

# **SOUTHEAST FOREST PRODUCTS EMPLOYMENT**

**By Brit Harvey**

**T**he Southeast forest products industry is based on a complex combination of corporate investment, public resource use policy, and foreign demand. From the pre-statehood establishment of the industry through 1980, these factors combined to produce a viable industry. During the past two years diminished demand has depressed production, curtailed employment, and threatened the continued operations of industry firms. This depression is threatening to force a restructuring of the industry. While 1983 may be a year of moderate recovery, continued difficulties are a distinct possibility.

## **INDUSTRY HISTORY**

The origins of the Southeast forest products industry were not so much in supply and demand as in public policy. As a territory, Alaska lacked sufficient population to support statehood. The federal government adopted a policy of stimulating Alaska population growth. To this end, the U.S. Forest Service negotiated 50-year timber sales with corporations willing to invest in mills in the Tongass National Forest. The lure for the corporations was an assured supply of inexpensive timber. The government in turn achieved population increases in Southeast Alaska.

In order to maximize domestic employment, the export of unprocessed logs felled on federal land was prohibited. This "primary manufacture" law resulted in the establishment of a cant industry which would not otherwise exist. A cant is a squared off log.

Forest Service accounting methods render an accurate forest by forest comparison of government costs of providing timber vs. revenue received difficult. It has been persuasively argued, however, that during the 1970's the Tongass as a whole ran a deficit on timber sales. This means that Forest Service costs of administration, pre-commercial thinning and transportation facility construction were greater in an average year than timber sale revenues. This is the case whether or not logging roads, such as the system on Prince of Wales Island, are

Included as a public benefit. This pattern of "deficit" sales is not unique to the Tongass nor to Alaska.

A very large proportion of Southeast Alaska cants and pulp have historically been exported to Japan. Japanese demand, while cyclical, supported the development of the industry, and peaked in the early 1970's. Communities based wholly or partially on forest products employment, such as Wrangell, Ketchikan and Sitka, developed around the industry. These communities, like the industry itself, were dependent on continued Japanese demand, industry investment and financial health, and federal public policy which supported deficit sales and primary manufacture.

The Alaska Native Claims Settlement Act (ANCSA) introduced Sealaska Corporation into the industry during the early 1970's. Sealaska, along with other Southeast Native corporations, is exempt from primary manufacture requirements for timber felled on land it owns. Native corporations' land selections were usually the most densely forested areas in the Tongass. ANCSA changed the industry in two major ways: 1) by decreasing the available high density timber for sale to non-native corporations; and 2) by providing for the first time a source of unprocessed Southeast logs for export.

In 1980, the Alaska National Interest Lands Conservation Act (ANILCA commonly referred to as d-2) was passed. The Southeast timber industry was a particular focus of this act. The policy goal embodied in ANILCA was to maintain the then current employment in the Southeast forest products industry. The method by which this goal was to be achieved was a guaranteed offering by the Forest Service of 450 MMBF annually for 10 years in the Tongass. At the time, employment was perceived as a function of the supply of timber, with sufficient demand assumed to exist. The trade-off considered in public policy debate was, bluntly put, jobs vs. wilderness. In retrospect, ANILCA overestimated the role of public policy in influencing employment. Conversely, the power of the market on the downside was either ignored or underestimated.

## **RECENT EVENTS**

Not long after ANILCA became law, the Southeast forest products industry began a long slide into what industry sources are calling a depression. In June 1980, Southeast industry employment was 3,500. Two years later it was 2,550. Annual

average employment in 1980 was 2,700, in 1981, 2,200 and in 1982, 1,900. Recurrent temporary mill closures during 1982 make even the low employment figures deceptively high when actual days worked are considered. (See Southeast Statistical Anomalies, page 25.)

Timber harvests in Southeast Alaska totaled 556 MMBF in 1980, 513 MMBF in 1981, and 290 MMBF in 1982.<sup>2/</sup>

The primary cause of these declines is a prolonged slump in Japanese housing construction. Japanese housing starts in fiscal year 1979 (Japanese fiscal years run from April to March) totaled 1.47 million. In FY 1980 starts dropped to 1.21 million, and in FY 1981 to 1.14 million. During the most recent one year period for which data are available (September 1981 through August 1982), housing starts were only 1.11 million.<sup>3/</sup> Declining housing starts are reflected by a drop in Japanese demand for North American timber, from 1,285 thousand cubic meters in 1979, to 868 thousand cubic meters (estimated) in 1982.<sup>4/</sup>

The unusually severe depth and duration of the downturn is eroding the financial position of industry firms. Alaska Lumber and Pulp (ALP), one of the two major corporations operating in Southeast, operates a pulp mill in Sitka and a cant mill in Wrangell. ALP is reportedly attempting to sell its pulp mill and refinance its overall operations.

Louisiana-Pacific (LP), the other major Southeast operator, is more geographically diversified than ALP, which makes analysis of its Southeast operations difficult. LP is the 18th largest U.S. paper and forest products corporation, ranked by 1981 sales.<sup>5/</sup> It had the largest percentage sales decrease among the 28 major U.S. paper and forest products corporations during 1981, and one of the largest percentage profit declines. During the first three quarters of 1982, this trend continued. LP sales declined 20% and the corporation lost \$15.4 million, the second highest loss in the industry.<sup>6/</sup> While LP has relatively little debt and a strong asset position, the industry recession has hurt LP as much or more than any other major paper and forest products corporation.

LP does not report separately on its Southeast operations. It is therefore not possible to state whether LP is operating at a loss in Southeast. Some industry observers see Native corporation competition hurting LP (and ALP). Exempt from primary man-

ufacture restrictions, Native corporations have captured the top end of the Japanese export market by supplying old-growth timber in the more valuable log form. Having lost the top end of the market, LP may be pulping logs which otherwise might have been exported as cants. This diversion of raw materials to a lower value product might have hurt the profitability of LP operations. The temporary closures which typified LP's 1982 operations would be consistent with lowered profitability, as LP cut nonprofitable production awaiting an upturn in markets.

## **CURRENT ISSUES**

Clearly both LP and ALP are under financial pressure. The indefinite closure of more mills is a possibility. While cant mills are under immediate pressure due to competition from Native corporation logs, the pulp mills are the key to the Southeast industry. Both LP and ALP hold 50-year sale contracts with the Forest Service. These contracts are valuable corporate assets and are attached to the pulp mills. They can be sold with the mills, as has occurred in LP's case.<sup>7/</sup> A 50-year sale is voided if a pulp mill owner closes the mill for non-market reasons. LP threatened to close its pulp mill during the 1970's if required to install pollution control equipment. This non-market based closure would have voided the contract.<sup>8/</sup>

The weakened financial condition of ALP and LP bring into question the viability of the 50-year sales, which are the backbone of the industry. Although the conditions under which a sale contract would be broken are apparently subject to administrative review, continued depression in the industry could produce this result. Bankruptcy or prolonged inability to operate a pulp mill are scenarios which could void a sale. At this point it is very unlikely that this would occur. The 50-year sales allow price redeterminations designed to allow a profit for the operators. LP received a retroactive price adjustment in July which reduced its average stumpage (timber) price from \$73.15/thousand board feet to \$3.09. ALP has applied for a similar reduction. Obviously, a 50-year sale is a valuable asset, whether retained by the current owners or sold with a pulp mill. Additionally, the 50-year sales have strong political backing. Forest Service administrators would likely make every attempt to continue the sales and keep the pulp mills operating.

Another aspect of the industry affected by the slump is Forest Service sales and releases. The Forest Service is obligated to

offer at least 450 MMBF of timber per year under ANILCA. This total comes from regular sales and releases from the 50-year sales. Sales have a duration of one to eight years, with operators deciding when to log during the sale period. Operators pay for the timber when harvested. Extensions can be granted, but the operator must start paying for the timber whether or not it is cut during the extension period, under current law.

Typically, operators will close a sale contract with the Forest Service based on the future prices they expect to receive for the timber when it is harvested. During 1981 sales and releases remained high, despite the decline in actual harvest volume. In 1982 harvest volume from Forest Service land plummeted by 25%.<sup>9/</sup> Early in 1982 sales and releases remained high, but in the latter half of the year they also declined. In the last quarter of 1982 no major sales were made.<sup>10/</sup>

This indicates that as the downturn lengthens, firms are no longer willing and/or able to commit themselves to further future harvests. Without an increase in demand, it appears that the ANILCA-required offering of at least 450 MMBF/year will not result in anywhere near equivalent sales.

### **ECONOMIC OUTLOOK**

The recent increase in U.S. housing starts and a broadly anticipated economic recovery have prompted many economists to predict a better year in 1983 for the U.S. forest products industry. Demographic trends point toward strong housing demand throughout the 1980's. Interest costs are generally viewed as the key housing start variable. Although interest costs have declined recently, sparking new housing construction, they remain historically very high when viewed in real terms. This is likely to continue, resulting in a trend toward smaller housing units and an increasing proportion of multiple-unit construction. While opinions vary, it is likely that much of the mill capacity closed during the current recession will never reopen. This is particularly true of Washington and Oregon.

Ironically, the Southeast Alaska forest products industry is also impacted by U.S. interest rates, but for a completely different reason. Southeast products, due to dependence on Japanese markets, are affected by the strength of the dollar against the yen. Recently the dollar has weakened against the yen. The

timing of this change suggests that U.S. interest rates are the primary influence on the yen/dollar relationship. Decreasing U.S. interest rates therefore tend to directly benefit the *lower-48* forest products industry and indirectly benefit the Alaska industry.

U.S. interest rate forecasts vary widely. Most analysts predict a continued gradual decline during 1983. Others predict increases due to the effects of the Reagan administration's gigantic budget deficit.

Japanese housing starts, another important factor in demand for Southeast forest products, have increased recently, although they remain historically low. Once again, forecasts of Japanese housing starts vary. World economic recovery would fuel Japan's export-led economy, supporting increased demand. Should a recovery fail to materialize, Japanese housing starts are unlikely to advance substantially.

Two scenarios for 1983 Southeast forest products employment can be hypothesized. Should the U.S. economy begin a long-awaited recovery accompanied by declining interest rates, industry employment can be expected to bounce back to at least the 1981 level. The financial pressure on the industry would be partially relieved. Should the U.S. recession persist, with interest rates climbing in response to record budget deficits, Southeast forest products employment is unlikely to increase. Continued financial pressure, particularly on ALP, could result in structural changes in the industry which could further reduce employment, perhaps for longer than just 1983.

The consensus of economic forecasts would tend to favor the first scenario. Considering the recent track record of economic forecasting, this is scant solace for unemployed industry workers or their employers.

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#### SOURCES

- 1/ Alaska Department of Labor, Research and Analysis.
- 2/ "Timber Supply and Demand 1982"; U.S. Forest Service; p.4.

- 3/ "Monthly Report", Industrial Bank of Japan; November 1982; p.3.
  - 4/ "Timber Supply and Demand 1982"; U.S. Forest Service; p. A-22.
  - 5/ BusinessWeek, March 15, 1982; p. 93.
  - 6/ BusinessWeek, November 15, 1982; p. 102.
  - 7/ Al Akin, U.S. Forest Service, Timber Management, Juneau; Conversation, 12/22/82
  - 8/ (same as above)
  - 9/ "Timber Supply and Demand 1982"; U.S. Forest Service; p. 4, p. 12.
  - 10/ Al Akin, U.S. Forest Service, Timber Management, Juneau; Conversation, 1/3/83.
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