Reform of forest use payments in Russia

Sari Karvinen and Antti Mutanen, 11/2019

NATURAL RESOURCES INSTITUTE FINLAND

Russian logging companies pay the state a fee for forest use, which is currently about one euro per cubic metre of wood. The forest use payment is one tenth of the production costs of wood.

In order to increase the state's forestry income and to intensify forestry, the minimum rate of forest use payment is being converted to market-based. According to the plan, the forest use payment would be based, among other things, on the forest leaser's wood processing capacity and degree of processing, as well as the amount of forest regeneration work and forest road construction.

The planned reform would increase the forest use payments significantly, in particular for SMEs, and strengthen the concentration of logging companies on large forest industry groups.

- **19 per cent of Russian forests are leased for wood harvesting.**
- **In Russia, there are 5700 forest leasers, half of them small or medium sized by logging volumes.**
- **Forest leasers cover 80 per cent of wood harvesting.**
- **Standing sales of forest stands are targeted especially at SMEs.**

Forest use rights

Russian forest fund (*lesnoy fond*) is owned by the Russian Federation and it covers 95 per cent of the forest area. Forests outside the forest fund are located for example in military areas and settlements. Forest use is subject to a charge, and private companies as well as individuals can obtain paid forest use rights for a limited period of time.

Logging rights can be obtained through forest lease for 10-49 years or through a standing sale agreement for less than one year. Forest use rights are primarily granted through auctions and competitive tendering. Companies approved to the priority investment list receive harvesting rights without competition.

The forest use payment is based on the minimum rate set in the regulations. The minimum rate is used as the starting price for the auctions, whereas the regional forest authorities may set a higher starting price than the minimum rates. The forest use payment is based on the allowable cut of the leased forest area or stand being sold, and is charged according to the logging volumes specified in the contract irrespective of the actual volumes harvested.

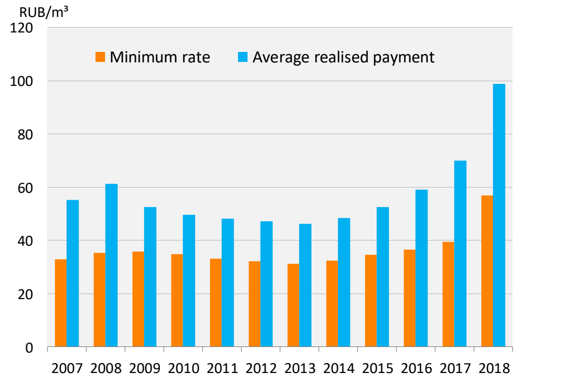
Current minimum rates less than one euro per cubic metre

The minimum rate of wood harvesting is differentiated according to tree species, transport distance and timber assortment structure for 53 payment zones. In Northwest Russia, the payment zones correspond to the Federation subjects, with the exception of Arkhangelsk-Vologda payment zone. In addition, the coefficients for logging type and wood harvesting conditions are used in the calculation of the minimum rate. The minimum rate for priority investments is reduced by 50 per cent.

In 2014-2018, the minimum rate for wood harvesting was 40 roubles per cubic metre (0.6 €/m³) and the actual forest use payment was 66 roubles (1 €/m³), which is 65 per cent higher than the minimum rate (Figure 1).

The last decree on minimum rates for wood harvesting was adopted in 2007 (22.5.2007 № 310).

Figure 1. Development of forest use payments in Russia 2007-2018



Sources: Petrunin 2019, Strategiya...2030

There have been several increases in the minimum rates, the highest of which was 44 per cent in 2018. During the weak economic situation in 2010-2014, increases were put on hold to support forest industry. (Table 1)

In Russia, the forest use payment accounts, on the average, for 10 per cent of the harvesting company's production costs, i.e. the cost price of wood (Karvinen et al. 2016, Strategiya...2030). In Northwest Russia, the share of forest use payment is about 4 per cent of the cost price of wood (Figure 2). The share of forest use payment in the prices of different timber assortments is estimated as follows (Strategiya...2030):

- Sawlogs 3-4%
- Veneer logs: softwood 7%, hardwood 2%
- Pulpwood 6-7%.

Table1. Valid increases of minimum rates for wood harvesting.

Year	Coefficient, increasing the rate of 2007	% from previous year
2008	1.15	15
2009	1.30	13
2015	1.37	5
2016	1.43	4
2017	1.51	6
2018	2.17	44
2019	2.38	10
2020	2.62	10
2021	2.72	4
2022	2.83	4
2023	2.94	4

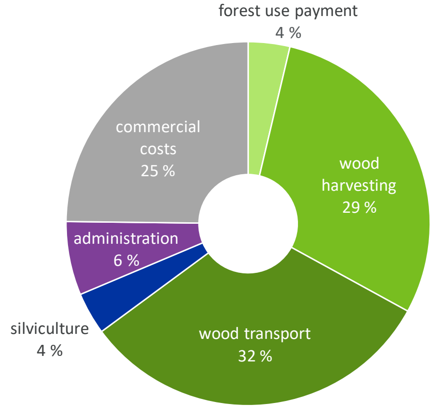
Sources: Federal laws on budget, Government decree...310

Reform of forest use payments

Forest use payments are considered too low from the viewpoint of the state and the basis for their determination is being revised. The aim is to increase government revenue and improve the profitability of forestry from a state-owner perspective. In addition, aim is to create financial incentives for companies to intensify forestry and develop high value added production.

Several approaches to calculate the market-based forest use payment has been presented. The most concrete proposal is the draft decree published by the Russian Ministry of Natural Resources and Environment in autumn 2019, which is currently in the public consultation phase.

Figure 2. Structure of wood cost price in Northwest Russia 2016



Source: Strategiya...2030

The background report of the draft decree justifies the need for reform as follows:

- The current minimum rates are too low and do not reflect the true value of forest resources in the regions.
- Forest use payments do not motivate companies to process wood, and forest leasers underutilise wood harvesting opportunities (2/3 of leasers' allowable cut is harvested).
- In Russia, there is no financial incentive for forest users to intensify the use and regeneration of forests or to increase the degree of wood processing.

The proposal for a market-based forest use payment in the draft regulation, which motivates forest users to develop wood processing and high value added production, outlines following actions:

- Supplementing the current minimum rate with a weighting factor, which depends on the forest leaser's own wood processing rate (does not apply to priority investments):
  0-30 %: 2-fold rate
  30.1-60 %: 1,5-fold rate
  > 60.1 %: 1-fold rate
- The definition of minimum rates will in the future be based on the market price of wood, the costs of harvesting and transporting wood, the costs of forest protection and silviculture, and the standard profit of the logging company.

- For a transition period from 1.1.2021 to 31.12.2023, market-based minimum rates will apply only to new forest lease contracts, from 1.1.2024 for all contracts.

The proposed new minimum rates will be calculated using 13 correction factors, some of which are already used in the calculation of the current rate (e.g. transport distance, thinnings, wood volume per hectare, slope of the terrain). New correction factors:

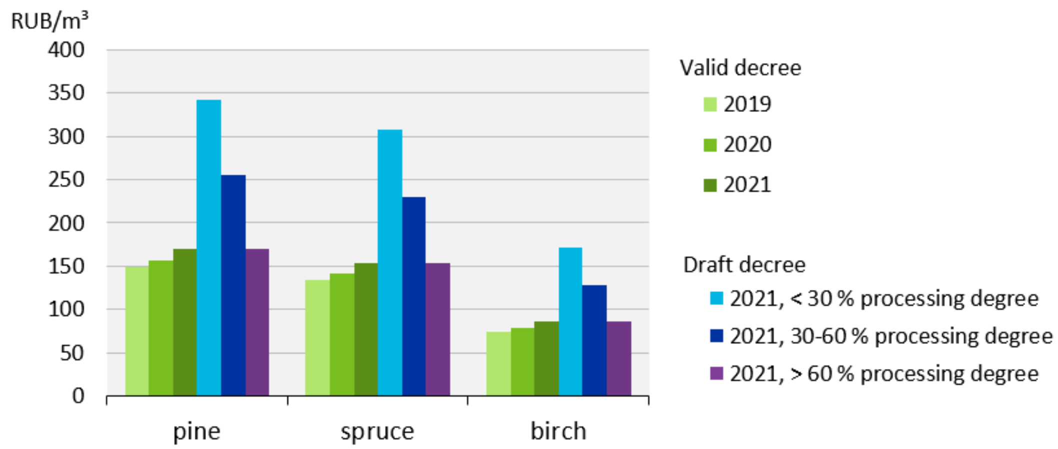
- Small and medium sized companies and entrepreneurs: 0.5.
- Forest leaser's degree of own wood processing:
  - 10 - 20 %: 0.95
  - 20.1 - 30 %: 0.9
  - 30.1 - 40 %: 0.85
  - 40.1 - 50 %: 0.8
  - 50.1 - 60 %: 0.75
  - 60.1 - 70 %: 0.7
  - 70.1 - 80 %; 0.65
  - 80.1 - 90 %: 0.6
  - > 90.1 %: 0.55
- Products manufactured by the leaser:
  - Roundwood: 1,0
  - Sawn wood: 0.8
  - Wood-based panels and pulp: 0.65
  - Joinery products, paper and paperboard: 0.6
- Forest regeneration with container seedlings of improved origin:
  - 10.1 - 50 ha: 0.97
  - 50.1 - 100 ha: 0.95
  - 100.1 - 200 ha: 0.93
  - 200.1 - 300 ha: 0.9
  - > 300.1 ha: 0.85.
- Realisation of allowable cut:
  - 70.1 - 80 %: 0.95
  - 80.1 - 90 %: 0.9
  - > 90.1 %: 0.85
- Construction of all-season forest roads:
  - < 1 km: 1
  - 1 - 5 km: 0.9
  - 6 - 15 km: 0.85
  - 16 - 30 km: 0.8
  - 31 - 50 km: 0.75
  - > 50.1 km: 0.7

Forest use payments are adjusted annually by the above coefficients based on the previous year's results.

Assessment

If the draft decree of the Russian Ministry of Natural Resources and Environment is approved without changes, in the beginning of 2021, the minimum rate for existing lease agreements might even double for companies that are not able to process over 60 per cent of harvested wood (Figure 3).

Figure 3. Minimum rates for wood harvesting in Arkhangelsk and Vologda regions for existing lease contracts*.



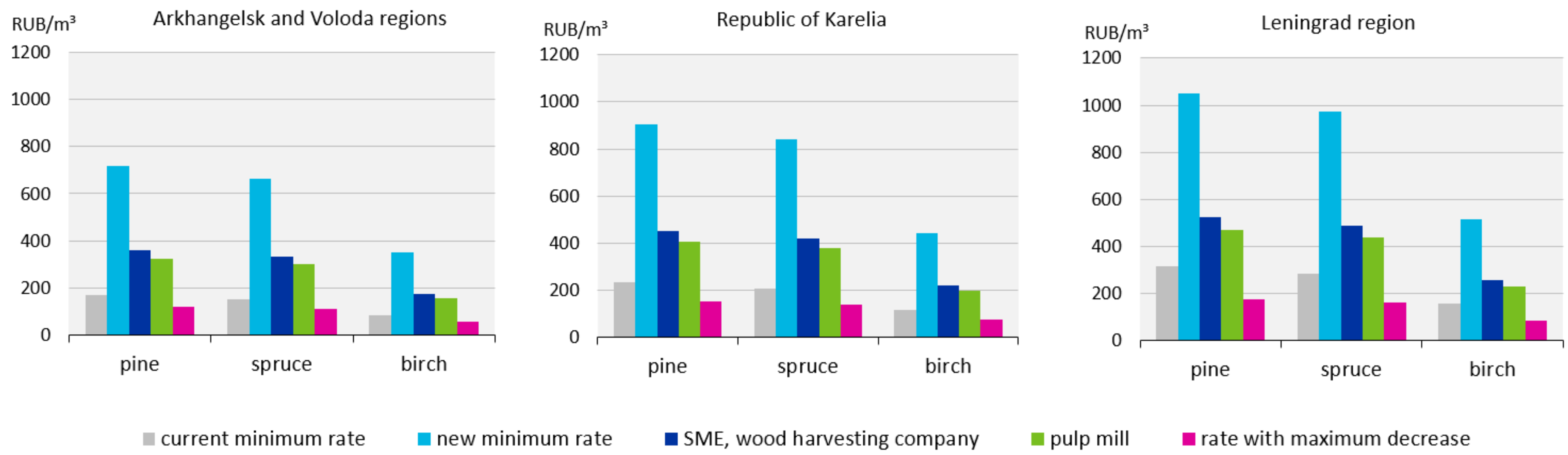
* Industrial roundwood without bark, clearfellings, wood volume 100.1-150 m³/ha, transport distance from forest to the nearest loading point max. 100 km, slope of the terrain < 20 degrees. Present minimium rate with valid increases of the decree 310, average for timber assortment groups. New minimum rate according to the draft decree with correction factors on degree of own wood processing .

Sources: Government decree...310, Minprirody 2019

In practice, the increase of minimum rate would affect a large number of forest leasers as only few of them have opportunities for processing both logs and pulpwood. The share of logs accounted, on the average, for 50 per cent of roundwood production in Northwest Russia in 2014-2018, and the share of pulpwood was 30 per cent (Rosstat 2019). The increase of minimum rated would be particularly severe for SMEs, which account for almost 90 per cent of forest leasers in the Arkhangelsk region, for example (Lesnoi Region 2015). According to the background report of the draft regulation, a new minimum rate would apply to old forest lease contracts from 2024 onwards, i.e. the above-mentioned increases would only apply for a transition period. However, this is not mentioned in the draft regulation itself.

The minimum rates set in the draft regulation for new forest lease agreements concluded after 2021 are 3-4 times higher than the current rates. The correction coefficient for SMEs would halve the increases for most independent harvesting companies. For the wood processing industry, the minimum rate increases would be smaller (Figure 4). If the forest leaser could be able to take full advantage of the new correction factors, the minimum rate might de-

Figure 4. Minimum rates of wood harvesting for new forest lease contracts 1.1.2021*.



* Industrial roundwood without bark, clearfellings, wood volume 150.1-185 m³/ha, transport distance from forest to the nearest loading point max. 100 km, slope of the terrain < 20 degrees. Present minimium rate with valid increases of the decree 310, average for timber assortment groups. New minimum rate according to the draft decree with correction factors:

SME harvesting company: without own wood processing coefficient 1; SME coefficient 0.5

Pulp mill: wood processing degree 50-60 % coefficient 0.75; products paper and paperboard coefficient 0.6.

Source: Government decree...310, Minprirody 2019 crease from the current level. Reduction rates based on forest regeneration and forest road construction are easy to achieve, but a full reduction based on the degree of wood processing and utilisation rate of the allowable cut may be practically impossible. The preconditions for processing more than 90 per cent of harvested wood are poor when firewood alone accounts for more than 10 per cent of the harvested volumes (Rosstat 2019). The calculation criteria for the allowable cut are criticised in Russia and the actual felling potential is considered to be significantly lower than the calculated one (Shvarts et al. 2018, Strategiya...2030). In addition, outdated and inaccurate forest resource data do not reflect the true characteristics of the stand, which increases the probability of errors when determining the allowable cut.

Increases in the current forest use payments appear to have had a statistically significant effect on the development of roundwood producer prices in Northwest Russia after 2015, when the annual increases in the minimum rate have led to wood price increases. The exception is hardwood logs, for which only the 44 per cent increase in 2018 is statistically significant. Similar effect was not observed in the development of euro-denominated border prices of wood imported from Russia to Finland. The analysis was carried out using a time series model, which used, in addition to past price observations, the increases in the minimum rate and, in the case of wood imported to Finland, changes in the Russian export duties on roundwood. Statistics on roundwood market prices in Russia were not available, thus, roundwood producer prices were used in the model.

The increases in forest use payments would further strengthen the concentration of wood harvesting on companies belonging to large forest industry groups. From the viewpoint of the Russian state, a small number of large forest leasers might, on one hand, increase investments in forestry and improve the quality of silviculture, as well as facilitate the control of forest use. On the other hand, concentration will reduce competition in the roundwood markets and lower prices. As a result, the wood price would not be market-based, the aim which the reform strives to achieve.

Work on the reform of Russia's forest use payments is ongoing, and the current draft regulation is unlikely to proceed with approval soon. In September 2019, the Russian Forestry Agency set up a working group comprised of the representatives of Russian forest authorities and large forest companies to prepare proposals for reforming price formation in forestry (Segezha Group 2019).

Further information
Sari Karvinen
Natural Resources Institute Finland (Luke)
Tel. +358 29 532 3256
firstname.lastname@luke.fi

Sources

Federal laws on budget 24.7.2007 N 198-FZ, 24.11.2008 N 204-FZ, 2.12.2009 N 308-FZ, 13.12.2010 N 357-FZ. 30.11.2011 N 371-FZ, 3.12.2012 N 216-FZ and 2.12.2013 N 349-FZ

Government decree 22.05.2007 N 310, updates 17.9.2014 N 947, 14.12.2016 N 1350, 11.11.2017 N 1363 and 12.10.2019 N 1318.

Karvinen S., Mutanen A., Pirhonen I., Kuryatnikova A. 2016. Puun myyjien ja ostajien näkemyksiä Luoteis-Venäjän puumarkkinoista [Views of wood sellers and buyers on roundwood markets in Northwest Russia]. Metsätieteen aikakauskirja vuosikerta 2016 numero 3-4 artikkeli id 5705. https://doi.org/10.14214/ma.5705

Lesnoi Region. 2015. Доступ к лесфонду [Availability of forest resources]. Лесной Регион № 02(164). http://lesregion.ru/main/2269-dostup-k-lesfondu.html

Minprirody Rossii. 2019. Draft decree on minimum rates for forest use payments 02/07/06-19/00092010. https://regulation.gov.ru/projects#npa=92010

Petrunin N.A. 2019. Вопросы совершенствования арендных отношений в лесном хозяйстве и их влияние на уровень доходности отрасли [Reform of forest lease and its impact on profitability of the branch]. Presentation in the National Forest Forum, Perm 22.-23.4.2019. https://xn--e1aiegdgbqezi.xn--p1ai/wp-content/uploads/2019/04/08-2019_04_22-%D0%9F%D0%B5%D1%82%D1%80%D1%83%D0%BD%D0%B8%D0%BD-%D0%9D%D0%9B%D0%A4-%D0%9F%D0%B5%D1%80%D0%BC%D1%8C_%D0%B0%D1%80%D0%B5%D0%BD%D0%B4%D0%B0.pdf

Rosstat. 2019. Производство основных видов продукции в натуральном выражении с 2017 г. [Production of main products since 2017]. https://www.fedstat.ru/indicator/57783

Segezha Group. 2019. Представители Segezha Group вошли в состав рабочей группы Рослесхоза РФ по совершенствованию системы ценообразования в лесном хозяйстве [Representatives of Segezha Group included into working group under Rosleshoz RF on reforming price formation in forestry]. http://segezha-group.com/press-center/news/predstaviteli-segezha-group-voshli-v-sostav-rabochey-gruppy-rosleskhoza-rf-po-sovershenstvovaniyu-si/

Shvarts E., Shmatkov N., Kobjakov K., Rodionov A., Jaroshenko A. 2018. Некоторые причины кризиса лесного сектора и пути выхода из него. [Some reasons for crisis in the forest sector and suggestions on way out]. Устойчивое лесопользование [Sustainable forestry] № 3 (55). https://wwf.ru/upload/iblock/e0b/02.pdf

Strategiya lesnogo kompleksa Rossiyskoy Federatsii do 2030 goda [Forest sector development strategy of the Russian Federation till 2030]. Confirmed by the Government decree 20.9.2018 № 1989-r.