo plywood mill and Pestovo sawmill, both in the Novgorod Region (UPM), and Impilahti sawmill about 300 km from St. Petersburg by Lake Ladoga in Karelia, as well Nebolchi sawmill in the Novgorod Region (Stora Enso). Most of the production is exported to western markets. Metsä Botnia has a sawmill (Svir Timber) located in the Leningrad Region with an export share of 70%. Thomesto have bought or are partners in many wood procurement firms in Russia.

In 2006, Koskivilva Oy, a subsidiary of Koskisen Oy, started a greenfield investment in Sheksna, located in the Vologda Region, aimed at starting birch plywood production in 2008-2010 with a capacity of 30-40 000 cubic metres. The Ruukki Group aims at building a plywood and sawmill in the Kostroma Region. Eurotiivi, a subsidiary of Tiivi Oy, has a window and door production facility in the city of Murmansk, with production

targeted at the Russian market. The total value of Finnish investments in Russia's forest sector is about 300 million euros (Holopainen et al. 2006).

5.4. Results of the expert survey

5.4.1. *Opportunities and threats related to the export of wood products from Finland to NWR*

In the analysis of the study's expert interviews the SWOT approach (Strengths, Weaknesses, Opportunities and Threats) is partly applied. Regarding the export possibilities of wood products from Finland to NWR, only the opportunities and threats are examined. SWOT analysis, as a common-sense checklist, has been used for many years (Tilles 1968). In studies on forest product markets, SWOT analysis has also been successfully used in analysing export possibilities and business environments (e.g. Mäki et al. 2003, Gerasimov et al. 2005).

A SWOT analysis explores the relationship between the main environmental influences and the strategic capability of the organisation (Jonson & Scholes 2002). SWOT analysis could, however, be interpreted as a business environment assessment tool that analyzes the strengths, weaknesses, opportunities and threats of the market and marketing environment. The following grids (Tables 26-28) represent an interpretation of the opportunities and threats analysis regarding the possibilities of exporting wood products to NWR (see also questionnaire in Annex 1 and Annex 2).

The statements in the opportunities and threats analysis grids are drawn from the answers in the survey of various respondent groups (experts, large exporters and producers and SME (small and medium sized enterprises) exporters and producers). It is worth noting that the answers are not ranked according to importance. Generally speaking, the results of opportunities and threat analysis are very similar for separate respondent groups.

Table 26. *Opinions of experts on the export possibilities of wood products from Finland to NWR*

OPPORTUNITIES:	THREATS:
+ Large and growing market size	- Bureaucracy of NW Russian society
+ Growth of purchasing power	- Poor knowledge and availability of market information
+ Finnish products considered to have a good quality among NWR end-users	- High import expenses (VAT, customs duties)
	- Inconsistency in customs regulations
	- Corruption
	- Trade restrictions will expand and change suddenly
	- Own sales office is essential to success in NWR

Table 27. *Opinions of large exporters and producers on the export possibilities of wood products from Finland to NWR*

OPPORTUNITIES:	THREATS:
+ Business environment in NWR is becoming stable	- Strong price competition in NWR's wood product markets
+ NWR's country risk is decreasing	- Necessity to closely co-operate with local authorities
+ Good quality of Finnish products among NWR end-users	- Relatively more difficult market entry compared with other countries
+ NWR operations contribute positively to business profitability	- Local NWR competitors
+ Better market growth prospects in NWR than in Finland	- Bureaucracy of NW Russian society
+ Quality will in the future play a bigger role even in low added value product groups	- Own sales office is essential to success in NWR

Table 28. *Opinions of SME exporters opinions on the export possibilities wood products from Finland to NWR*

OPPORTUNITIES:	THREATS:
+ Constant improvement of economic situation in NWR	- Tight customs regulations
+ Improving and shorter payment times	- Poor knowledge and availability of market information
+ Good quality of Finnish products among NWR end-users	- Fierce competition with other foreign exporters
+ Improving quality and availability of market information from NWR	- Bureaucracy of the NWR society
+ Constantly growing market size	- Own sales office is essential to success in NWR

To summarise, a few similarities can be noticed in the opinions of various respondent groups. The *improving economic situation, large market size and strong future growth of the market* are considered opportunities provided by the Russian market. Furthermore, the respondents perceive that the *good quality of Finnish products* offers export possibilities for the Finnish woodworking industry in NWR. On the other hand, *bureaucracy, fierce and simultaneously regulated competition and the lack of market information* are generally considered as the main threats in exporting wood products from Finland to the Northwest Russian markets.

As can be observed from Tables 26-28, most of the threats related to the export of wood products from Finland to NWR are not dependent on the macro-level aspects. Improvements could thus also be made by the Finnish exporters themselves. For instance, the availability of market information can be improved by Finnish exporters taking their

own measures. In addition, the poor availability of market information is a similar problem for all market players. Similarly, a sales office is essential in all other markets having a different business culture from that, for example, in Western Europe.

5.4.2. *SWOT related to production possibilities in NWR*

Table 29 summarises expert opinions about the Finnish woodworking industry’s investment possibilities in NWR. *Strengths* are mainly related to the improving society. Difficulties with authorities and customs are the main *weaknesses* when the Finnish woodworking industry is considering investments in NWR. Most *opportunities* can be seen in the development of trade policy. Finally, *threats* can be seen in the development of adopted investment policy.

Table 29. *SWOT analysis of NWR markets concerning the Finnish woodworking industry’s production possibilities in NWR*

<p>STRENGTHS:</p> <ul style="list-style-type: none"> • Proximity to western markets for exporting products • Political willingness of NWR authorities to develop the region • Political environment in NWR is rather stable • NWR’s country risk is moderate and getting lower • Favourable investment climate in NWR • Raw material is abundantly available in NWR • Low production costs in NWR 	<p>WEAKNESSES:</p> <ul style="list-style-type: none"> • Bureaucracy of NW Russian society • Difficulties in finding skilled personnel in NWR • Corruption • Necessity to closely co-operate with local authorities • Relatively more difficult market entry compared with other countries • Poor raw material procurement infrastructure
<p>OPPORTUNITIES:</p> <ul style="list-style-type: none"> • Possible WTO membership and abolishment of certain trade barriers • Increasing building activity due to the growing middle class • Trade restriction, such as export tax on logs, improved raw material supply of producers in NWR 	<p>THREATS:</p> <ul style="list-style-type: none"> • Restriction on foreign ownership, protectionism • Politicisation of management • Restrictions of business activities in strategic raw materials (e.g. uncertainty in wood supply)

5.4.3. *Position of Finnish wood products on the markets of NWR*

The market positions of Finnish wood products are examined from interviews and by examining secondary data. Based on expert opinions, the following inferences can be drawn with respect to the micro- and macro-environment: The economic and political situation was found rather stable by most of the experts. The region of NWR is one of the centres of economic growth in Russia, and the proximity to western market makes it quite an attractive area for foreign investment. The main aspects of the macro-environment are the decreased level of inflation and relatively fast growth of incomes, which further increases private and public building and construction.

The main positive features of the wood products market are the size of the market, its growth rate and the good raw material supply. The main challenges are successful market entry and finding the right marketing channels, as well as the lack of market information. In plywood, particle board and fibreboard trade, the main competitors are local producers, who can effectively compete in prices with any foreign producer (see also Table 30). MDF and OSB are not produced in Finland, thus leaving Finnish producers out of the competition. The most significant competitors of Finnish furniture importers are local producers as well as Italian and German manufacturers. The most prominent product groups are OSB and MFD, due to the small-scale production in Russia, as well as the higher value added products of joinery, flooring and furniture.

Table 30. *The main competitors of Finnish producers on the wood product markets of NWR*

	Local	Foreign
Sawn timber	+	+
Wood-based panels	+	+
Joinery	+	
Flooring		+
Furniture	+	+

To summarize the position of Finnish wood products, the prospects of high added value wood products such as furniture, joinery and wooden flooring are relatively good. The position of other wood products such as wood-based panels is more challenging. The challenges are mainly on the micro-level; competitiveness in these products requires economies of scale in production, as well as effective marketing channels. The results of this expert survey do not differ significantly from those in a study of China's wood product markets (see Mäki et al. 2003), even though NWR and China are very different market areas in many respects.

6. CONCLUSIONS

A few appropriate measures for Finnish wood product exporters to NWR can be suggested based on this study. These measures are presented in Table 31.

Table 31. *Recommendations for Finnish exporters to successfully penetrate the NWR wood product markets*

MARKETING-RELATED ISSUES:

- Further develop the marketing channels in NWR by focusing on JIT (just in time) deliveries directly from the production plant to the industrial customer, retailer or wholesaler.
- Acquire up-to-date information on the market and marketing environment by conducting market research (lack of readily available statistics and data).
- Improve knowledge of consumer preferences by implementing consumer surveys or by following more systematically market trends in construction and the use of wood in construction.

OPERATING ENVIRONMENT RELATED ISSUES:

- Co-operate closely with authorities to get up-to-date information on building regulations and customs formalities.
- Attain Russian partners using networking (e.g. with sales promotion organisations such as Finpro or the Chamber of Commerce).
- Find skilled and reliable personnel by networking with local institutions (educational organisations).
- Improve knowledge of business culture (e.g. by engaging more native workers, or by learning Russian and Russian culture).
- Concentrate on close personal contacts with business partners.

PRODUCT-RELATED ISSUES:

- Develop an own product brand and also improve the awareness of the company in NWR.
 - Emphasize the good quality of the physical product in marketing communication.
 - Expand the product range to cover products that are not available from local producers, i.e. value added joinery products.
-

In comparison to many developing economies (e.g. China), there are no dramatic differences in the recommended measures entering the new emerging markets (see e.g. Mäki et al. 2003). In general, the overall situation for Finnish wood products exporters in NWR is fairly favourable. The demand for wood products, especially board and joinery products, will remain stable and most probably expand. By not concentrating on the bureaucracy issues and informal aspects of the customs regulations, one could conclude that GDP and market growth provide good opportunities for Finnish exporters in all product groups. By concentrating on developing marketing channels as well as the brand, personnel and the availability of market information, the possibilities of Finnish wood products exporters may significantly improve. The export of high value added wood products, such as furniture and joinery, will probably give the highest yield.

The market-based approach has also shaped marketing channels in the wood products industry. According to Finnish producers of wood products in NWR, marketing channel logistic systems can be quite developed in some supplier groups, but the main problems are still the poor punctuality and reliability of raw materials deliveries. This could be partly explained by the undeveloped road infrastructure and partly by the scarce resources of skilled labour. With the transport network there is nevertheless much to be done to make it truly efficient.

REFERENCES

- BOFIT Russia Review 2005. Yearbook. BOFIT Russia Desk. Bank of Finland. Institute for Economies in Transition. Helsinki 2005.
- BOLTRAMOVICH, SERGEY & FILIPPOV, PAVEL & HERNESNIEMI, HANNU. 2004. The Innovation System and Business Environment of Northwest Russia. ETLA. Taloustieto. Helsinki 2004.
- CHERNENKO, EVJENIJ. 2003. Obzor okonnogo rynka Rossii. Vse okna No 1/2003. Available at www.oknaidveri.ru.
- COMTRADE The United Nations Commodity Trade Statistics Database (UN Comtrade) COMTRADE database 2007.
- DORONICHEV, DMITRIJ. 2005 Lesopromyshlennyj kompleks: ponjatija, problemy, perspektivy. "Statistika Rossii" Moscow. 2005.
- DUDAREV, GRIGORY & HERNESNIEMI, HANNU & FILIPPOV, PAVEL 2002A Emergin clusters of Northern Dimension. The Research Institute of the Finnish Economy. Taloustieto. Helsinki. 2002.
- DUDAREV, GRIGORY & BOLTRAMOVICH, SERGEY & EFREMOV, DMITRY. 2002B. From Russian Forests to World Markets. A Competitive Analysis of the Northwest Russian Forest Cluster. ETLA. Taloustieto. Helsinki 2002.
- EUWID 2006. EUROPÄISCHER WIRTSCHAFTSDIENST, Wood Products and Panels, Vol 80, number 25, 21 June 2006.
- EXPERT RA 2006. EXPERT RA Rating Agency. Rynok mebeli dlja doma 2005-2007. Available at www.raexpert.ru
- FAO Timber Committee 2006. Production, consumption and trade in forest products in the Russian Federation. Country Statement.
- FAOSTAT. Database. Available at <http://faostat.fao.org/site/381/default.aspx>.
- Federal State Statistics Service 2004. Rossijskij statisticheskij ezhegodnik 2004. Russian Statistical Year Book 2004. Moscow 2004.
- Federal State Statistics Service 2005 Rossijskij statisticheskij ezhegodnik 2005. Russian Statistical Year Book 2005. Moscow 2005.
- Federal State Statistics Service 2006. www.gsk.ru. Official Internet site of Russian Federal State Statistics Service.
- FFIF 2007. Finnish Forest Industries Federation. Available at <http://english.forestindustries.fi/press/2007/20070209142455.html>.
- GERASIMOV, YURI & SIOUNEV, VLADIMIR & CHIKULAEV, PAVEL & PECHORIN, VLADIMIR & DYAKONOV, VICTOR & KOMKOV, VICTOR & SIKANEN, LAURI & KARJALAINEN, TIMO. 2005 An Analysis of Logging Companies in the Republic of Karelia. Working Papers of the Finnish Forest Research Institute 16 2005. Available at <http://www.metla.fi/julkaisut/workingpapers/2005/mwp016.htm>
- GOSSTROY: Russian Federal Agency for Building and Construction. www.gosstroy.gov.ru.
- HOLOPAINEN, PÄIVI & OLLONQUIST, PEKKA & VIITANEN, JARI. 2006. Factors Affecting Investments in Northwest Russian Forest Sector and Industry. Working papers of the Finnish Forest Research Institute 32.. Available at <http://www.metla.fi/julkaisut/workingpapers/2006/mwp032.htm>
- IMF Russian Federation. Staff Report for the 2006 Article IV Consultation. IMF Country Report No. 06/429. Washington D.C. 2006. Available at <http://www.imf.org/external/pubs/ft/scr/2006/cr06429.pdf>.
- JONSON, GERRY & SCHOLLES, KEVAN 2002. Exploring Corporate Strategy. Sixth Ed. Prentice Hall. Harlow 2002.
- KARVINEN, SARI & VÄLKKY, ELINA & TORNIAINEN, TATU. 2005. Luoteis-Venäjän metsätalouden taskutieto. Finnish Forest Research Institute. 116 p.
- KIVELÄ, HANNU. 2006. Interview with Hannu Kivelä, Counsellor for Forestry Affairs, Embassy of Finland. 24.6.2006 Moscow.
- MÄKI, PÄIVI & TOIVONEN, RITVA & ENROTH, RAIJA-RIITTA. 2003 Export Prospects for Wood Products to China. Pellervo Economic Research Institute. Reports 187. Helsinki. 2003.
- MINISTRY OF ECONOMIC DEVELOPMENT OF REPUBLIC OF KARELIA. Available at www.gov.karelia.ru.

- MUTANEN, ANTTI & VIITANEN, JARI & TOPPINEN, ANNE & HÄNNINEN, RIITTA & HOLO-PAINEN, PÄIVI. 2005 Forest Resources, Production and Exports of Roundwood and Sawn wood from Russia Working Papers of the Finnish Forest Research Institute 9 2005. Available at <http://www.metla.fi/julkaisut/workingpapers/2005/mwp009.htm> .
- NASIBULLIN, URAL & PRUDNIKOV, OLEG. 2005 Lesprom Inform No 5 (27) 2005. Woodworking Journal. Available at www.lesprom.spb.ru.
- OECD 2002. OECD Economic Surveys 2001-2002. Russian Federation. Volume 2002/5-February. Paris 2002.
- PETROV, ANATOLY. 2005. Seminar on the New Russian Forest Code. Seminar presentation. 21.3-23.3.2005. Helsinki (Unpublished).
- RIA Russian News and Information Agency Novosti. available at www.rian.ru
- RUSSIAN FEDERAL CUSTOMS SERVICE 2004
- RUSSIAN FEDERAL CUSTOMS SERVICE 2006.
- SPIRIDOVITSH, SEIJA. 2006 Country report. Russia. May 2006. Finpro Ry. In Finnish.
- THE POWER MARKET IN NORTHWEST RUSSIA 2003. Four scenarios for decommissioning of the oldest units at Kola and Leningrad Nuclear Power Plants. The Norwegian Society (NNV) for the Conservation of Nature. Available at www.naturvern.no/powermarket.PDF
- TILLES, SEYMOUR 1968. Making strategy explicit. In Igor Ansoff's Business Strategy. Penguin 1968.
- TILLI, TAPIO & SKUTIN, STEN-GUNNAR. 2004. Pellervo Economic Research Institute Working Paper No 75. Forest Sector Scenarios in the Baltic Sea Area and Russia till 2010. 59 p.
- UNECE 2006. Forest Products Annual Market Review 2005-2006. ECE/TIM/SP/21.
- UNECE 2003. Geneva Timber and Forest Discussion Paper 27. Russian Federation Forest Sector Outlook.

INTERNET PORTALS:

- www.arge.de, Arbeitsgemeinschaft deutscher wirtschaftswissenschaftlicher Forschungsinstitute e.V. Berlin
- www.bof.fi, Bank of Finland
- www.drevesina.com, Trade portal for wood products
- www.forest.ru/eng/news
- www.idanmetsatieto.fi
- www.kronostar.com, Swiss Krono Group. Kronostar
- www.metinfo.fi. Finnish Forest Research Institute
- www.szfo.ru. Official Internet portal of the Northwest Russian Federal District
- www.uni-kiel.de. University of Kiel. Germany

ANNEX 1 QUESTIONNAIRE: PRODUCERS

**Pellervo Economic Research Institute
Eerikinkatu 28 A
00180 HELSINKI**

Questionnaire

NORTHWEST RUSSIAN WOOD PRODUCTS MARKET

Interviewee: _____

Organization: _____

This questionnaire is a part of a PTT project aimed to assess the production and export possibilities of Finnish wood products in Northwest Russia. Finnish wood product exporters, producers as well as expert organizations will be interviewed in order to produce an evaluative description of the Northwest Russian wood products market, as well as assess the export and production possibilities of Finnish wood products companies.

We are especially interested in your opinion concerning the future development of the Northwest Russian wood products market up to the year 2010.

1) Background information

1.1 Producer ____ / Exporter ____ / Both _____

1.2 Business area

1.3 Amount of turnover from Northwest Russian operations

1.4 Product(s)

1.5 Own production unit in Northwest Russia – location, number of employees.

1.6 Own sales office in Northwest Russia – location, number of employees.

1.7 Agent

1.8 Year of entering Russian market (was Northwest Russia your first market area in Russia?)

1.9 Are you planning to expand production (if producer) or volume of exports (if exporter)?

2) General trade policy.

- 2.1 How do you see the economic and political state of Northwest Russia in the light of your business?
- 2.2 Do you see any major changes that are likely to occur in your business environment?
- 2.3 How do you assess the country risk?
- 2.4 What are the challenges for the Finnish investor in Northwest Russia?
- 2.5 What kind of effect do Russian trade restrictions (such as tariffs/quotas) have on your business?
- 2.6 Is entering the Northwest Russian market significantly more difficult than entering some other market inside Russia?
- 2.7 Has the enlargement of the EU affected your operations in Northwest Russia?

3) Enterprise specific

- 3.1 What objectives does your business have in the Northwest Russian region?
- 3.2 If your primary business activity is exports, do you plan to invest in production capacity in Northwest Russia? If yes, why?
- 3.3 If you have production capacity in Northwest Russia, has this capacity replaced production in Finland?
- 3.4 Is your business activity concentrated in the Northwest Russian region? How do you see the situation in 2010?
- 3.5 How important is the Northwest Russian wood products market for your business?

4) Competition and market structure

- 4.1 Are your major competitors:
- a) Foreign producers in Northwest Russia
 - b) Foreign exporters to Northwest Russia
 - c) Local competitors
- 4.2 How has the demand for your products changed during 1990-2005? How would you estimate the demand in 2010?
- 4.3 What are the main aspects affecting the demand for your products?
- 4.4 Who are the biggest players on the Northwest Russian wood products market? How do you see their market position?

4.5 How do you think the structure of the wood products market will change in the next 10 years?

4.6 What are the marketing / distribution channels for your products?

4.7 Do you consider your marketing / distribution channels efficient and reliable?

4.8 Who are your major customers?

- a) Mediators (agents, wholesalers)
- b) Industrial end-users
- c) Retailers
- d) Public institutions

5) Profitability

5.1 How would you describe the state of your business in Northwest Russia? (Market share, profitability, expectations)

5.2 What are the major strengths of your business in Northwest Russia?

5.3 What are the major challenges for your business in Northwest Russia?

5.4 Have your operations in Russia contributed to the profitability of your business as a whole?

Please send your answers to allan.flink@helsinki.fi by 7.8.2006.

Thank you very much for your time!

*Allan Flink
+358 9-34 888 412
allan.flink@helsinki.fi*

ANNEX 2 QUESTIONNAIRE: EXPERT ORGANIZATIONS

**Pellervo Economic Research Institute
Eerikinkatu 28 A
00180 HELSINKI**

Questionnaire

NORTHWEST RUSSIAN WOOD PRODUCTS MARKET

Interviewee: _____

Organization: _____

This questionnaire is a part of a PTT project aimed to assess the production and export possibilities for Finnish wood products in Northwest Russia. Finnish wood product exporters, producers as well as expert organizations will be interviewed in order to produce an evaluative description of the Northwest Russian wood products market, as well as assess the export and production possibilities of Finnish wood products companies.

We are especially interested in your opinion concerning the future development of the Northwest Russian wood products market up to the year 2010.

1) Background information

1.1 Organization

1.2 Government _____ / NGO _____ / Private _____ / Research _____

1.3 Location Finland ___ / Russia ___

2) Investments

2.1 How would you describe the economic and political state of Northwest Russia?

2.2 Do you see any major changes that are likely to occur in the Russian economic and political environment?

2.3 How do you assess the country risk?

2.4 What are the challenges for the Finnish investor in Northwest Russia?

2.5 Is the enlargement of the EU affecting the operations of Finnish wood product companies in Northwest Russia?

3) Trade policies

3.1 What is the major course of Russian trade policies?

3.2 What kind of system of trade preferences does the Russian Federation have with other countries? Does Finland have economic agreements with the Russian Federation other than those related to the EU?

3.3 What kinds of effects do export subsidies (and other measures) have on trade between Finland and the Russian Federation?

3.4 What kind of effect may Russian trade restrictions (such as tariffs/quotas) have on Finnish wood product exporters?

3.5 What kinds of problems do you see in the Russian customs system?

3.6 What kinds of trade barriers do you see in Russia?

3.7 What kinds of difficulties may Finnish exporters/producers face in entering the Russian market?

3.8 Please answer the following question by ticking the right box. (1-strongly agree, 2-partly agree, 3- partly disagree, 4-strongly disagree).

The following statements describe the difficulties of Finnish exporters in entering the Russian market.

	1	2	3	4
General tariff level prevents exports to Russia.				
Lack of market information prevents exports to Russia.				
System of entering the Russian market is complicated.				
Customs and other legal regulations change frequently.				
Own sales office is essential to success in Russia.				
Personal contacts are crucial to business success in Russia.				

4) WTO

4.1 What are the main reasons for Finland wanting Russia to become a member of the WTO?

4.2 What benefits is Russia pursuing in WTO negotiations?

4.3 What are the main benefits for Finnish wood product exporters and producers from Russia's WTO membership?

5) Wood products market in Northwest Russia

5.1 Do you see the Northwest Russian wood products market as an attractive market area for Finnish wood products?

5.2 What aspects may contribute to the growth of the Northwest Russian wood products market?

- 5.3 Who are the main competitors of Finnish firms on the Northwest Russian wood products market?
- 5.4 What are the main strengths of Finnish wood products on the Northwest Russian wood products market?
- 5.5 What are the main challenges for Finnish wood product exporters and producers in Northwest Russia?
- 5.6 How do you see position of Finnish wood products on Northwest Russian wood products market in 2010?

Please send your answers to allan.flink@helsinki.fi by 31.7.2006.

Thank you very much for your time!

*Allan Flink
+358 9-34 888 412
allan.flink@helsinki.fi*



Pellervon taloudellisen tutkimuslaitoksen julkaisuja, publikationer, Publications

19. Perttu Pyykkönen. 2006. Factors affecting farmland prices in Finland
18. Vesa Silaskivi. 2004. Tutkimus kilpailuoikeuden ja maatalouden sääntelyn yhteensovittamisesta
17. Aki Kangasharju. 1998. Regional Economic Differences in Finland: Variations in Income Growth and Firm Formation.
16. Pertti Kukkonen. 1997. Rahapolitiikka ja Suomen kriisi

Pellervon taloudellisen tutkimuslaitoksen raportteja, forskningsrapporter, Reports

202. Pasi Holm – Anneli Hopponen. 2007. Vammaisten työkyky vuonna 2007. Vertailua työttömiin.
201. Meri Virolainen – Panu Kallio – Philip Abbott. 2006. Implications of export subsidy removal for the Finnish and EU dairy sectors
200. Pasi Holm - Jaakko Kiander - Timo Rauhanen - Matti Virén. 2007. Elintarvikkeiden arvonlisäverokannan alentamisen vaikutukset
199. Erno Järvinen – Anna-Kaisa Rämö – Harri Silvennoinen. 2006. Energiapuun tuotanto ja markkinat: Metsänomistajakysely
198. Janne Huovari – Jaakko Kiander - Raija Volk. 2006. Väestörakenteen muutos, tuottavuus ja kasvu
197. Anssi Rantala. 2006. Growth of new firms: Evidence from Finland 1996-2003
196. Timo Rauhanen – Ari Peltoniemi. 2006. Elintarvikkeiden ja ruokapalveluiden arvonlisävero EU:ssa ja Suomessa. VATT-tutkimuksia 122.
195. Pasi Holm – Jukka Jalava – Pekka Ylöstalo. 2006. Työttömien työkyky vuonna 2005. Työpoliittinen tutkimus 308., työministeriö

Pellervon taloudellisen tutkimuslaitoksen työpapereita, diskussionsunderlag, Working Papers

98. Liisa Kähkönen. 2007. Neljä näkökulmaa kuntasektorin palvelujen kilpailuttamiseen
97. Matti Virén. 2007. Analyzing the Incidence of Consumption Taxes
96. Janne Huovari – Jukka Jalava. 2007. Kansainvälinen ja vertaileva näkökulma Suomen tuottavuuskehitykseen
95. Ritva Toivonen – Raija-Riitta Enroth. 2007. Etsikkoaika. Metsäsektorin tulevaisuus Suomessa – selvitys asiantuntijanäkemyksistä
94. Jukka Jalava - Matti Pohjola. 2007. The roles of electricity and ICT in growth and productivity: Case Finland
93. Arto Kokkinen - Jukka Jalava – Riitta Hjerppe - Matti Hannikainen. 2007. Catching-up in Europe: Finland's convergence to Sweden and EU15
92. Petri Soppi - Raija Volk. 2007. Julkisen palvelutuotannon kilpailuttaminen taloudellisesta näkökulmasta – Katsaus kansainvälisiin kokemuksiin
91. Pasi Holm. 2007. Matalan tuottavuuden työn tukimallin laajentaminen alle 26-vuotiaisiin
90. Kalle Laaksonen – Petri Mäki-Fränti – Meri Virolainen. 2006. Mauritius and Jamaica as Case Studies of the Lomé Sugar Protocol
89. Kalle Laaksonen – Petri Mäki-Fränti – Meri Virolainen. 2006. Lomé Convention, Agriculture and Trade Relations between the EU and the ACP Countries in 1975-2000
88. Terhi Latvala – Erno Järvinen – Harri Silvennoinen. 2007. Bioenergiaa pellolta – Maa- ja metsätilan omistajien halukkuus viljellä peltobio-massaa