The term "globalization" has become a popular way to describe the fact that the U.S. economy is becoming increasingly interdependent with those of other countries. But it also means something more -- it means that we are integrated into those economies in ways that are different than they used to be.

The U.S. is no stranger to internationalization. Ever since the end of World War II, the U.S. has been a vital part of world economies.

In the 1950's and 1960's the combination of a strong currency and a broad based thriving industrial complex provided the opportunity for U.S. business to increase investments overseas. Some of you may recall a book by the French author Servan-Schreiber published in the 1960's protesting that the U.S. would eventually control the whole world through its investments.

All through this phase of active U.S. investments in foreign facilities, the forest-based industries remained in their usual mode of being concerned primarily with North American markets. Some companies did buy converting plants overseas to provide markets for their raw materials, particularly linerboard. But the moves were small compared with the large investments made by consumer and capital goods manufacturers.

The weakening of the dollar in the early 1970's shifted the international strategies of U.S. companies. A steep escalation of inflation in the U.S., a growing militancy by the U.S. public on social and environmental issues, and a stagnating economy kept U.S. companies preoccupied with these domestic issues. Furthermore, the surge in energy costs occasioned by the
first Arab oil embargo in late 1973, properly gave concern to U.S. producers over the profitability of foreign ventures.

Oddly enough, while the U.S. became ingrown in its response to the repeated surges in oil prices, the Japanese chose to use exports and foreign investment as their defensive mechanisms. If countries required domestic content, the Japanese simply built a plant or bought one in order to participate in that country's business activity. You might say, they copied our early Post World War II strategy. These investments protected their sources of raw materials as well as provided markets for enlarging exports. Now this strategy is being copied by other Pacific Rim developing countries such as Korea, Taiwan, Singapore and more recently China.

The trend toward domestication of all U.S. investments in the 1970's fit very nicely into the strategies of our own forest based industry. Home is where we wanted to be because the U.S. offered many advantages for our industry.

The U.S. paper industry produces close to 70 million tons of paper and paperboard and about 6 million tons of paper grade chemical market pulp. Our exports are principally linerboard, amounting to about 2 million tons a year and market pulp which is about 4 million tons a year. We also import some market pulp and about 8.5 million tons of newsprint, primarily from Canadian mills. This is the extent of the internationalization of the paper industry.

Despite their relatively small size, the tonnages involved in international trade, however, have been very important because they make a difference "at the margin" as we economists say. And since small differences in operating rates can have large effects on the industry's profitability, foreign trade is important.

It was in the 1980's, however, that the industry became more aware of the significance of foreign pressures, including the globalization of all American industry.

The trigger mechanism was the strengthening dollar that began in 1981. As the dollar advanced in relation to other currencies, the costs to foreigners of U.S. made goods increased while the costs of imports declined.

The paper industry began to feel these effects in 1984. That year started out on a high note for the industry. Bookings were escalating and mills were operating at maximum capacity -- backlogs were high.
Suddenly the picture changed as we moved into the second half of that year. Demand became much cooler and backlogs declined as U.S. customers found foreign supplies that were not only ample but cheap in terms of the strong dollar.

For example, imports of printing-writing papers which usually amounted to 4% of the total U.S. consumption of these papers, supplied 10% of our needs in both 1984 and 1985.

Exports of linerboard declined about 15% in 1985.

That was bad enough but something even more devastating was affecting our markets. Manufacturers and distributors of consumer goods and of capital goods were finding cheaper finished wares and component parts over-seas. Our balance of trade in goods, excluding oil, which was in reasonable balance until 1982 moved into a strong negative position. In 1984 and 1985 our imports exceeded exports by ever larger amounts. That escalating negative trade balance curtailed the growth in U. S. manufacturing output and reduced the demand for boxes and linerboard. 1985 was a disappointing year for box and linerboard demand.

These problems on the paper side were compounded by the flood of wood imports from Canada.

These examples of some internationally induced shifts in the market place illustrate the need for new strategies. What it boils down to is the fact that the forest based industry has received a lot of negative signals from the international pressures in the market place during the past two years while foreign producers have had positive signals which encouraged them to increase capacity.

The U.S. industry can be hurt by these forces and the degree of U. S. exposure, risk and response is what we will examine today.

Historically our investment decisions have been controlled by the need to maximize the output of the tree. The factors that motivate us are clear. They include our wonderful natural resources and the infrastructure the industry has developed to make those resources productive.

The industry has invested billions in timberland ownership and management. The return on those investments has been small. About fifteen years ago I did a study for a few companies on the economics of timberland ownership which concluded that an investor in timberlands could double his return if he invested in
a safe government bond rather than in timberlands. Of course we know that these investments in land were not made on the basis of their returns but rather on securing and maintaining supplies of raw materials for future demands.

Managers today are reassessing that strategy, however, and some are using limited partnerships to provide not only needed liquidity but also to literally force the issue of getting a proper return on those investments. While there is merit in that approach, there is also a great deal of risk.

Our biggest threat at the present comes from the federal government which under the guise of tax reform proposes to alter the tax treatment of timber income and timber management expenses. As you know the American Paper Institute has combined its resources with those of the National Forest Products Association and the Forest Industries Council on Timber Valuation and Taxation to remove these onerous features from tax reform legislation. It is a tough battle.

The industry may be succeeding somewhat, although the battle will continue for us so long as tax reform efforts remain. And these efforts seem to have staying power.

In the case of lumber imports, the industry has properly asked for redress for what it considers subsidies to Canadian lumber exports. But while these issues are being addressed in Washington, the critical question still remains for our companies. How much money should they put into forestlands given all of these forces? A small change today will open up a huge wedge in available wood supply thirty years from now. We are certainly not getting much credit for our past investments -- why should we make more?

The concern over lumber imports will be helped by the strong stand taken by the President in his major trade policy statement which requires the Office of the Special Trade Representative to speed up all complaints concerning unfair trade practices that affect U.S. industries. I believe -- and judging from recent actions - there is a great deal of sincerity in this position. We look for more sensitive government responses to our needs.

Also significant in the Canadian lumber issue are the efforts of both governments to develop free trade between the two countries. The lumber question will obviously figure significantly in these discussions.
Moving past the raw materials base into the manufacturing side of our business we see some exciting trends.

The paper industry continues to spend large amounts on plant and equipment. This year it will spend over $8.5 billion on plant and equipment, double the amount spent only seven or eight years ago. These high expenditures along with a significant amount of restructuring in the industry during the past two years have made it stronger. Ownership has shifted from multi-industry companies to companies that want to concentrate their resources on the paper business. This redeployment of assets gives our industry a sharper focus and a better chance of success.

Consider for a moment how the assessments of market opportunities by individual companies have varied and how this has helped create healthy changes in the paper industry. The paper bag is a good example. Threatened by inroads from plastic bags made at home and abroad, manufacturers of kraft paper bags have had to face the fact that imports of plastic bags have been sizable and join the growing volume of domestic plastic bags produced to displace some demand for kraft papers. The paper industry's response was to mount a major marketing campaign to sell the advantages of the paper bag. The aim is to prevent -- or at the very least -- slow down further loss to plastic bags. The sharp reductions in crude oil prices -- another international influence -- makes that job even tougher. As a result of these changing international pressures, some kraft paper manufacturers have shut down or converted large tonnages of kraft paper capacity. In 1985 and in 1986, 775,000 tons of kraft paper capacity will be converted to other grades -- about 555,000 to printing-writing grades and about 220,000 tons were shifted to linerboard capacity where the outlook is much better.

As a matter of fact, API's capacity survey taken last year shows a remarkable degree of flexibility in all manufacturing facilities as capacity was diverted from markets with little or no growth to those with greater promise.

But while the domestic industry was busy restructuring and enlarging its capacity along specific lines, foreign producers were doing the same, while focusing their sales efforts on the huge U.S. market. In that sense, we can consider worldwide pulp and paper capacity excessive in terms of today's market conditions. The U.S. market simply cannot absorb all the added world wide capacity. Foreign producers must look to their own markets to take the additional capacity.

The question is "Can they find additional sales in their
own markets?" Before answering this question, I would like to touch briefly on the cost competitiveness of U.S. manufacturing mills vis-a-vis foreign producers.

Inflation rates in all major industrial countries have moderated and this year they will be as close together as they possibly can be. For example, the Consumer Price Index rose 13.5% in the U.S. in 1980 -- this year consumer price inflation is expected to be a slim 3%.

Japan's inflation rate of 8% in 1980 shrinks to 1.7% in 1986.

Germany's consumer prices advanced 5.5% in 1980 and are growing a mere 1.5% this year.

Taking the U.K., France, Italy and Sweden as a group, we see inflation rates of 15 to 20% in 1980 moderating to 5% in 1986.

This year's inflation rates for all countries may even be lower than cited above, if oil prices hold at $13 a barrel.

This narrowing of inflation rates in all countries makes competition among them keener. If you recall that 60 to 70% of any country's inflation is caused by labor cost increases, you will recognize that wage moderation is a world wide phenomenon. Our competitive position therefore, will depend upon how we manage not only labor costs but other costs as well and how productive our mills are compared with those of foreign producers. That productivity is not simply a matter of investment -- it is a matter of good management by everyone involved in the process of converting a tree or recyclable paper into a final product. It means having top management conscious of that need and committed to it.

It means woodland managers who are willing to find a better way to do their job of cutting for present needs and planning for future requirements.

Production workers, first line supervisors -- all are responsible for productivity. It must come from all contributors to production.

How competitive are we? Well that's difficult to tell but I have one illustration that is very heartening.

Last year I compared the costs of producing linerboard in the U.S. with costs in a mill in Sweden over the period
1979-1985. Our costs rose about 4% a year during that period or half the over-all inflation rate in our country.

The costs in the Swedish mill rose at the same rate as their inflation rate which was close to 10% a year.

That cost advantage in U.S. mills over the Swedish mill, however, was more than offset by the fact that the Swedish government reduced the value of the Kroner twice during that period. This unilateral devaluation when combined with our strengthening dollar really put us at a price disadvantage in world markets vis-a-vis Swedish producers.

Given these changing international pressures on the U.S. forest based industry, what can - or should - it do to increase its profitability, returns on assets and its growth potential?

First of all it needs a favorable climate for its operations. That means national policies that help the industry rather than hinder its strategic planning process. Three policy initiatives must be made.

First: The value of our currency must receive more attention by our policy makers. That attention began in September when the Finance Ministers of France, Germany, Japan, U.K. and U.S. met and decided to drive the value of the dollar down. They have succeeded and today the dollar is about 30% below the levels reached at its peak in March 1985. But more needs to be done. We would like to see another drop of 10% - 15% in the value of the dollar. Secretary Baker appears to agree with that position. He must convince our trading partners and at the same time make certain that monetary policies recognize the need to drive the value of the dollar down farther.

Second: All major industrial countries must stimulate their economies so that their domestic demands increase. With a rise in domestic demand, export pressures will ease and those countries may even begin to import more aggressively. Unemployment rates in Europe have exceeded 10% for more than five years. Even in Germany, unemployment is in excess of 8%, considerably higher than its historic average of 3.5%.

These countries are in a position to induce faster growth in their economies through easier
money policies and lower interest rates. This is a good time for coordinated actions by all major countries.

Third: Major industrial countries are moving through a difficult period in international trade and reason must prevail. The huge trade surpluses of Japan and some other Pacific Rim countries have created problems for all major industrial countries. Reduced output and job dislocations have resulted from this flood of Asian goods to all parts of the world.

In the U.S., this has understandably led to calls for more protection of American industry and this mood has now spread to Europe. As a matter of fact, our industry's export potential in Europe is threatened by retaliatory actions such as the imposition of quotas on imports of paper products from the U.S. We are concerned over this escalation -- and in particular the inclusion of paper and paperboard in these retaliatory actions.

Up until the present, our industry position has remained liberal. We want fair and equitable trade and this principle has guided our policy recommendations to date. But even that position can change.

A clearer over-all trading climate, will nonetheless require the U.S. paper industry to make firm commitments to international markets if it is to participate in world growth. And it is doing that.

Our industry has stepped up its export activities in recent years. Many more companies are devoting more resources to the challenge of increasing exports. The number of companies with sales offices in Japan has risen sharply during the past two years because of the sales opportunities opening up there.

If these export efforts are not only successful but durable, they will make a big difference in the industry's planning and profitability.

Another challenge relates to the shift of production of a large volume of packaged goods to Asian countries in particular. That means box demand is shifted from the U.S. to Asia. Can we be a part of that shift? The obvious step is the export of
linerboard to box makers overseas but can we -- and should we get into the converting business?

The chess game in the industry goes on -- and it is exciting. Strategy planning has never been more demanding in this industry than it now is. We are shedding our homebody image and moving more visibly and permanently into the international arena.

Things will never be the same in the paper industry -- and they should not.