How Competitive is the Southern Timber Industry? An Examination of Georgia’s Pulp and Paper Sector

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Abstract

This paper reviews global competitive conditions with implications for the Southern Pulp and Paper Sector. Initial stages of this study focus on timber based markets and the linerboard sector of the pulp and paper industry with emphases on Georgia.

Key Words: markets, prices, southern pine
Four overriding issues shape how the Southern Timber Industry competes internationally: 1) World timber supply/demand 2) trade globalization 3) Forest Industry consolidation and 4) a major shift in forestland ownership.

The World population is growing at about 1.3 percent per year and World forest area is declining at about 0.2 percent per year. In the resulting decline of forest area per capita, the impact of continued demand for forest products varies by region, economy and forest-type. In general, most forest losses were in the tropics while the temperate and boreal forests show stability or expansion. Managed forests have increased in importance. The United Nations Food and Agricultural Organization (FAO) estimates that plantation forests account for less than 5 percent of the World’s total forestland but produce an increasingly higher proportion of global roundwood requirements. Global per capita use of wood is declining as forest product manufacturing becomes more efficient and fuel wood use declines in developing economies.¹

The U.S. has about 6 percent of the World’s forestland and 8 percent of its timber inventory. From this base, the U.S. produces about 27 percent of global industrial roundwood. The U.S. is also the World’s largest consumer of wood products with per capita consumption about six times the World’s average.²

The timber resources of the U.S. are concentrated along the West coast, in the South, and in the Northeast, despite its urbanization. Nearly 90 percent of U.S. timber production came from privately owned forests in 2000, up from about 80 percent in 1990. As policy curtailed harvest from public land, mostly in the West, production increased on private land in the South. The South, with its high levels of harvests from Virginia, through the Carolinas, to east Texas and Arkansas, produces 18 percent of the World’s industrial roundwood with just 2 percent of the World’s forestland and roughly 2 percent of the World’s forest inventory. One of the South’s big producing states, such as Georgia or Alabama, has just slightly less production than Sweden or Finland.

The U.S. South faces heightened global competition and increasingly global markets compared to twenty years ago. The value of global trade for value added forest products has increased. In 1980, between 15 and 20 percent of sawnwood, panels, paper and board were traded internationally. By 2000, that number had risen to between 25 and 30 percent. Global forest industry trade means that the strength of the U.S. dollar may influence timber and other forest product prices. As shown in Figure 1, the rising trade-weighted exchange rate since the mid-80s has an inverse relationship to the falling forest product balance of trade.³
Most of the competitive disadvantages of the South relate to higher costs.

- Changing paper demand
- High labor costs
- High fiber costs
- High tax rates

The U.S. is still the largest paper and paperboard market, consuming more than 300 KG per person annually. Developed markets such as Canada and Japan use more than 200 KG per capita while developing markets such as China and Russia use less than 30 KG per person. The expectation for increased consumption in the developing markets pulls new investment and reduced consumption in developed economies drive curtailment and cost cutting.

U.S. pulpwood consumption in the South has decreased since the 1990s. Worldwide pulp prices have been on a downward trend since 1995. Delivered conifer pulpwood prices have risen in the South since 1995 but have decreased in most of the other wood pulp producing regions, thus reducing Southern competitiveness.

Global trade may limit price appreciation for U.S. forest products. For example, between 1995 and 2002, wood fiber costs in the U.S. South dropped slightly, but they dropped dramatically in the U.S. Northwest, and western Canada. Sweden had a major decline in the U.S. dollar value of their wood fiber, as did Brazil, Chile and New Zealand. As shown in Figure 2, by early 2002, near the peak of the strong dollar, the South had lost a substantial cost advantage in the World markets.4

In 2004, the weakening dollar means current wood costs delivered to a
southern pulp mill are slightly below those delivered to a Swedish mill. U.S. imports of wood products have stabilized or declined and exports have edged upward.

Since 1999, the Forest Industry has implemented major consolidation and restructuring, mostly in the name of improving “global competitiveness.” Table 1 shows that several of the greater consolidations occurred in some of the key pulpwood markets, such as tissue and linerboard. Companies have also concentrated production, shutting some mills and making improvements to others. Plywood production has ceded ground to Oriented Strand Board (OSB.)

<table>
<thead>
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<th>Table 1: U.S. Consolidation/Restructuring</th>
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<td>Big Plays 1999 to 2004</td>
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<td>Is it Working?</td>
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| Georgia-Pacific: | + Fort James & Plywood mills from L-P |
|                 | - The Timber Co. (Timberland) & OSB mill |
|                 | - Brunswick and New Augusta mills to Koch |
| International Paper: | + Union Camp & Champion |
| Weyerhaeuser: | + MacMillan-Bloedel/Trus-Joist & Willamette |
|               | - Timberland |
| Temple-Inland: | + Gaylord Container |
|               | - Timberland |
| Bowater: | + Alliance Forest Products |
|           | - Timberland |
| Louisiana-Pacific: | + OSB mill from G-P |
|                 | - Timberland & Plywood mills to G-P |
| Mead & Westvaco: | - Timberland & Stevenson Mill to Smurfit-Stone |
| Plum Creek: | + & - Timberland |
| Rayonier: | + & - Timberland |

The record of consolidation also indicates a relatively new move, a major divestiture of forest industry timberland. This policy has increased the acreage in private hands and removed many “higher and better use” acres from forest production. The rise in institutional investment in timberland and the increase in the size of the major timberland management organizations (TIMOs) since the 1980s has created a “global” pool of buyers and vehicles for trading in timberland. Differences in timber growing regions have increasingly become “portfolio characteristics” to be measured and watched. The consequences of such land ownership changes for traditional private forest landowners remain uncertain.
Table 2 shows the relative timberland holdings at the end of 2003 between the major forest industry owners. In this case, the Top Ten TIMOs include: Hancock Natural Resources Group, The Forestland Group, Molpus Woodlands, Forest Investment Associates, RMK Timberland Group (formerly Wachovia Evergreen), Campbell Group, Wagner Forest Management, Fountain Investments, Prudential Timber, and Forest Systems.

Timberland ownership impacts corporate profits as well as fiber cost. Property tax burden reduction has provided at least part of the incentive for large corporate owners to divest.

Georgia, for example, limits “current use” tax relief to only 2,000 acres of a landowner’s holding and industrial landowners are not eligible. A shift to private ownership may allow more acres to qualify for tax relief. A transfer to entities such as pension funds can influence income tax receipts at both Federal and State levels. Two of the listed public corporations have shifted their ownership configuration to a more tax-advantaged real estate investment trust (REIT) structure. Plum Creek converted from a master limited partnership (MLP) to a REIT in 1999. Rayonier converted at the beginning of 2004. Both companies have been buying as well as selling timberland in the current market and state that the REIT structure increased profits as well as shareholder value.

The future competitive advantage for the South depends on a favorable combination:

- Location near active markets
- Terrain
- Climate
- Solid infrastructure
- Good management skills
- Good government
- A unique system of private land ownership and timber ownership.

Specific issues and challenges to Georgia Pulp and Paper production include several product categories as well as links to Gross National (State) Product.

- Linerboard production has changed and producers have moved much production to countries-of-origin for imports rather than making containers in the U.S.
• Pulp production has competition in Brazil and the Southern Cone. Some technical evaluators argue against the superiority of the highly touted eucalyptus pulp.
• Newsprint suffers from reduced newspaper circulation. Advertisers increasingly prefer coated paper for marketing their products.
• Printing and writing paper grades face challenges from electronic media.

We expect that the South will continue to be a strong fiber-producing region on the World scale. Published timber prices, such as Timber Mart-South’s Southeast Average Stumpage series in Figure 3, provide an index to the South’s well-established open market for timber.

The South and Georgia in 2004 have both an abundant supply of pulpwood and a market system that has kept pulpwood stumpage prices low. Pine prices have been nearly the same, when adjusted for inflation, for the last quarter of the Twentieth Century. While supply costs still concern Pulp and Paper manufacturers in the South and Georgia, such stability in a major commodity can ensure the profitability of capital improvements designed to improve competitiveness.

Figure 3: South-wide Average Pulpwood Stumpage Prices 1976 to Present
Sources:


USDA Trade Reports http://www.fas.usda.gov/ustrade/