Forest industry has a leading position in the economy of the Republic of Karelia. The share of the forest sector in the total volume of commodity output of the republic makes over 40%. Cross-border location, relatively low transportation costs, rich natural resources and their high quality create good competitive advantages and high investment potential. Products of the forest sector of the Republic have demand in many countries of the world, such as the USA, Canada, China, India, the UK, Italy, Germany, Finland, Denmark, and Sweden.

Just like all over Russia, the period of extensive and relatively low-cost stage in the development of investment activities is coming to an end. The latest period (2003-2006) features maximal possible use of available technical and transport infrastructure. Forest resources were utilized in places attainable for harvesting.

What comes to the current and future investment policy, the Government of the Republic of Karelia sees that the major factor in the economic and social development of the region is investments. Therefore, the key goal is to make the republic, its industries and territories investment-friendly, which may ensure the necessary investment volumes and may help in the achievement of planned economic and social indicators.

Creation of an investment-friendly environment is going on in the following ways:

- Work with local authorities aimed at creating investment-friendly environment locally.
- Work with republican executive authorities and territorial federal authorities on developing investment activities and investment-friendly environment.
- Development of information openness of the Republic and information support to investors.
- Assistance to the development of innovative and research activities.
- Upgrading legal framework in the area of investments.
- Assistance to the development of investment infrastructure etc.

With the aim of forming favorable business environment and investment climate in the Republic, a system of state support to investment activities and entrepreneurship has been established. Financial support to specific projects is provided in the form of tax exemptions, state guarantees and budget loans for investors. During the recent years, tax exemptions have been granted to 16 projects in the Republic of Karelia. Over 0.5 billion RUR of credits have been provided on a tendering basis for the implementation of 33 projects, and 27 of them have been completed already.

Over 70% of the forest fund of the Republic with an annual production of about 6.9 million cubic meters of timber has been provided for long-term lease. One of the basic conditions to motivate enterprises in long-term future planning of their development and investments is present in the region. Forest areas were provided on a tendering basis, first of all, for the implementation of business plans, which envisage timber processing or timber processing development. One of the criteria for the identification of winners of forest tenders has been the volume of investments.

In the framework of the abovementioned areas, a database of investment projects has been developed and it is working permanently, which allows to trace regularly the execution of investment liabilities. On the basis of the database, investment activities are analyzed by sectors and territories, forecasts are made of the volumes of investments and economic development as well as of possible achievement of economic and social values.

Bigger projects in the forest sector being implemented on the territory of the Republic of Karelia:

- Construction of a woodworking plant OOO Swedwood Karelia with the processing volume of 350,000 m$^{3}$ of pine lumber and production of 42,000 m$^{3}$ of glued furniture boards per year. The total volume of investments will make about 37 million euros. In 2006, a sawmill was commissioned. At present, construction of a plant for producing furniture boards is being completed (commissioning in
November 2007). The third stage of the project is planned, i.e. construction of a furniture plant with the investment volume of 30 million euros.

- Reconstruction of OAO Segezhskii TSBK (Segezha pulp-and-paper mill). Total volume of investments is over 16 billion RUR (460 million euros). Upgrading of existing equipment is planned including paper bag production line (E-1,E-2) and capital repairs of sodium production machines.

- Project of OOO Medvezhjegorakii Lespromkhooz (logging company) – construction of a sawing and woodworking plant with new technologies of feed, sawing, drying and packaging lumber. Investments – 600 million RUR (17 million euros).

- Implementation of the second stage of the project OOO Setles. The management of the company intends to establish a modern woodworking plant including woodworking cycle (drying, planed lumber, furniture boards, furniture production, fuel pellets) on the basis of an existing woodworking plant. The cost of the second stage is estimated to be 12,7 million euros.

- Reconstruction of OAO Kondopoga. Investment in the sum of over 9 billion RUR till 2011 (260 million euros) is planned within the reconstruction project.

- Construction of a new sawmilling plant at ZAO Solomenskii Lesozavod. The project envisages construction of a new sawmilling complex with complete cycle of woodworking with the capacity of 115 thousand m³ of lumber per year. Reconstruction of the boiler house which provides heating for the residential area of Solomennoye is also planned. The project is 1060 million RUR (30 million euros) (start-up in November 2007).

- In August 2007, the “first brick” was laid for the construction of a plant for production of woodboards with investment of about 150 million euros, which will allow to process hardwood in the volume of up to 700,000 m³ from the year 2009.

The volume of investments in the forest industry of the Republic of Karelia during the 1st six months of 2007 was 1276,8 million RUR, which is by 45,5% more than during the similar period of last year. The growth was achieved by means of increasing investments in woodworking plants by 9,3 times (investments in economic activities “Woodworking and production of goods from timber” were 501,8 million, whereas last year the figure was 48,5 million RUR)

Investments in logging industry are also growing. One of the indications of this is the volume dynamics of cut-to-length harvestings. The biggest sales of harvesting machinery have been made by companies Timberjack, Valmet, and Ponsse that are well-known in Finland.

According to our estimates, the total volume of investments in investment projects implemented in the forest sector of the Republic of Karelia in 2007 will be about 5 billion RUR (140 million euros).

We should note that there are some objective reasons hindering investment activities in the forest sector of the Republic of Karelia. One of the major barriers for investment projects implementation in 2007 are gaps in legislation in the area of legal relationships in forest sector due to the new Forest Code enforced since January 1, 2007. Forest users leasing forests face problems aligning lease agreements with the Forest Code in 2007 in terms of sources of financing of forestry operations, developing techniques for calculating forest use etc. Due to this fact, some forest lessees – who have already started investing in logging, have postponed the activities in woodworking till the moment when lease agreements are renewed to have all guarantees for supplying planned plants with raw materials.

When formulating regional investment concept one should take into account that investment policies of large companies – foreign companies first of all – are mainly defined by the trends of the world market and competition, which is getting more severe. At the same time, regions are selected for investments mainly according to the following factors: geographical position (proximity to main sales markets), capacity of domestic market, cost of labor, availability of human resources with necessary qualification etc. Objective circumstances are also accounted for, such as level of development of road infrastructure, and availability of raw materials. Experience shows that investors prefer to come to prepared forest areas despite of higher price due to the level of their development.

One of the major reasons hindering wider attraction of western and domestic investors to our republic is the lack of industrial sites prepared and developed in terms of infrastructure. Huge work has been done in the Republic on recording the sites potentially suitable for business (Governmental Site http://www.gov.karelia.ru). Predominantly those are small sites, and some of them have some buildings and are located in remote areas. At the same time, there remains a need in large sites suitable for strategic
investors. Therefore, enlargement of industrial areas and development of their infrastructure remains the key mechanism of attracting investments to the industry of the Republic of Karelia.

For solving the issue of development of industrial areas and their financing, a series of actions is needed at both republican and local levels. The main locations of investments should be identified in the process of producing a plan for regional planning of the republic on the basis of labor market analysis, opportunities and initiatives of local authorities, geographical position, availability and condition of transportation routes etc.

Analyzing the situation in putting into operation facilities, which have been planned in some commercial investment projects of forest sector companies, in 2007, we should note that projects are progressing mainly in accordance with the work schedule. This can be said about such large projects as:

- upgrading OAO Kondopoga and OAO Segezhskii TSBK;
- ООО «Swedwood Karelia»;
- ООО «Setles» etc.

At the same time, even these seemingly successful projects were protracted due to slow solving of the issue of energy supply, allocation of land for access railroads, customs permits, sanitary control and definition of weight limitations.

Analyzing the current situation in terms of problems causing disruption or protraction in the time schedule for implementing investment projects, we can make a conclusion that management of companies do not prepare projects thoroughly enough at the stage of studying and agreeing upon the conditions that ensure timely project implementation:

- getting permits for connecting to the sources of electricity and heat;
- getting permits for land allocation;
- difficulties with getting budget investment loans, insufficient elaboration of conditions for obtaining budget loans at the initial state of project development by heads of enterprises.

Lack of high-quality staff is also a problematic issue.

There is a need to create a constructive dialog and close contact among all participants of investment process, i.e. authorities and investors. A working group has been established under the lead of the Prime Minister of the Government of the Republic of Karelia for supporting the attraction of investments to the economy of the Republic. The key goal of the group is to assist investors in solving problems during the implementation of projects. At present, work on adopting a program “Main Areas of Investment Policy of the Government of the Republic of Karelia for 2007-2010” is about to be completed in the Republic.

It has been planned to reach a volume of investments of 27 billion RUR in the fixed capital by 2010, what corresponds to 70% increase in the prices of 2006, by means of implementing measures identified in the Main Areas of Investment Policy. The implementation will allow to create over 9,000 jobs including 2,800 additional jobs in the forest sector.

The key objective of republican authorities during the planned period will be to create conditions for attracting both Russian and foreign corporations and vertically integrated structures that have necessary finances and experience of managing forest industry assets and that area capable of acting as strategic investors to the forest industry of Karelia. At the same time, if all other conditions are equal, preferences will be given to investors, whose business is maximally integrated on the territory of the Republic of Karelia.

At present, “Plan of Actions of the Government of the RK on Upgrading the System of Management of Forestry and Forest Industry till 2010” is being finalized in the Republic. The Plan envisages the following:

- Upgrading the management structure of forest sector;
- Creation of conditions for the balance of cost-effectiveness of forest industries;
- Assistance in forming balanced structure of production and consumption of timber raw material on the territory of the Republic of Karelia, including the development of activities on preventing illegal harvesting and illegal timber sales;
- Upgrading staffing policy in the forest sector;
- Research and methodical support to the development of the forest sector.
During the era of globalization and decreasing barriers for trade, and in the future – due to Russia’s entering WTO, companies cannot survive and develop counting only on domestic market. The process of reselling traditional Karelian forest sector enterprises and their integration into vertically integrated structures vividly demonstrate current trend of forming a forest cluster. Taking this into account we understand that if regions do not make additional efforts to create investment-friendly environment and to timely implement their credentials, they can simply remain as a raw material supplier.

Thank you