

Article

The effect of forest policy on the use of forest resources and forest industry investments in Russia

Timo Karjalainen ^{1,*}, Lasse Jutila ², Timo Leinonen ¹ and Yuri Gerasimov ¹

¹ Finnish Forest Research Institute Metla, P.O. Box 68, 80101 Joensuu, Finland; Email: timo.leinonen@metla.fi (T.L.); yuri.gerasimov@metla.fi (Y.G.)

² Finnish Customs, P.O. Box 512, 00101 Helsinki, Finland; Email: lasse.jutila@pp.inet.fi

* Author to whom correspondence should be addressed; Email: timo.karjalainen@metla.fi; Tel.: +358 29 532 3080; Fax: +358 29 532 3113.

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Abstract: In 2007, some noteworthy modifications took place in the Russian forest sector. Almost at the same time as the new Forest Code came into effect, a decree supporting prioritised investments in the forest sector and another decree aimed at ending the export of roundwood through the raising of export duties were also implemented. The purpose of the aforementioned documents was to promote the massive restructuring of the forest sector, in which the promoter was supposed to be forest industrial clusters in particular around pulp and paper production. These industrial clusters were intended to be able to meet the challenges of the new forest legislation, in terms of wood harvesting and the production of value added products. The reformation of the Russian forest sector did not begin favourably in 2008–2012, as all of the essential indicators showed that the situation in both forestry and the forest industry had continued to weaken since the year 2007. 120 priority investment ventures had been officially approved by the beginning of 2013, of which 27 have been completed or started. At this point, it is evident that the great majority of these undertakings will not come to fruition in line with the original goals. The successful development of the forest sector in Russia will require a more predictable legislative environment and liberalisation of the domestic market from protectionist custody.

Keywords: forest sector; forest code; priority investment; custom duties; development strategy

1. Introduction

Rebuilding the forest sector during the transitional period from a planning economy to a market economy has not been very successful. There have been delays in the development of the forest sector due to poor infrastructure (in particular, the forest road network), extensive forestry, low productivity resulting from using outdated methods and machinery, a lack of the capacity to produce upgraded products, low innovation activity and low interest in investing [1–3]. Forest policy has been incoherent, based on separate programmes and regulated by partly conflicting legislation, and thus any overall guidance has been missing [4,5]. The forest resources of the Russian Federation are the largest in the world [6]. The extent to which they are utilised could be increased substantially, as the actual cut has been far below the allowable cut [7].

The President of the Russian Federation commented on the state of the forest sector in the Komi Republic in 2006, listing the main issues which require solutions. These included the export of roundwood, the improvement of the quality of the forests, illegal wood harvesting, and efficiency in the forest industry. In terms of actions to improve the situation, he suggested strong support for development through forest policy formulation, legislation, motivation for structural changes and the creation of favourable conditions for investment in wood processing. More or less same issues were repeated by the President in the Republic of Buryatia in spring 2013. In this article, we have analysed the main tools that have been used in the Russian forest sector reform i.e. how the new forest code, the decree for raising custom duties on the exportation of roundwood, and the decree for supporting prioritised investments in the forest sector have influenced the use of forest resources and investment in the forest industry in Russia. To a large extent, the geographical focus is on the northwestern part of the Russian Federation, and this analysis has been conducted predominantly from the point of view of foreign/Finnish stakeholders.

2. Materials and Methods

The Russian forest sector reform was initiated through three major legislative measures which were put in place almost simultaneously in 2007. A new Forest Code [8], later becoming the New Forest Code, was introduced in the beginning of 2007. Customs duty phasing out unprocessed timber exports was laid down on the 5th of February 2007 [9], and the first increases in export duties came into force on the 1st of July 2007. The third important measure was the decree for priority investments in the forest sector on the 30th of June 2007 [10]. These were the principal means by which the Russian government tried to turn the Russian forest sector away from its miserable state and towards prosperity.

The forest policy measures in question are summarised in Table 1, according to their key impacts from the viewpoint of the main stakeholders: logging companies, small and medium sized manufacturers, big forest industry companies, and the budget of the Russian Federation.

Table 1. Impacts of the forest policy measures in question on different stakeholders (– negative, ± neutral, + positive).

	Key impact	Logging companies	Small and medium sized manufacturers	Big forest industry companies	Budget of the Russian Federation
New Forest Code	<ul style="list-style-type: none"> • additional responsibilities for forest leasers without compensation 	<ul style="list-style-type: none"> – additional costs – difficult to fulfill responsibilities → problems with authorities – decreasing willingness to lease forests – conflicting and inflexible normatives 	<ul style="list-style-type: none"> – decreasing willingness to lease forests and to harvest one's own wood – conflicting and inflexible normatives 	<ul style="list-style-type: none"> – additional costs – conflicting and inflexible normatives + big companies have resources for investments + ”companionship” with the state provides opportunities to negotiate responsibilities 	<ul style="list-style-type: none"> + part of the forestry expenses to companies + incomes from forest lease
Degree on priority investments	<ul style="list-style-type: none"> • forest lease without auction • 50 % discount on the forest use payment during the payback period 	± not applicable to normal logging companies	± not applicable to small companies	<ul style="list-style-type: none"> + securing availability of the raw material through own logging operations + competitive advantage compared to small players 	<ul style="list-style-type: none"> – income from forest use decreasing (at least temporarily) – infrastructure investments require strong state support
Custom duties for roundwood export	<ul style="list-style-type: none"> • decreasing demand for wood from abroad 	<ul style="list-style-type: none"> – decreasing logging volumes – profitability of wood harvesting decreasing – income from wood sales decreasing – many companies have to close operation – difficulties to sell pulp wood 	+ cheaper raw material (in particular pulpwood)	+ cheaper raw material (in particular pulp wood)	<ul style="list-style-type: none"> – loss of income from duties on roundwood export – fewer forest use payments due to decreasing wood removals

The New Forest Code was designed both to clarify the ownership of forests, and to control the use of forest resources. Its overall aims were to intensify the use of forests, to increase income from forests, and to prevent/control illegal wood harvesting. As a result, the role of the private forest sector increased, forest use was to be based on long-term leasing (with a maximum of 49 years), and regions were responsible for the provision of forest plans.

The decree on priority investment projects in forest development focuses on big companies which are capable of managing the whole chain, from the forest to value added products. Priority investment projects should be related to improvements in the forest infrastructure and/or wood processing, and these can be either new green field projects or modernisation projects in which the capital investment should exceed 300 million Rubles (> 7 million €). Such projects require an application to the regional authorities, and also approval from the Federal Forestry Agency (Rosleshoz), while the final approval comes from the Ministry of Industry and Trade of the Russian Federation.

Top level politicians have previously been dissatisfied with the structure of forest sector exportation, as Russia has mainly exported unprocessed timber and imported value added products. Increasing custom duties for the exportation of roundwood were introduced in order to change this situation. Aim was to eventually stop the export of roundwood and force foreign companies to invest in wood processing in Russia. The first increases were implemented in the summer of 2007, and step by step in April 2008, the duties increased to a minimum of 15 € per m³ (25% of the export value) for coniferous wood and birch exceeding 15 cm in diameter. From the beginning of 2009, duties should have been at least 50 € per m³ (80% of the export value) for all other assortments, except for birch of less than 15 cm in diameter (0% of the export value). This increasing, however, was not realized. Other custom policy measures included a custom union with Belarus and Kazakhstan, reduction in the number of handling points for custom matters, reduction of custom duties for exporting value added products and importing advanced technology not available in Russia, and increasing custom duties for imported machinery and devices manufactured in Russia. Export duties were one of the obstacles preventing Russia from joining the World Trade Organisation (WTO). Active custom policy was aimed towards protecting goods which are produced in Russia.

These measures were implemented in Russia during a late phase of the long-running economic boom. At that time, the economic outlook suggested that the state could, where appropriate, vigorously support the development of the forest sector according to these new strategies. New strategies were formed and published shortly after the onset of the reform as the Russian Forest Sector Development Strategy 2020 Programme [3]. This programme was the first attempt to assemble a joint long-term forest policy agenda for the entire forest sector, instead of the earlier separate programmes for forestry and the forest industry. The Ministry of Agriculture and the Ministry of Industry and Commerce of the Russian Federation confirmed the common strategy in late October 2008. This strategy includes a number of detailed objectives and activities for forestry. However, how these objectives will be achieved in practice is not mentioned, only that the New

Forest Code will be the main tool for directing forestry. This strategy includes two scenarios. The baseline scenario assumes that there will be no major innovations, but focusses mainly on the modernisation and development of existing capacities, the continuing import of value added products and about 675 billion Rubles worth of investment, of which 3% will go to forestry. The innovation scenario, which is the target, assumes that active state policy will lead to new innovations, modernisation and the creation of new capacities and value added products. This would involve about 2910 billion Rubles of investment, of which 21% would go to forestry.

3. Results

The Russian forest sector reform seems to have started poorly during the period 2007–2009, according to the set parameters of the forest sector. The main indicators of forestry and the forest industry show a decline in the development of the forest sector in 2008 and 2009, and slight recovery afterwards, but far behind the targets set in the Russian Forest Sector Development Strategy 2020 (Table 2). Those responsible for the Russian forest policy may wish to explain this decline in development as a result of the global financial crisis which began in late 2008 and the subsequent economic downturn. However, the international economic downturn cannot explain the poor development of the Russian forest sector in 2008. The international financial crisis only began to influence the real economy in Russia in late 2008, as the full-year gross domestic product (GDP) grew by 5.6% in Russia in 2008 [11].

Table 2. The performance of the forest sector in 2007–2012 based on the statistics and targets for 2012 and 2020 according to the innovation scenario of the Russian Forest Sector Development Strategy 2020 [3,7,12].

Industry	Forest sector performances						Targets according to the innovation scenario of the Forest Sector Development Strategy 2020	
	2007	2008	2009	2010	2011	2012	2012	2020
Logging, mill. m ³	206	167	159	174	197	191	236	294
Industrial wood production, mill. m ³	107	91	80	106	111	113	165	254
Sawnwood production, mill. m ³	24.3	21.6	19.0	19.1	20.0	20.5	37	55
Plywood production, mill. m ³	2.8	2.6	2.1	2.7	3.0	3.1	3.8	4.9
Pulp production, mill. tons	6.0	5.9	5.5	5.9	7.4	7.7	8.3	13.4
Paper and cardboard production, mill. tons	7.6	7.7	7.5	7.6	7.6	7.7	9.9	15.8

The development of economic activities in the forest sector is also well illustrated in the monthly statistics of the commercial roundwood removals over the period 2006–2009 (Figure 1). In 2007, the commercial roundwood removals were still higher than in 2006. It could be concluded that the New Forest Code that came into force on the 1st of January 2007 did not immediately reverse the usage of wood and the decline in economic activity in the forest sector. The effects of the New Forest Code may also be evident in the statistics showing the delay due to the transitional period and the slow implementation of the law. The combined impact of all of the legislative changes which contributed to the forest sector reform began to appear in the 2008 statistics regarding commercial roundwood removals, in particular the impact of increasing duties for the exportation of roundwood. The statistics clearly show that the commercial roundwood removals were on a lower level at the beginning of 2008 compared to the previous year. The decline in Russia's use of wood in 2008 cannot be explained by the change in the overall economic situation, as in early 2008 both the Russian economy and the global economy were still in the final phase of an upward trend. The most likely explanation for this significant drop in commercial roundwood removals is the reform which was carried out within the Russian forest sector. Due to the combined impact, the demand for wood collapsed and commercial roundwood removals were substantially reduced due to the decreasing demand. In 2009, commercial roundwood removals were at an even lower level than in 2008. The continuous downward trend in 2009 in commercial roundwood removals may be explained by the continued decline in unprocessed timber exports as a consequence of rising export duties, which was not compensated for by the domestic consumption of wood.

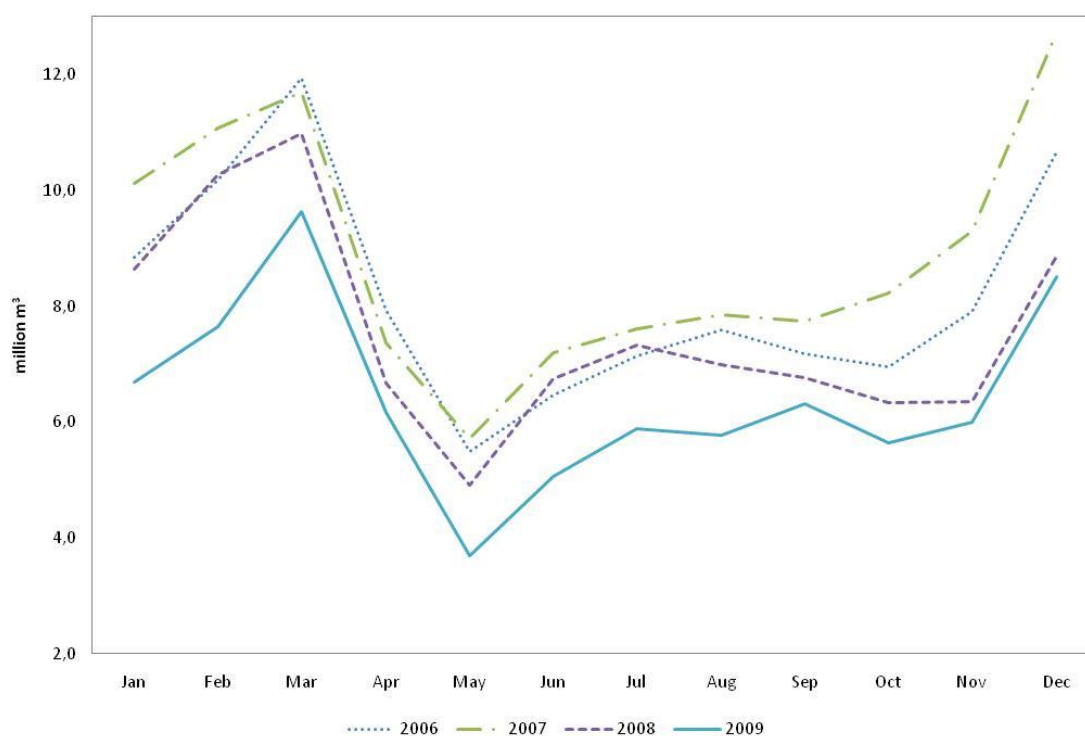


Figure 1. Monthly commercial roundwood removals in 2006–2009 [13]

In early 2013, a total of 120 priority investment projects had been announced that the Ministry of Industry and Commerce of the Russian Federation had accepted [3,14]. Most of these projects are in the Northwestern and Siberian regions (Table 3). If the priority projects are realised, the total investment would exceed 400 billion Rubles, and the projects would need about 70 million m³ of raw materials every year. On their own, the 10 biggest priority investment projects would need investments worth about 330 billion Rubles and 30–35 million m³ of raw materials every year.

Table 3. Announced and accepted priority investment projects in 2013.

Region	Number of projects	Investment, mill. Rub	Raw material needed, 1000 m ³	Annual allowable cut requested, 1000 m ³
Altaysky kray	2	1 937	381	689
Amurskaya oblast	2	699	292	151
Arkhangelskaya oblast	7	22 582	3 586	2 798
Bryanskaya oblast	3	2 743	780	505
Evreyskaya AO	3	656	325	325
Irkutskaya oblast	6	32 865	16 208	11 528
Ivanovskay oblast	1	961	463	463
Kaluzhskaya oblast	8	1 300	200	238
Kemerovskaya oblast	1	2 405	334	334
Khabarovskiy kray	1	18 523	3 758	3 563
Kirovskaya oblast	9	7 854	3 339	3 002
Krasnodarsky kray	1	9 440	600	600
Krasnoyarsky kray	2	116 819	12 690	18 054
Kurganskay oblast	2	458	100	100
Leningradskaya oblast	1	6 790	1 170	728
Novgorodskaya oblast	8	4 335	1 460	1 500
Omskskay oblast	3	949	278	278
Permsky kray	1	19 684	4 248	3 723
Primorsky kray	3	6 736	1 136	722
Pskovskaya oblast	5	437	300	500
Republic of Bashkortostan	3	3 660	1 368	1 368
Republic of Buryatia	6	6 454	1 414	1 621
Republic of Karelia	1	35 145	4 000	223
Republic of Komi	2	20 640	2 595	3 501
Republic of Udmurtia	17	306	80	60
Ryazanskaya oblast	1	1 155	681	681
Sakhalinskaya oblast	2	6 000	750	750
Smolenskaya oblast	1	11 003	1 752	1 000
Sverdlovskaya oblast	3	2 227	1 650	1 791
Tomskaya oblast	2	6 309	570	570
Tverskaya oblast	3	7 658	791	698
Tyumenskaya oblast	2	1 806	740	842
Vladimirskey oblast	1	753	383	473
Vologdskaya oblast	6	12 843	3 952	3 237
Zabaykalsky kray	1	22 000	700	700
Total	120	396 132	73 074	67 316

One of the aims was to attract foreign investors to invest in wood processing in Russia. In 2008–2009, foreign investments dropped from 812 to 682 million USD in mechanical wood processing and from 1077 to 945 million USD in the pulp and paper industry. During the first six months of

2010, investments dropped by 48% in mechanical wood processing and 47% in the pulp and paper industry compared to the same period in 2009 [15].

To date (spring 2013) 27 of the priority investment projects have started or have been realised, and 11 projects have been excluded from the list [14,16,17]. According to the Ministry of Industry and Commerce of the Russian Federation, one third of the projects have been delayed and it is clear that the targets set in the strategy will not be reached.

4. Discussion and Conclusions

The key measures which made up the Russian forest sector reform which began in 2007 were intended to support the restructuring of the sector. Forest clusters based on large scale pulp and paper production, which are able to take care themselves about silviculture, organizing wood harvesting and to be able to produce competitive, value added products, have been thought to be locomotives to the forest sector development. In order to support this development, the government, using legislation, has created a situation in which commercially interesting forests can be reallocated to those with large investment projects. Features in the New Forest Code that favour big companies include also opportunities for priority investors to lease forests without a tender procedure and also many obligations for the forest leasers, for which the resources of smaller companies are not sufficient. Small and medium-sized businesses tend to suffer as a result of these measures which favour big companies.

Increasing duties which were introduced for roundwood export also mainly benefited big pulp and paper producers in Russia. The decline in the demand for roundwood in Russia has resulted in a drop in the price of pulpwood, and pulp mills have facilitated the acquisition of raw materials. The reduced price of wood and the collapse in demand for some assortments of wood, however, have meant a steep decline in the profitability of the logging companies.

Unquestionably, one of the prerequisites for the success of Russia's forest reform is the rapid start-up of major investment projects in the forest industry. A considerable number of priority investment projects arose quickly, and initially the situation seemed promising in that respect. A closer examination of the projects shows that many of the projects were based more on wishful thinking than on a thorough mastery of the industry, business and long-term economic considerations. In Europe and North America forest industry has adjusted capacity to reflect shrinking demand in the markets [18].

After the initial assault of priority investment projects, it seems that only a handful of real projects which have been taken seriously have remained. With these projects alone, Russia will not be able to enable the forest sector to grow. In order to obtain large investments in the forest industry, Russia should attract global forest industry players to invest in the Russian forest industry. So far, significant foreign investments in the pulp and paper industry were made before the current forest sector reform. The measures inherent in the forest sector reform which were designed to gain the confidence of investors have not been very convincing. The development of legislation for the forest sector has been unpredictable and subject to constant change. Protectionist trade and

industrial policy have also reduced investors' interest in the region. Forcing foreigners to invest in wood processing in Russia by stopping the export of roundwood through export duties may be a fatal mistake.

The desired direct and indirect effects of stopping the exportation of roundwood were not catalytic; instead, they acted like a poison. Roundwood export duties had an important external influence on the attitude of international forest companies towards Russia as an investment territory. Many tended to think that there would be plenty of raw material for domestic use and also for export, and thus raw material to provide the necessary export income. The implementation of large new pulp and paper projects was made difficult by the export duties which were introduced, as the domestic roundwood market for all assortments is not operating well. All in all, the imposition of export duties reduced investors' confidence in the country's politics, and thus reduced their willingness to invest in Russia. In addition, in Finland, for example, the decrease in the importation of wood from Russia caused adjustments and cutbacks in production in the forest industry, and thus had an impact on the forest industry's financial situation and indirectly reduced the possibility of new investments. However, the effects of decreasing unprocessed timber exports from Russia have been more devastating. The biggest roundwood exporters and logging companies are suffering the most through losing revenue from timber sales. The domestic demand for roundwood has not compensated for the decrease in exportation. The difficulties encountered by the logging companies have also had significant indirect effects on employment and people's livelihoods, especially in the border regions of Russia. Furthermore, the Russian state has lost income from wood export payments and has also got fewer forest use payments due to decreased wood removals. Thus, opportunities for logging companies to invest in silviculture, wood harvesting and forest infrastructure in line with the requirements of the New Forest Code have been few due to the impaired economic situation of these companies. At the same time, the forest sector revenues to the state have decreased and thus there is no longer the possibility that state funding for forestry will be able to repair the damage. This has created a vicious circle, which reflects on wood supply and future investment opportunities in forestry and the forest industry. Unfortunately, the effects which have been identified so far are negative.

At the Russian-Finnish forest summit in St. Petersburg in October 2009, there were visible differences in the views of the representatives of the Finnish forest industry and the Russian political leaders. The representatives of the Finnish forest industry pointed out the clear interest in and the importance of the Russian forest sector, but also pointed out that globally operating forest industry companies will invest in regions which they decide have the best conditions for investment. In addition to profitability, a stable legislative environment, security for foreign investments, the availability of raw materials at competitive prices, a functioning infrastructure and a better market for the final product all have an impact on investors' decision-making according to the Finnish representatives of the forest industry companies. In addition, according to these representatives, export duties for roundwood had further weakened the investment preconditions through the sizeable impact of the reduced export of roundwood. Work on reducing the barriers preventing

international trade was seen important as well. Situation was partly fixed when Russia joined the WTO in 2012 after 18 years negotiations.

The Chairman of the Board of the association lobbying the Russian pulp and paper industry [19] commented on the poor situation in the pulp and paper industry at the International Forest Forum in St. Petersburg in October 2010 by saying that although the new legislation in Russia has had a positive impact on the development of the pulp and paper industry, reforms are still partially inadequate, thus the industry has not been able to increase production, even to the level that it had reached at the end of the 1980s. He also wondered where to find investors who would be able to invest approximately one billion Euros to build a new pulp mill with payback time of about 15 years in the unstable Russian legislative environment. This statement describes well the situation regarding the big new green field projects in the forest industry.

One of the latest moves took place in 2012, when the President of the Russian Federation signed an order to move the Federal Forestry Agency (Rosleshoz) from the subordination of the government to the subordination of the Ministry of Natural Resources and Ecology. This was a move back to the earlier structure in forestry administration, as the Federal Forestry Agency was a dependent civil service department in 2000–2010. In practice, this move meant that the status of the Federal Forestry Agency was weaker and that forestry matters which in 2010–2012 concentrated in one place were divided between various civil service departments. The Federal Forestry Service now has less responsibilities as well as power to influence on the use of forest resources and forest industry investments in Russia.

The Russian forest sector reform may look like a gamble. Selected forest policy measures, which were designed to bring about huge profits very quickly, are also high risk strategies. Decision makers have to think about the next policy moves in the forest sector from an increasingly difficult position. A continuation of the current strategy would mean that the position of smaller players would get steadily worse and continuation of decision maker's blind trust to those responsible of the large investment projects to make their decisions quickly. Otherwise, the gambling table will soon be empty and the game will need to start from the beginning. Another option is to change the strategy. There are two main options for a new strategy. The first strategic option could be to continue with the current rules of the game, meaning that the state itself must substantially increase its contribution and thus ensure an improvement in development. In this option, the state should invest much more in forestry infrastructure, and also directly in the forest industry. According to the current rules of the game, only those who are willing to accept the risks which are inherent in Russia's situation will be able to manage in the forest sector. It seems that the political risks included in the large investments in the Russian forest sector can be managed only by those actors who can influence political decision making in Russia. In the second strategic option, Russia could begin to play by the same rules other places in which investments have been made. Then, sooner or later, contributions will start to flow on the gambling table and the game will become profitable. This option would require the creation of a predictable legislative environment, and the liberalisation of the domestic market from protectionist custody. The membership in WTO is a step

to this direction. Another step to improve current situation with forest resources and forest industry investments in Russia is forest policy formulation. The forest policy document is under discussion in Russia and should be adopted in late 2013 [20]. The policy should contain measures for the support of forestry, the forest industry, demand for forest products, forest trade, investments, research, education, international cooperation and collaboration with international organizations [21].

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