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Northwest Woodlands

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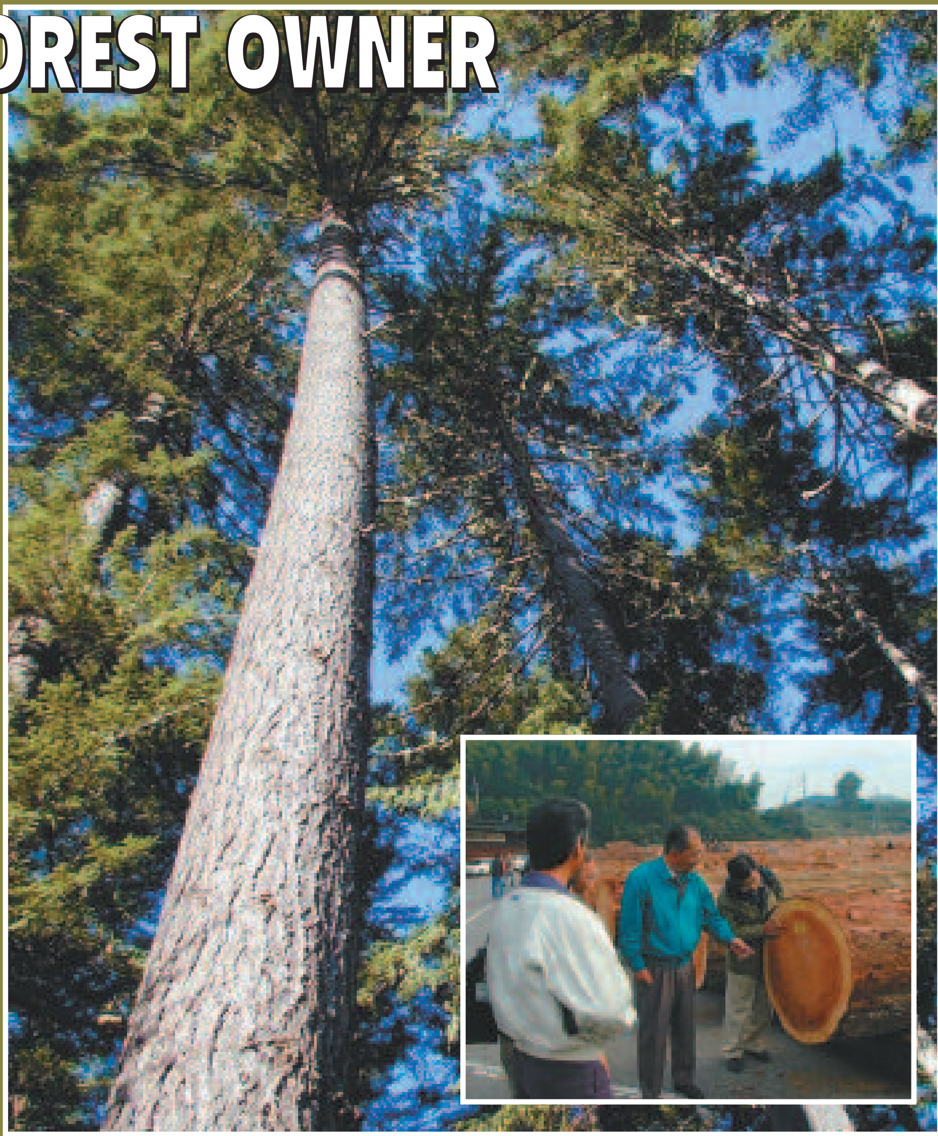
INTERNATIONAL MARKETS AND THE FAMILY FOREST OWNER



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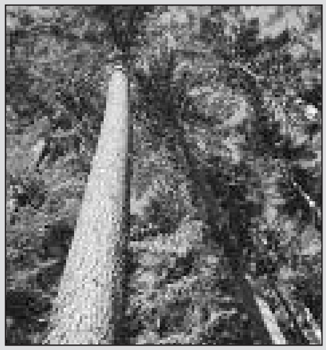

This high-value Douglas-fir timber on Starker Forests lands is not easily duplicated elsewhere in the world.

Inset photo: Local log market auctions like this one in Nara, are becoming more common place in Japan.

Photos courtesy of Rick Fletcher

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Global Forest Products Markets: Impacts on Family Forest Owners

By ERIC HANSEN

Globalization of forest products markets continues to dramatically impact the North American forest sector. As one of the largest global consumers for most types of forest products, the United States is the market of choice for manufacturers around the globe. Not only is the size of the U.S. market highly attractive to foreign producers, but so is its relative homogeneity. Despite 50 states and meaningful regional differences, the United States presents an affluent market of over 300 million people with generally similar product codes, standards, practices and legal requirements. This article provides an overview of global market issues impacting family forest owners. Additional articles provide further insights into the roles of specific countries and regions and how family forest owners can best position themselves for a positive future.

Competitiveness of PNW Manufacturing Operations

The North American forest industry has historically relied on a low-cost business strategy to maintain competitiveness. Considering the nature of today's global competition, this approach is tenuous at best. Modern competitive theory suggests that firms must develop resources that are valuable, rare, without substitutes and something others cannot easily imitate. Low costs are easily imitated by many foreign competitors. For example, an average shop floor worker in an Indian wood industry manufacturing operation makes about $80 per month. Similarly, low labor rates in developing countries give manufacturers in those countries a significant edge in the low-cost game.

PHOTOS COURTESY OF ERIC HANSEN

Top photo: The Pskov Model Forest in western Russia. Bottom photo: A mountain forest in central Bulgaria.

Old-growth, high-quality Douglas-fir and ponderosa pine have few substitutes. When this raw material was readily available, western companies had a competitive advantage. As rotation ages and overall wood quality fall, many of the distinguishing characteristics of the resource are either lost or diminished. With a trend toward more engineered products, fiber requirements tend to be less quality-based and more quantity-based. The attitude by some has become that of "produce as much fiber as possible and we'll figure out how to make it into a product." This view fits well with the growth of plantation area in the world. According to estimates by *Wood Markets*[1], plantations represent about 40 percent of global industrial roundwood supply, and in less than two decades from now plantations will supply over half of all industrial roundwood. According to the *Wood Markets* report, New

Zealand, China, Australia, Chile, Uruguay and Argentina obtain the majority of their wood supply from plantations. As can be expected, those countries listed above that also have small populations (thus large volumes per capita) are currently or becoming key global exporters. The bottom line is that the Pacific Northwest resource base is no longer the differentiating factor it once was.

According to a recent Oregon Forest Resources Institute-sponsored study, Oregon is particularly strong in sawmilling. However, according to *Wood Markets*, log costs in the region are some of the highest in the world and are only partially offset by lower milling costs (due to high use of technology and larger mills). As a group, North American sawmills have higher costs than South American and European sawmills, and the lowest costs can be found in Russia.

Recent years have seen significant inroads by foreign competitors into a variety of U.S. markets. Al Schuler at the USDA Forest Service, Forest Sciences Lab in West Virginia has shown that the domestic share of wood products consumption has fallen significantly in a number of sectors. For example, structural panels were close to 100 percent domestically produced in 1990, but fell to around 75 percent in 2002. Forest health woes in British Columbia are contributing to high harvest levels in the short term, but will decrease in the coming years as the province is forced to reduce the annual cut to bring sustained yield back even. Imports of softwood lumber into North America have increased dramatically from both South America and Europe. Further down the value chain, U.S. Department of Commerce statistics show that tens of thousands of furniture manufacturing jobs have been lost in the United States in recent years, largely due to Chinese imports.

Major shifts in land ownership are taking place as large corporations divest forestland. Temple-Inland in

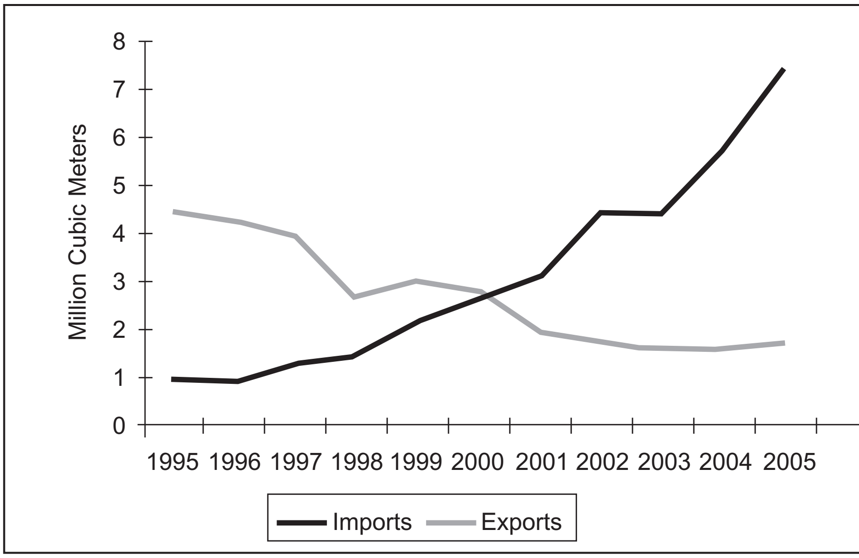
PHOTO COURTESY OF ERIC HANSEN

A typical resaw operation in India.

Texas is the latest company to announce it is selling most of its forestland and converting the remaining land to real estate operations. The rumor mill has been busy regarding the future of Weyerhaeuser's forestlands. The company recently appointed a new member to its board of directors with a background in real estate investment trusts, possibly indicating things to come. In any event, the shift toward ownership residing with timberland investment management organizations and real estate investment trusts will have a yet-to-be-determined impact on markets and family forest owners. In the short term, forestland prices are at all-time highs, a benefit if your desire is to liquidate.

Family forest owners have seen their log marketing options diminish as mills have gone out of business. Contributing to the loss of mills is an effort by the manufacturing sector to consolidate as a means to maintain competitiveness. Losing mills does not necessarily equate to drops in volume produced. Rather, we are seeing fewer, larger mills. This market reality places the buying power with the mill and leaves family forest owners in a precarious situation. One article in this issue discusses options that can enhance the financial success of family operations and another provides an overview of a success story (see articles by Rick Fletcher and Chris Knowles).

Figure 1. U.S. softwood lumber exports and imports, exclusive of Canada.



SOURCE: WWW.FAS.USDA.GOV

What happened to exports?

U.S. companies have a long-established reputation of jumping into the export market when the domestic market is difficult, and dropping out of the export market when the domestic market picks up. Up until the last year, domestic markets were very healthy for a number of years with high housing starts and strong prices in many product categories, leaving little interest in export markets.

Since the 1990s, the Pacific Northwest has seen a dramatic decrease in log and lumber exports (see Figure 1). This is, of course, largely a result of local supply restrictions, but changes in foreign markets have also contributed. Aftermath of the 1995 Kobe earthquake in Japan resulted in creation of a new housing quality assurance law and a move toward performance-based standards. The result has been a shift of products used in the marketplace toward kiln dried and engineered/laminated products. Scandinavian producers have entered the Japanese market with high-quality lumber and a market-share-growth strategy. Their success has meant loss of market share by others.

Often, companies in the United States export lumber to countries that add value and export finished products back into the United States. This is the case with hardwood lumber and veneer bound for China, used to manufacture furniture, and re-exported to the U.S. Similarly, exports of softwood lumber to Mexico often return to the United States as finished moldings or furniture.

Major trade flows to the U.S.[2]

Canada is the largest exporter of forest products to the United States, supplying approximately one-third of U.S. consumption of softwood lumber. This particular flow of raw materials has been controversial for many years with continued trade disputes. A result of the many trade disputes with Canada has been a window of opportunity for other countries to export softwood products to the U.S. (see Figure 1). Even high-cost regions such as Europe have increased volumes exported to the United States (see article by Erlend Nybakk). Between 2000 and 2005, the volume of softwood lumber imports from European Union countries to the U.S. grew over five times. Germany represents the biggest player with nearly half of the volume. Higher value-added products are also increasingly entering the United States. For example, last year Cascade Structural Laminators in Eugene, Ore., signed an exclusive agreement to conduct nationwide sales for glue laminated timbers produced in Austria by Kaufmann.

Around a decade ago, secondary manufacturers in eastern Oregon were just beginning to experiment with radiata pine. Most weren't particularly happy with the species and found it to be difficult to work with.

Following improved drying practices and learning better how to process the imported pine, it has become widely accepted in the industry. By some estimates, nearly three-quarters of all solid sawn moldings used in the U.S. are now imported, mostly of radiata pine. Southern yellow pines have been planted extensively in Brazil and significant volumes of lumber and plywood are now entering the U.S. from that country. The future will see other South American countries enter the fray. For example, Weyerhaeuser Company and other multi-nationals have nearly two million acres of plantation forests growing in Uruguay (see article by Ernesto Wagner for more information on South America).

When it comes to furniture, China has dramatically impacted the U.S. industry and market. Over half of Chinese exports of furniture make their way into the U.S. marketplace. The Chinese are having dramatic impacts in other sectors of the industry as well. Hardwood plywood imports from China have increased nearly 30 times since 2000 to approximately two million cubic meters. It is expected that Chinese exporters will soon be shipping structural plywood bearing requisite grade stamps as well. Softwood logs from Russia's Siberian forests are a major source of softwood fiber for the Chinese industry (see China article by Jeff Cao). Russia recently announced a new tariff structure that will mean hefty tariffs on softwood exports, reaching as high as 80 percent by 2009[1].

What does all this mean for the family forest owner?

According to Forest Service research, approximately 4.9 million family owners control 44 percent of the 620 million acres of forestland in the United States. Ownership proportion varies by region of the country: it is 59 percent in the North, 64 percent in the South, and 17 percent in the West. The West differs because of extensive public ownership. Accordingly, family forest owners are a very important element of raw material supply for the forest industry. In Oregon, they make up nearly one-fifth of the log supply.

Healthy Pacific Northwest forests are highly dependent upon strong local log markets. Without these markets, landowners like you will have little incentive to actively manage. Thus, a healthy manufacturing sector and healthy forests are inextricably linked. While most family forest owners may keep their forestland despite limited economic returns resulting from a diminishing processing infrastructure, this will not be the case with timberland investment management organizations and real estate investment trusts. If the return on investment becomes too low, these organizations will quickly divest their portfolio of timberlands, presenting potential significant negative impacts on sustainability of our forests.

The U.S. housing sector experienced a sustained, strong run between 2002 and 2006. The slight downturn since then has impacted markets and as demand contracts, import volumes into the United States will be impacted, as will domestic manufacturers who face additional challenges to their competitiveness. In the short to medium term we can expect to see the same trends continuing that we see today. However, high energy prices could create new advantages for local production. The healthy forest described as being inextricably linked to healthy wood processing infrastructure can be emphasized again, except from a different angle. The economic health of family forest owner operations is also inextricably tied to a healthy wood processing infrastructure. ■

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[1] Wood Markets: Monthly International Report is a newsletter from the International WOOD MARKETS Group, Inc. from Vancouver, B.C., Canada. Several issues from 2005, 2006 and 2007 were used in preparing this article.

[2] Import and export statistics are from the United States Department of Agriculture, Foreign Agricultural Service, www.fas.usda.gov.