

DRAFT

Globalization and the Forest Sector

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1 Introduction

The Swedish Federation of Forest Industries (2001) stated that “*Globalization is sweeping the forest industry like a tidal wave. The companies are getting bigger, stronger, fewer and national borders are being steadily eroded*”.

However, globalization is a word of obscure meaning, coined in the 1960s and came into much use in the 1990s (Cable, 1999). Globalization is not a new phenomena; it may have started some 100,000 years ago with the departure of Homo sapiens from Africa and the succeeding colonization of the world. Examples of ancient globalization are the old trade with China, introduction of the printing technology (Guthenberg), financial crisis, etc. Findlay (2002) claims that real globalization began with the unification of the Eurasian land mass by the Mongols. The word globalization is used with different meanings. The contested nature of the concept is part of the explanation for the very confused public debate on *globalization* (DFID, 2005). It can also be concluded that throughout human history, exposure to outside influence has tended to enrich, rather than impoverish, individuals and societies.

2 What is Globalization?

Given the nature of the globalization concept, many definitions of the term exist and we will just illustrate some of them. Hirst and Thompson (1999) state that globalization is a catch-phrase for often very different economic, cultural and social processes. Krueger (2000) defines globalization as a phenomenon by which economic agents in any given part of the world are much more affected by events elsewhere in the world than before. Henderson (1999) defines globalization as the “*free movement of goods, services, labor and capital, merely creating a single market in inputs and outputs; and full national treatment for foreign investors so that, economically speaking, there are no foreigners*”.

Lindsay (2002) states that globalization is a movement in the direction of greater integration. Wolf (2004) defines globalization of what follows as *integration of economic activities via markets*. DFID (2005) states that globalization means growing *interdependence* and *interconnections* of the modern world. Dicken (1999) and Sklair (1999) claim that globalization can be regarded as *economic integration*.

In the following sections I will use the definition of globalization as *integration of economic activities via markets*.

It is also important to point out that I am speaking about *economic globalization*. Economic globalization has, in turn, cultural, social and political consequences. Economic globalization is a crucial component that drives even wider exchanges thereby creating bigger and more complex institutions (Wolf, 2004). DFID (2005) states that these wider exchanges include the diffusion of global norms and values, the proliferation of global agreements and treaties, and the spread of democracy.

Finally, I think it is important to make a distinction between *internationalization* and the *globalization* processes in the debate. The internationalization process involves a simple extension of economic activities across national borders while

globalization is a complex of inter-related processes without an end state. (Dicken, 1999).

3 What Drives Globalization?

The overall driving forces of globalization are technological and policy changes. Friedman (2000) has stressed that the technological innovations during the last decades have made it difficult to prevent rapid globalization. This is especially valid for the technological development of transport and communication (Wolf, 2004). Technological advances reduce the costs for international transactions, increase the share of trade in world production, increase the mobility of capital but also diffuse new technologies and ideas. The other driving force for globalization is economic policy change. These policy changes are mainly dealing with measures to open economies and liberalize international trade.

4 What Does Globalization Do?

There is immense literature and confusion on what economic globalization causes. There is a strong anti-globalization movement in place. Wolf (2004) summarizes what he calls the antiglobalization.com arguments in the following way:

- It destroys the ability of states to regulate their national economies, raise taxes and spend money on public goods and social welfare.
- In the process, it undermines democracy, imposing in its place the rule of unaccountable bureaucrats, corporations and markets.
- It amounts to an abdication of power by benevolent democratic governments in favor of predatory private corporations.
- It is causing mass destitution and increased inequality within and between nations.

- It is destroying the livelihood of farmers.
- It is depriving the poor of affordable medicines.
- It is lowering real wages and labor standards and increasing economic insecurity everywhere.
- It is destroying the environment, eliminating species and harming animal welfare.
- It is causing a global race to low taxes, low regulatory standards and low wages are imposed in every country.
- It is permitting global financial markets to generate crisis that impose heavy costs particularly on the less advanced economies.
- It enshrines greed as the motive-force of human behavior.
- It is destroying the variety of human cultures.

Wolf (2004) has also carefully analyzed this criticism of globalization and concludes that most of it is not at all relevant or wrong. DFID (2005) also arrived at a similar conclusion. However, Wolf (2004) admits the critics are right that the *institutions* set up to manage the global economy do not work well, particularly in finance. He also admits that the critics are right about the *hypocrisy on liberalization* by the developed world in the globalization process. The developed countries call on the developing countries to adjust, liberalize and respond to the market forces—but the developed countries do not do it themselves. Stiglitz (2002) has also strongly warned about the effects of liberalizing controls on capital flows and the integration of the capital market and the required *global institutional reforms*, and he also speaks about substantial higher risks for financial crisis. DFID (2005) stresses that globalization needs *wise management* in the form of policy choices adopted by governments, international institutions,

the private sector and the civil society. DFID (2005) also underline that globalization brings in systematic risks like *financial volatility*.

So what does economic globalization do? It generates *economic growth*. And economic growth distributes new wealth with which opportunities are created to lift people out of poverty. It provides universal availability of consumer goods and services. It also offers opportunities for countries to access new technologies being less resource-intensive and less polluting.

Globalization brings *rapid economic change*. Economic change always imposes losses as well as gains. To close a plant in one country and build a new one in another country is a symbol of rapid economic change.

Thus, globalization generates massive wealth through the economic growth generated (DFID, 2005). But, as illustrated above, if it is not managed well it may pose a threat to financial stability and security across the world. Globalization works namely in both ways: it spreads benefits widely in good times but it also transmits economic and financial shocks rapidly around the world. This can be illustrated by the American Viagra Economy. In summary, the US economy is built on people buying each other's houses at dramatically increased prices on borrowed money from China. If this housing bubble were to burst, it would cause American consumers to cut spending sharply. Given Asia's heavy dependence on exports to China, which in turn relies for much of its growth on exports to the USA, the shock waves would spread throughout the region. In addition, the value of the dollar would drop and the enormous financial foreign reserves of dollars built up in the emerging economies (through trade surplus) would lose value and these countries would start to sell off the dollar with the accelerated decline of the dollar value as a result (Financial Times, 2005).

If we are to make globalization function as we want it to do we need more effective, open and accountable *international financial systems* as well as better global *political institutions*.

Based on our knowledge today, economic growth and a market economy is the only arrangement capable of generating sustained increases in prosperity in the global society and *globalization* is a key driver for this needed economic growth.

During the next couple of decades, globalization will probably continue to sustain world economic growth, raise world living standards and substantially deepen global interdependence. At the same time, it will *substantially shake up the status quo almost everywhere* with economic, cultural and political convulsions as a result (NIC, 2005).

Can globalization derail? Of course it can. If a new pandemic appears the globalization process will probably collapse. It was recently concluded that the Spanish Disease killing 30–40 million people in Europe during the last century was a bird influenza and there is now major concern on how the Asian bird influenza will develop.

Another risk is the *fear of globalization and politicians*. If politicians *fear* economic and physical insecurity and introduce controls on the flow of capital, goods, people and technology there will be a stop to globalization and economic growth. Thus, it is important for politicians to reject protectionism and national self-interest arising from fearing globalization.

5 What Are the Indicators of Globalization of the Forest Sector?

IDB (2002) claims that globalization has had a significant impact on forests and forest industry-based development worldwide. It has brought about increased international trade in forest and forest industry products, launched new and value-added products, promoted advanced technologies and witnessed a substantial amount of company mergers and acquisitions.

ILO (2001) analyzed the indicators of globalization of the forest sector and in the following subsections I will follow a similar structure.

5.1 Trade Versus Production

During the last decade trade has risen faster than production; solid wood products with some 50%, pulp and paper products with some 60%, and furniture with some 150%.

5.2 Foreign Direct Investments (FDI)

There seems to be a steep increase in FDIs in the forest sector (Uusivuori and Laaksonen-Craig, 2000).

5.3 Mergers and Acquisitions

Mergers and acquisitions in the forest sector have been on the rise for at least two decades (ILO, 2001).

5.4 New Players

There are an increasing number of new players acting on the international markets both as brand new players and joint ventures, and in the establishment of subsidiaries in foreign countries.

5.5 Market Integration

Analysis of the last 40 years of wood products' markets shows increased market integration over time (Nyrud *et al.*, 2004).

5.6 Emergence of World Prices

There is an emergence of world prices of forest products taking place with a downward price development globally but with a closing of the gap between old and new producers.

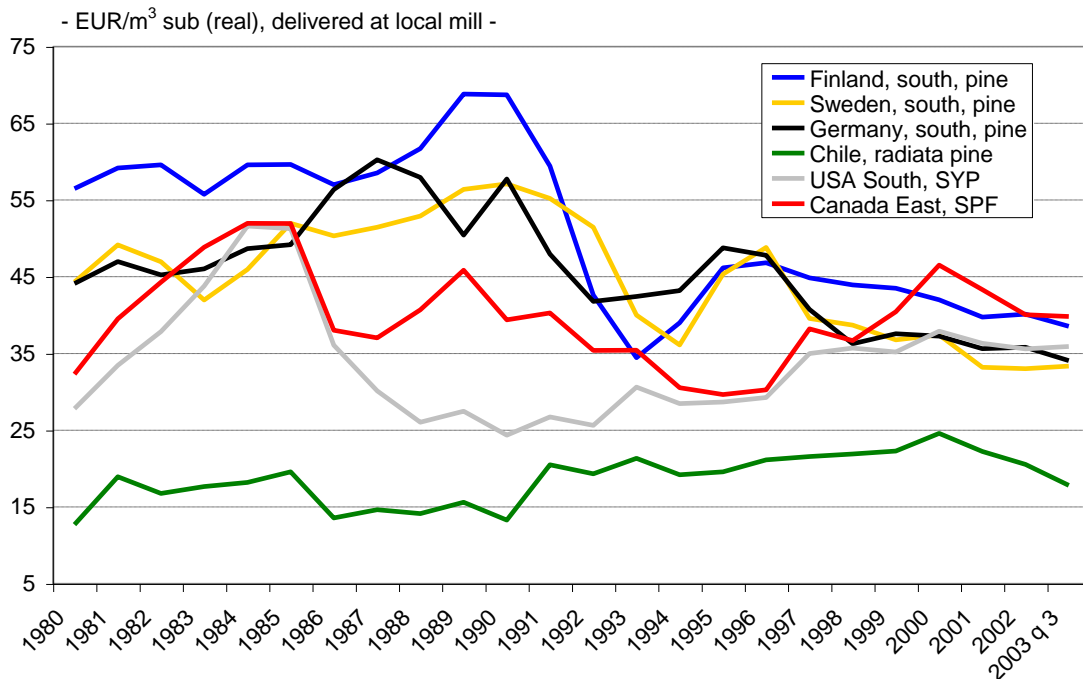


Figure 1: Softwood pulpwood cost for chemical pulping. Source: Jaakko Pöyry (2004).

5.7 Enterprise Volatility

Enterprise volatility has increased resulting in the closure of mills and machines which leads to structural change of the sector.

6 What Are the Forces of Globalization of the Forest Sector?

The opportunities to enter new markets or increase market penetration and/or access to inputs and production at lower costs are the primary causes for globalization in the sector. The opportunities are generated through the liberalization of regulations and policies with respect to FDIs and markets. This, in turn, will result in proximity and access to other new markets. The enabling of new technologies, like ICT, makes it possible. There is also an under-utilized shipping capacity on return trips from the developed world to the emerging economies, which makes transportation inexpensive.

7 What Does it Mean for the Forest Sector?

What does the indicator development discussed in Section 5 mean for the overall development of the forest sector?

7.1 *A Relocation of the Forest Sector from Traditional Producers in the North to the Southern Hemisphere and Emerging Economies*

Forest industry companies have growing incentives to relocate production to rapidly growing markets (Asia, Latin America, Russia) and to areas where raw material and labor costs are relatively low (plantations in the South). As a result, demand for wood in the traditional producing areas in the North declines, as do the real prices for wood. These trends are likely strengthened by the ICT development by increasing the downward pressure on the real prices of wood raw material (Hetemäki and Nilsson, 2005). These trends also weaken the potential for profitable wood production and forest management in the North and the closure of industries resulting in less employment. Without new strategies in the North, it is difficult to see how a viable forest sector could be maintained in the traditional forestry regions in the long term. Thus, globalization effects, together with other economic forces, will decide the competitive position of different producing regions of forest and forest industrial products in the future (MTI, 2004).

7.2 *Governance of Forest Sector Enterprises*

The governance of forest companies has come under redefinition by globalization. The shareholder interests increasingly condition the managers' decision making. The conditioning is often in the form of pressure on improvement of financial attractiveness and short-term profitability (Hoen and Lilja, 2001). In addition, the interrelations between companies and their suppliers and customers have changed with globalization. But this development has also created a shareholder democracy instead of patrimonial traditions in a conservative sector (Lehtinen, 2002).

The globalized companies can not, to the same extent as before, incorporate local and national policies into their strategies. It would cost too much from a competitive point of view (Koskinen, 1999).

7.3 *Integration of Environmental Values*

Globalization has made environmental values integrated elements of trade of forest products. The environmental regulation following this integration (e.g., in Europe the Natura Programs and Greenbelt Visions) act as risk signals for the companies. And this, together with the other trends following globalization, pushes investments abroad and slows modernization and investments in the domestic production (Lehtinen, 2002).

7.4 *Governance by Governments*

With globalization, national governments have less and less possibilities to influence the development of the forest sector. The role of government institutions is restricted to policies, legislation (which is also driven by global trends) and law enforcement. An area where governments can play a crucial role is in forest sector research (FAO, 2001).

7.5 *Regional Development*

It was pointed out earlier that the companies concern themselves less and less with regional policies in order to stay competitive in a globalized sector. This means that there will be less dynamics and driving forces for regional development in forested regions (Lehtinen, 2002). This acts as a vicious circle—with less regional development, the competitive position will be weakened and forest companies will be forced to close down and/or move to other locations.

7.6 *Competitiveness*

The guiding stars for the industry to stay competitive during globalization, so far, have been volume-based expansion through mergers and technological

development. But the question is whether or not these approaches have been exhausted and will not help in the future.

The way the industry has employed new technologies under globalization has been to reduce the overall industry operating costs thereby increasing profitability (cost-saving strategy). I will illustrate with the case of e-business based on Ince *et al.* (2005).

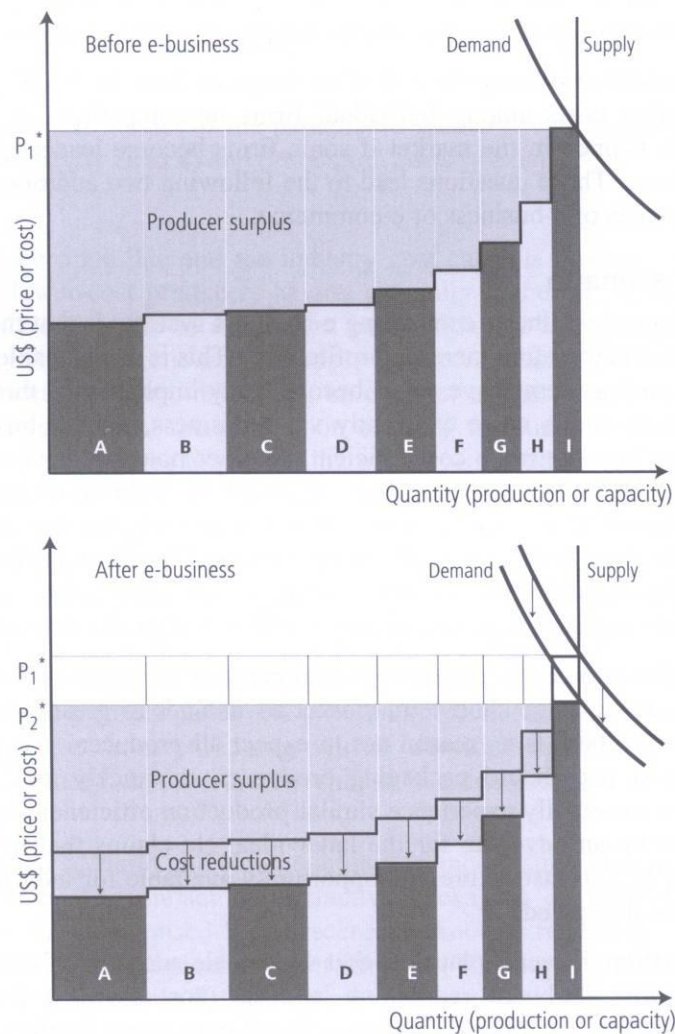


Figure 2: Market impacts of e-business in a commodity market, assuming the primary effect is to reduce operating costs.

The long-term effect is that the costs are reduced but there is also a decrease in the market prices and the effect will be reduced profitability across the sector (reduced producer surplus). Thus, to implement the new technologies just in a cost-saving strategy will increase profitability in the short-term for the companies implementing the technology, but when most of the companies have implemented the technology the profitability will decrease across the sector. Thus, you are shooting yourself in the foot. The only way to boost profits is to use the new technologies for creating new and transformational products—products with brand new functions—and this requires investments in innovation. Nilsson (2004) points out that the scope of investments for capacity expansions as a competitiveness source will be very limited.

This means we are moving into a new phase of globalization. This phase will require *innovations* and strong *networking* with new technologies (information, nano and bio).

The above are only some examples of the overall impacts of globalization of the forest sector and does not claim to be complete.

8 What Does Globalization in Other Sectors Mean for the Forest Sector?

Parallel to globalization in the forest sector, globalization is taking place with similar intensity in other sectors. Agriculture is one of these sectors.

It is assessed (Rounsevell *et al.*, 2005) that in Europe (EU15 + Norway and Switzerland) there will be a low increase in the demand of agricultural products, due to demographic development, further increased technology development, and increased import. This will result in structural changes. By 2080, cropland may have decreased by some 45% compared with today's area of cropland and grasslands by some 50%.

Will this development be a revitalization of the forest sector through increased production of fibers? Or will it be the last nail in the coffin due to collapsing regional development? Forests are not necessarily at all regarded as the means for rural development by rural populations (O'Leary and McCormack, 2000; Elands *et al.*, 2004).

Energy is another sector. One example is the Swedish utility providers, which are now being connected to the electricity net in continental Europe and are also the owners of facilities in continental Europe. Until now the Swedish industry has had the advantage of low energy prices, which has helped in the competitiveness race. But now the utility companies can earn more money by sending the electricity to continental Europe. This situation will increase electricity prices in Sweden and, in the long term, they will be at the same level as in the rest of Europe. On the other hand, most of the pulp and paper mills are net providers of electricity, meaning increased income for these companies. The issue is how globalization of the energy sector will influence the competitiveness and future structural change of the existing industry.

9 What Does This Mean for MCPFE?

The Ministerial Conference on the Protection of Forests in Europe (MCPFE) was launched as a regional initiative in 1990 as a political platform for a dialogue on European forest issues. Its objectives are sustainable management and protection of forests in Europe and a contribution to the sustainable development of society, with a special focus on the links between society and forestry (MCPFE, 2000). According to my judgment, MCPFE has so far taken a conventional approach dealing with conventional forest issues. But, as I have tried to illustrate in this paper, the conditions for sustainable forest management and especially the sustainable development of society is, to a large extent, not set in Europe but by globalization in the world outside Europe. This development will be even further expressed in the future. Therefore, I think MCPFE has urgently to address a number of issues in the wake of globalization.

In the following subsections some issues will be addressed that may be of future importance for MCPFE. The list is not given in any order of priority.

9.1 *Policy Making*

Globalization is reinforcing the need for a more integrated approach to policy making. Policies no longer fit into neat sectoral boxes and the distinction between national/regional and global policies is increasingly blurred.

9.2 *Research Agenda*

There is a need for a shift in the research agenda from European forests to global forest sector analysis.

9.3 *Competitiveness*

Globalization continuously changes competitiveness. There is a need for ongoing assessment of the competitive position of the European forest sector in order to understand where the sector is heading.

9.4 *Technological Development*

As stated above, technological developments are strong forces for increased globalization. These developments are taking place outside the sector, mainly in information, bio- and nano-technologies. It is important to follow these developments closely in order to understand future globalization and the future of the forest sector. I will illustrate with nano-technology (a nanometer is a billionth of a meter or 80,000 times thinner than a human hair). Nano-technology could transform the forest products industry in virtually all aspects—ranging from production of raw materials to new applications and to new generations of functional products (AFPA, 2005).

9.5 *Innovations*

It has been demonstrated that the current cost saving strategies in the European forest sector will lead to a further decline of the sector. In order to turn this into a

positive development, substantial efforts have to be paid to innovations in the sector (including the new technologies mentioned above). It is through innovations that value added can be created.

9.6 *Global Institutions and Global Financial Markets and Management*

It has been identified that the institutions managing globalization and global financial management are insufficient. Special efforts are needed to watch these operations and their impacts and to improve these functions.

9.7 *Trade*

Trade is a key function of globalization and increased efforts are needed in order to understand the aspects and impacts of a globalized forest products trade.

9.8 *Social Dimensions*

The social dimension of globalization has to be incorporated into policies relating to the forest sector.

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