TRENDS AND PROSPECTS FOR INDUSTRIAL FORESTRY IN THE SOUTH

H. DON SMITH

Abstract.—Industrial forestry in the South retains many traditional advantages relative to the remainder of the US but there are great financial pressures for change. Industry must find ways to adjust profitably to problems caused by high interest rates, trade imbalances and substitutions from competitive products. This situation provides opportunities for professionals trained in forestry economics, for forestry schools to incorporate more economic and financial training in traditional curricula, and for employees of public agencies to address topics in terms that industry will understand and accept.

INTRODUCTION

As this group well knows, rapid changes are occurring in the world of US forestry. It is not clear where these changes may lead us. Predictions are always risky and we can probably argue at length where each of us think we are going. We probably can agree however, that the fate of industrial forestry, especially in the South, is intertwined with the fate of the forestry economic profession. With that in mind let's examine where industrial forestry and forestry economics may go together.

CURRENT SITUATIONS

To put things in perspective, let me review the current situation for industrial forestry. We continue to have the highest real interest rates of this century. As we all know, real interest rates fluctuated in the range of 2 to 4 percent for low-risk investments throughout all of this century until the Federal Reserve made fundamental changes in the management of the nation's money supply. These changes were made in an effort to combat inflation and have been effective in achieving this goal. But the result has been real interest rates that hover in the 8 or 9 percent range and show no immediate prospect of decline. We now have a national trade deficit of alarming proportions and the consequences are especially serious for forest industry. Competition from Canadian lumber is steadily increasing and at least 50 percent of the dimension lumber sold in the South is of Canadian origin. Export markets for paper and pulp are in serious trouble and imports of foreign paper and pulp are gradually increasing. There are millions of acres of forest land for sale in the South, much of it placed on the market by forest

1 Vice President and Operations Manager, Canal Wood Corporation of Lumberton
industrial. Perhaps what is worse, land values are falling and this reduces the value of the collateral that supports lines of credit essential for forest industry to operate. This has led to deferment of modernization projects, freezes on hiring, postponed or abandoned plans for new mills and other predictable responses to tightened credit.

Forest industry is not alone in facing lean times. Federal and State agencies are living with tightened budgets and facing the prospect of still tighter ones. Forestry school enrollments are declining because the word is getting around that there are fewer good forestry jobs available upon graduation. University deans are watching federal funds dry up and wonder how they can continue to pay faculty salaries and maintain enough program diversity to be considered a leading forestry school.

Forest managers who sometimes have only had to worry about growing trees are having their share of problems, too. The corporate controllers are telling them they must get by with less site regeneration money and that they must help the company out of its cash crunch by selling some of the trees they have so carefully nurtured. When the forester does sell the trees for the company he is often receiving what he and the controller consider to be shockingly low returns.

Private landowners are not immune to the current siege of uncertainty and distress. For decades, service and consultant foresters have told private landowners to manage primarily for pine sawtimber production. The recommendation has generally been to produce pulpwood only as a by-product of pine sawtimber activity and to grow hardwood only if the site would not produce pine. Today, these service and consultant foresters and the private landowners are seeing sawtimber prices fall while pulpwood prices increase and they read about OSB and Waferboard technology that can be expected to accelerate the decline in the value of large trees. Should these large trees be sold today at an apparently distressed price and a new rotation begun, or should a chance be taken on holding them in the hope that the clock will turn back to a simpler time?

It would be possible to meditate on all of this and become depressed, but this would not solve our problems; instead let's discuss what we might do to make the best of the situation.

OUTLOOK FOR FORESTRY INDUSTRY IN THE SOUTH

Southern forestry industry is far from dead. The traditional advantages that we have enjoyed continue to exist. Southern pines grow more rapidly in the first thirty years than any trees anywhere else in the US. Logging costs for the South and Lake States are much cheaper than for the Rocky Mountain and Pacific Northwest areas. The South has a plentiful labor supply at relatively attractive rates and the attitude of workers is generally superior to that in many other areas. The Southern timber supply is relatively close to the ultimate markets. Southern timber is almost totally owned by private individuals and corporations as opposed to the public ownership of the West. Laws relating to the growth, transport, and property taxation of Southern
timber are determined by local, relatively responsive government and not by Washington bureaucrats. It is still true that the major competitor for wood and its derivatives is petroleum. And in spite of a recent decline in petroleum prices, oil is still not a renewable resource. Coal is another potential competitor for wood but until major breakthroughs in coal processing technology occur we need not be too worried about it.

In spite of these advantages, our current problems still exist. Forest industry is under great financial pressure. Virtually every company of every size is searching for ways to become more efficient. Marginal mills are being shut down. Efforts are under way to force down delivered wood costs. Land ownership is being re-evaluated and parcels deemed unprofitable are being offered for sale. Industry is beginning to realize that the world has changed and that they must adjust to it. Corporate staffs everywhere are busily engaged in investment analysis. The managers of operating divisions are being told to justify their budget requests with their own analyses. Managers, in turn, are instructing their foresters and logging supervisors to justify their management requests with more thorough analysis.

The point I am trying to make is that tough times require not only tough people but also smarter people. Industry can exist only if it makes a profit. Those too inefficient to make a reasonable profit must go. There has never been a greater need for economic training at every level in forest industry. Most foresters and forest industry managers are ill equipped for this new role. Many have never had a course in accounting or corporate finance. All many remember of economics is "D is Down". Most have never studied personnel management although this will quickly become a part of their duties after graduation from college. I am aware of forest industry managers who have only a vague knowledge of how national policies effect them and their companies, and few have ever written a letter to their congressman or become involved in the political process. This is astounding to me. Next to ineffectiveness the greatest danger to our industry comes from our own government. Government policies have forced us to choose between run-away inflation and 10 percent real interest rates at which relatively few forestry investments are attractive. Congress is now considering several alternative tax-revision bills. Even though God himself probably would not bet on what Congress will do in the next few months, there is a good chance that we in forest industry will not like what happens. The tax package proposed by former Treasury Secretary Regan would be bad for forestry. The NFPA, APA, and others lobby for us, but our industry is a novice in influencing the political process.

OUTLOOK FOR THE FORESTRY AND ECONOMIC PROFESSION

The cliche that the problems of one are the opportunities of another is true. Forest industry in the South has problems and many of these are related to things that economists know something about, therefore it is an opportunity for them.

We can divide those associated with industrial forestry into three basic
groups:
1. University Employees
2. US Forest Service and State Groups
3. Private Industrial Foresters

My assessment of current trends is that opportunities for employment and economic reward will be limited for the foreseeable future at universities and in forest service organizations. Forest industry, because of the unrelenting need for acceptable profits, will find people who can get the jobs done. Foresters and forest economists will be given the first opportunities to make profitable adjustments to existing and new situations. If forestry professionals cannot do the job then industrial managers will try MBA's, accountants, engineers or business management graduates from liberal arts schools. Opportunities for foresters and forest economists will be available with private industry, but those who are successful must have the skills to do the job. Economists can do more to provide these necessary skills than any other group. This is true whether we are employees of a university, a forest service organization, or directly employed by private industry.

Economists as a group tend to be clear thinkers. The rigors of economic training require logic and a careful assessment of all available facts. This type of thinking is important in any profession and has never been needed more than today in forest industry, but there is a problem. Relatively few forest economists know how to talk to business managers, and the leaders of large forestry corporations are not often seen in the company of forest economists. Part of the problem seems to be that economist spend too much of their time talking only to other economists.

When I went to work for Potlatch Corporation some years ago I thought I was pretty smart. After all, I was holding a fresh PHD award from a recognized forestry school and I had passed the courses of some economists who I knew to be even smarter than I was. It seemed clear to me that there were no forestry problems related to economics that I could not handle. During my first week at Potlatch I was invited to participate in a corporation-wide meeting, which was attended by all of the division managers. These were people responsible for tens of millions of dollars in assets and hundreds of millions of dollars in annual sales. In short, these were the major leaders of that company. As it turned out the major topic of that meeting was about how bad things were. Lumber sales had dropped drastically and inventories were building fast, decisions had to be made quickly about whether to continue to store inventory or to curtail operations and lay off people. Each division manager was asked to give his view of the situation and to make a recommendation on what policy the corporation as a whole should follow. It became clear to me as these people spoke that they were unaware of major activities being carried out by the Federal Reserve. Finally, I was asked to contribute to the meeting and I couldn't wait to tell them what I knew. For the next several minutes I told that group about Regulation Q, disintermediation and various activities of the Federal Reserve. As you remember, Regulation Q placed an interest rate ceiling on what savings institutions that specialized in mortgages could pay. Whenever activities of
the Federal Reserve caused interest rates to exceed the ceiling, this led to a transfer of funds - disintermediation - to financial institutions not affected by the ceiling. All of this was explained with as much economic jargon as possible. If my NC State professors had been there I probably would have gotten an A, but as it was, I did myself more harm in that ten minute span than I could overcome in the next year. In terms of communicating, I was so far apart from that group of managers that I would have been far better off to have never opened my mouth. I failed to use the language of business and there was no possibility these people could understand me. Nor could I really understand them. I made many additional mistakes in the coming months but I won't relate them here because they are too embarrassing. However, I was smart enough to notice that economists were not running that company. As it turned out, accountants were. This astounded me. I was under the impression that accountants and accounting were beneath contempt. My professors had given me many economic examples of accounting practices that led to incorrect decision making and had emphasized that economic calculations involving discounted cash flow were always superior to accounting practices. When I was in college it did not occur to me to ask how many wealthy economists there were and how many were running major companies. Had I been told that accountants were running everything I would have been astounded.

It soon became clear to me that the only reason I had a job was that none of the accountants had forestry training. I did have the ability to blend financial analysis with the biology of forestry and there were no foresters or accountants around who could do that. Even so, the first reports I did for that company were worthless because neither foresters nor accountants could understand them. It is not a profound idea but it did occur to me one day if I were to begin work for a company where all of the major managers were from Spain, I would probably have to learn to speak Spanish to be effective. In the same way, since I worked for a company where every major upper-level manager was an accountant or an MBA I needed to learn to speak accounting. Even to this day I don't like accounting and I am certainly not an accountant, but when I'm around a lot of MBA's and accountants I'm not going to brag about that.

Even though I had to humiliate myself and learn to speak accounting this did not reduce the usefulness of my economic training. There are many sorts of economic analysis of which accountants are not aware. Accountants do not understand regression analysis or linear programming or marginal analysis. Accountants do not understand present values and have only a rudimentary knowledge of rates of return. Forest economists can offer many useful tools and concepts to forest industry but the communication must always be in terms that accountants can understand.

These principles of communication are the same whether we work for a university, the forest service or private industry. Forestry students generally know how to cruise timber and prepare management plans but they seldom are aware that one day they will have to argue with an MBA about getting a share of the company's investment funds for tree planting. I have watched some heart rending scenes when a forester begged for funds on the
ground that his project would yield a present value of $200 per acre at an 8 percent real hurdle rate, only to be blasted out of the saddle by a mill manager who said he had a project that would yield a 500 percent rate of return once the depreciation was taken. How many of you have seen government publications written by brilliant people that could only be understood by other people equally brilliant? There just aren't that many of us brilliant people around and all publications should be written so that virtually anyone of normal intelligence can understand.

Let me repeat, forest industry leaders need more help from the economics profession. In case you haven't noticed, this is not common knowledge. Few industrial leaders know what forest economists can offer. There are many questions with which business leaders struggle where insight could be provided either by improved personal understanding of economics or by consultation with a knowledgeable forest economist. Forest industry tends to be fragmented and provincial. Organizations such as the NFPA and APA help but the basic problem starts at the grass roots level with business managers who cannot see the forest for the trees, with forest economists who spend all of their time on general subjects that are of little immediate use to the industry manager, and with foresters who leave school with virtually no economic or business management training.

CONCLUSION

To summarize, forest industry has never faced greater forces for change than today. Profit margins are razor thin, if they exist at all, and business managers must adjust rapidly if their companies and their jobs are to survive. There is no doubt that this adjustment will be made. The question is, how efficiently will these changes be made? Here is the opportunity for economic professionals. Forest industry needs more help from the economic profession but because there are more accountants and MBA's than there are forest economists it must be the forest economists who learn to communicate with the accountants. The future of forest industry and that of forest economists will be parallel. It is always possible to cut the funding for a government organization or a university. Forest industry operates under different rules and has more flexibility to change and survive. I hope that more forest economics professionals in every area can learn to speak the language of business and I hope that through the educational process more future business leaders can learn to speak the language of economics. I hope these things happen because all of us need it very much.