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Supply: The Product of Demand
A simple but great truth.

The graph of demand accompanying this article (Figure 1) shows hardwood lumber consumption by primary US market sectors has declined each year since 1999, with the falloff much sharper since September of 2008. The reasons for recent contractions in demand have been well documented. Initially, the housing bubble burst and was then followed by a historic global economic crisis.

The graph of Eastern US hardwood production (Figure 2) shows 1999 lumber output at 12.6 billion board feet. By August 2009, production had declined to 5.6 billion board feet (-55.6%). The degree of change is dramatic, but the correlation between demand and supplies is not surprising because supply is a product of demand.

The bigger question is, how have markets for North American hardwoods changed? Are we experiencing a cyclical change or fundamental change? Certainly, there is a cyclical element to current market events for hardwoods. Housing is the most glaring and relevant example. New home construction and overall housing prices rose to unsustainably high levels before peaking and dropping at unprecedented rates. In fact, contraction in new housing starts surpassed estimates for static demand, which have ranged from 1.4 to more than 1.8 million units per year.

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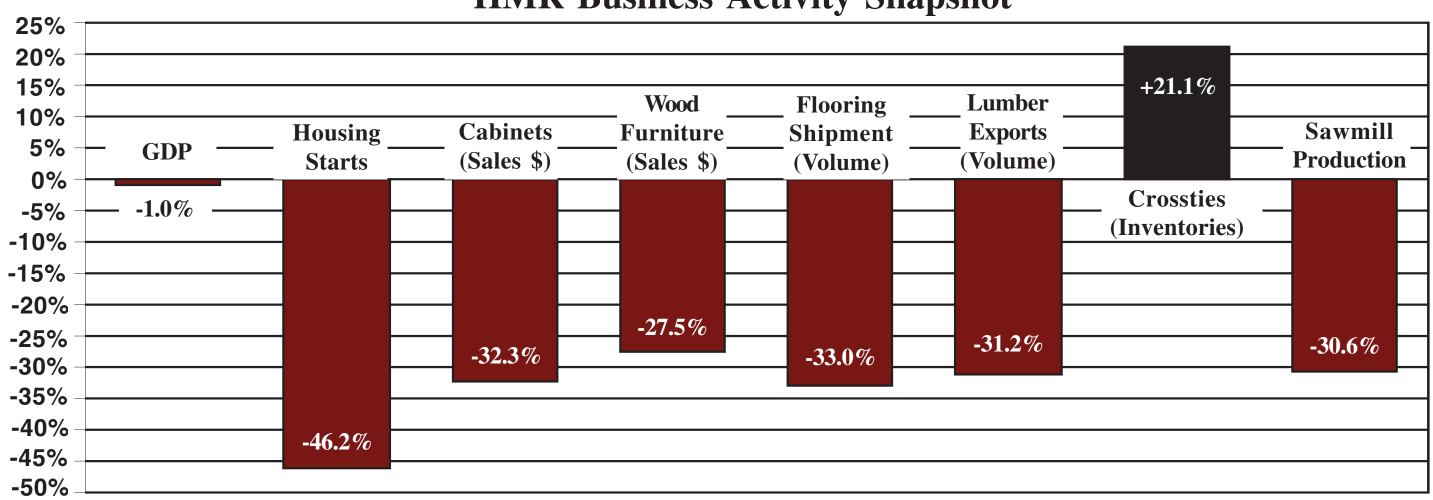
- Inventories of new single-family houses in the US fell to 271,000 units, -52.5% from August 2006 (peak). The number of single-family units under construction at the end of July increased for the second consecutive month, but at 326,900 units was 66.8% below the record high set in October 2005 (985,000 units). Multi-family units under construction totaled 296,700, which was low based on historic performance.
- In the Manufacturing At A Glance matrix of the ISM *Report On Business*®, solid gains were posted by the PMI, production, supplier deliveries, backlog of orders, and exports. Strong gains occurred for new orders, and prices. Marginal gains were listed for employment and inventories. Moderate decreases occurred for customers' inventories and imports.
- The US Advance Report on manufacturers' durable goods for July 2009 shows new orders increased 4.9%; shipments were up 2.0%; unfilled orders fell 0.1%; and, inventories decreased 0.8%.

HMR Business Activity Snapshot™



An example of fundamental change in the marketplace occurred from a shift in consumer preferences for species. Beginning at the start of this decade, closed-grained whitewoods gained favor. This occurred after decades of Oak being at the top of fashion. But, as consumers were ready for a change in show woods, many were more interested in general appearances rather than a particular North American species. We (the hardwood industry) can blame ourselves for not doing a better job of promoting homegrown products to the consumer, though that discussion is for another article on another day. The timing is uncertain, but a time will come when consumers will change to a different "look" from closed-grained species.

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A larger and much more significant fundamental market change for North American hardwoods has been globalization – the outsourcing of secondary manufacturing to low-cost producer nations. Furniture manufacturing is the US hardwood industry's poster child for outsourced manufacturing. Rather than investing in domestic plants, most US furniture manufacturers chose to enlist foreign producers to supply private labeled finished goods. It must be noted that pursuing low-cost sources is not a new trend for the US furniture industry; it has a long history of following low-cost labor and raw materials beginning in New York, to the Upper Midwest, to Virginia and North Carolina, to Mississippi, then Mexico, and now onto China and the greater Southeast Asia region.

An obvious downside to local/domestic markets relocating manufacturing to overseas sources is a loss in total business. In 1999, the US furniture industry represented 20% of the total hardwood lumber consumed. In 2008, the percentage share of total consumption dropped to 8%. Even more disruptive is the fact that the furniture industry was the single largest market for #1 common grade hardwood lumber. For hardwood lumber suppliers, what are the alternative market solutions for this portion of the log? And, what effect have lost and changing markets had on #1 common prices?

To address the first question - cabinet manufacturers continue to purchase #1 common as the primary grade. A shift to utilize more mid-grade lumber has come from solid wood flooring manufacturers. Additionally, yards have become significant buyers of #1 common hardwood lumber. However, yards, flooring, and the cabinet industry have not replaced demand for #1 common lumber lost with the furniture industry's exodus to Asia. Neither have exports. Even crediting slower business to weak economic conditions, conservative estimates put demand for #1 common hardwood lumber off more than 1.3 billion board feet from peak. To the second question, prices for kiln dried 4/4 #1 common Red Oak have declined 31% since January of 2000.

Supply and demand are tightly intertwined and are impacted by changes in global events. What all hardwood executives should also understand is that there is an interrelationship among the major market sectors in regard to supply. Additionally, hardwood lumber supplies are dependent upon demand being proportionate with the indigenous species of sawtimber, as well as the inherent grade quality of lumber production. With these ideas in mind, what will be the long-term effects of globalization on US manufacturers of hardwood logs, lumber, and finished goods? Better yet, how might this course of events be changed to benefit North American hardwood manufacturing?

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The U.S. Lacey Act: Are You Ready?

Anne Middleton,
Environmental Investigation Agency

Tips from an expert…on the inside.

Being the lone representative from an environmental organization at this year's National Wood Flooring Association convention in Long Beach, CA proved to be valuable, both for the NWFA attendees and for me. Until last April, I didn't know that one floor could contain wood from over 20 different tree species or that a person could install a wood floor without glue. On the flip side, it seems there were several attendees who did not know that a person could go to jail for trading in illegally harvested timber. Is your business in the know? Let's find out.

What is the Lacey Act[1] ?

The recently amended U.S. Lacey Act is the world's first ban on commerce of illegally sourced plants and plant products, making our country the global leader in fighting illegal logging and timber trade. Passed on May 22, 2008, the amendment changes a 100-year-old statute fighting wildlife trafficking crime. In addition to this underlying prohibition, the Lacey Act also requires importers of plants and plant products to fill out a declaration form[2] at the border declaring the value, volume, scientific name, and country of harvest origin of their plant product(s).

But what is illegal logging, exactly?

Illegal logging is extraction of trees in contravention of any state, foreign, or tribal law. Examples of illegal logging include timber theft, logging in a national park or protected area, failure to pay taxes or tariffs on a shipment of logs, or taking logs without proper authorization. An estimated 10% of the annual wood import stream to the U.S. is of illegal origin[3] . Illegal logging rates vary dramatically by exporting country, but estimates made earlier in the decade indicate that upwards of 70-80% of the hardwoods exported from Honduras or Indonesia, for example, were of illegal origin.

How can an importer tell if his or her wood product is illegal?

Know your suppliers. Clarify your supply chains. Use common sense. If you are buying lumber off the proverbial "back of the truck," you're probably in trouble. If you can trace all of your products and their accompanying documents back to the source, you're on the right track. Third-party verification and certification schemes such as FSC are one good way to exercise "due care," although they are not required under the Lacey Act.

What is due care? If I practice "due care" or "due diligence," am I Lacey compliant?

Due care is a flexible concept that has been developed over time by the U.S. legal system. Due care means "that degree of care which a reasonably prudent person would exercise under the same or similar circumstances." Due care varies on factors such as the sector, the size of the company, and how risky the product itself might be. A wood flooring professional, for example, would not be expected to understand that you need a CITES (Convention on International Trade in Endangered Species) permit to import a Siberian Tiger skin. He *would*, however, be expected to know that you need to obtain that same permit for any tree species listed on CITES, and to ask hard questions of anyone selling him high-value species harvested from natural forests.

"Lacey compliant" isn't defined by any one due diligence system or due care check-list; the government isn't going to provide that. The private sector is best equipped to design the best practices that will ensure companies are only sourcing legal timber. Also, these practices will probably evolve over time, another thing that government regulations don't do very well.

What are the leaders in your industry doing to comply? Look to your trade associations for leadership. If you need help looking up the scientific name of your wood product, visit http://www2.fpl.fs.fed.us/CommNames2000.html operated by the US Forest Service.

Need more information on the declaration form? Visit: http://www.aphis.usda.gov/plant_health/lacey_act/index.shtml to learn more. The US Department of Agriculture's Animal and Plant Health Inspection Service (APHIS) is in charge of processing the forms. The declaration form is required to be filled out by importers based on a *phased-in schedule**.

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The U.S. Lacey Act: Are You Ready?, *continued from page 3*

I December 2008-April 2009	**II** May 1, 2009-September 30, 2009	**III** Oct 1, 2009-March 31, 2010	**IV** April 1, 2010-September 30, 2010
PPQ Plant Import Declaration Form will be available on website, and accepted after December 15, 2008 Domestic and international outreach	HTS Chapters: Ch 44 Headings (wood and articles of wood) 4401 - (Fuel wood) 4403 - (Wood in the rough) 4404 - (Hoopwood; poles, piles, stakes) 4406 - (Railway or tramway sleepers) 4407 - (Wood sawn or chipped lengthwise) 4408 - (Sheets for veneering) 4409 - (Wood continuously shaped) 4417 - (Tools, tool handles, broom handles) 4418 - (Builders' joinery and carpentry of wood)	HTS Chapters: Ch. 44 Headings (wood & articles of wood) 4402 - (Wood charcoal) 4405 - (Wood wool [excelsior]) 4410 - (Particle board) 4411 - (Fiberboard of wood) 4412 - (Plywood, veneered panels) 4413 - (Densified wood) 4414 - (Wooden frames) 4415 - (Packing cases, boxes, crates, drums) 4416 - (Casks, barrels, vats, tubs) 4419 - (Tableware & kitchenware, of wood) 4420 - (Wood marquetry; caskets; statuettes) Ch. 47 Headings (wood pulp) 4701 - (Mechanical wood pulp) 4702 - (Chemical wood pulp, dissolving) 4703 - (Chemical wood pulp, sulfate) 4704 - (Chemical wood pulp, sulfite) 4705 - (Combination mechanical and chemical) **PLUS PHASE II**	HTS Chapters: Ch 44 Headings (wood & articles of wood) 4421 - (Articles of wood, nesoi) Ch. 48 Headings (paper & articles of wood) 4801 - (Newsprint) 4802 - (Uncoated writing paper) 4803 - (Toilet or facial tissue stock) 4804 - (Uncoated craft paper) 4805 - (Other uncoated paper and board) 4806 - (Vegetable parchment, etc.) 4807 - (Composite paper & board) 4808 - (Corrugated paper & board) 4809 - (Carbon paper) 4810 - (Coated paper and board) 4811 - (Paper coated, etc. other than 4803, 4809, or 4810) Ch. 94 Headings (furniture, etc.) 940169-(seats with wooden frames) 940330-(wooden office furniture) 940340-(wooden kitchen furniture) 940350-(wooden bedroom furniture) 940360-(other wooden furniture) 94039070-(wooden furniture parts) **PLUS PHASES II & III**

*Subject to change. For updates and future phases visit http://www.aphis.usda.gov/plant_health/lacey_act/index.shtml.

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What documents should I ask from my suppliers?

"How can I trust my suppliers? How can I be sure that the guy three links up the supply chain is trustworthy if I haven't met him?" Three words: know your suppliers. Check with your business associates and others in the industry and see who they trust (or who they *don't* trust). Establish long-term relationships rather than buying on spot markets. Make site visits to existing and potential suppliers, do independent research, and ask tough questions.

The Lacey Act is a fact-based, rather than a document-based statute. There are no specific "compliance" documents that you or your suppliers can provide to prove compliance. Keep in mind, however, that it is important to look behind the documents. EIA has seen and exposed many cases of forged papers, false certifications, and laundered wood crossing borders. Checking out and trusting your suppliers and the wood they're providing are as important as getting actual documents. Certain high-value species (such as Teak, Merbau, or Mahogany) and supplying countries with historically bad track records should get particularly targeted questions. That doesn't mean "don't import from some countries" – in fact, we want to reward businesses with good practices in tough countries – but it does mean "do your homework."

What about FSC or being "green" or "sustainable?" What does that mean for the Lacey Act? I'm already "green"- am I exempt or in compliance?

Third-party sustainable forestry certification under schemes such as FSC (Forest Stewardship Council), or legality verification schemes, are very good ways to demonstrate *due care*. They are not required, nor are they a get-out-of-jail free card, but they will help demonstrate to the government that you have taken the steps necessary to eliminate illegal wood from your supply chain. You still must submit the import declaration form to APHIS.

How will this be enforced?

U.S. government employees from Customs and Border Patrol (CBP), Fish and Wildlife Office of Law Enforcement (OLE), and Department of Agriculture's Animal Plant Health Inspection Service (APHIS) are on the job. Trained officers eventually will be stationed in ports and warehouses inspecting timber shipments, while investigators are already looking into cases of illegal trade. And of course, there are environmental watchdog organizations (like EIA) out there waiting to tip off the Department of Justice. The U.S. government has the burden of proof, but don't be caught unaware.

Have more questions? Visit our website, www.eia-global.org/lacey, and visit the APHIS website http://www.aphis.usda.gov/plant_health/lacey_act/index.shtml. If you still can't find what you're looking for, please email me: anne@eia-international.org. Additionally, if you'd like to receive periodic updates on the Lacey Act via email, please let me know.

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202-483-6621

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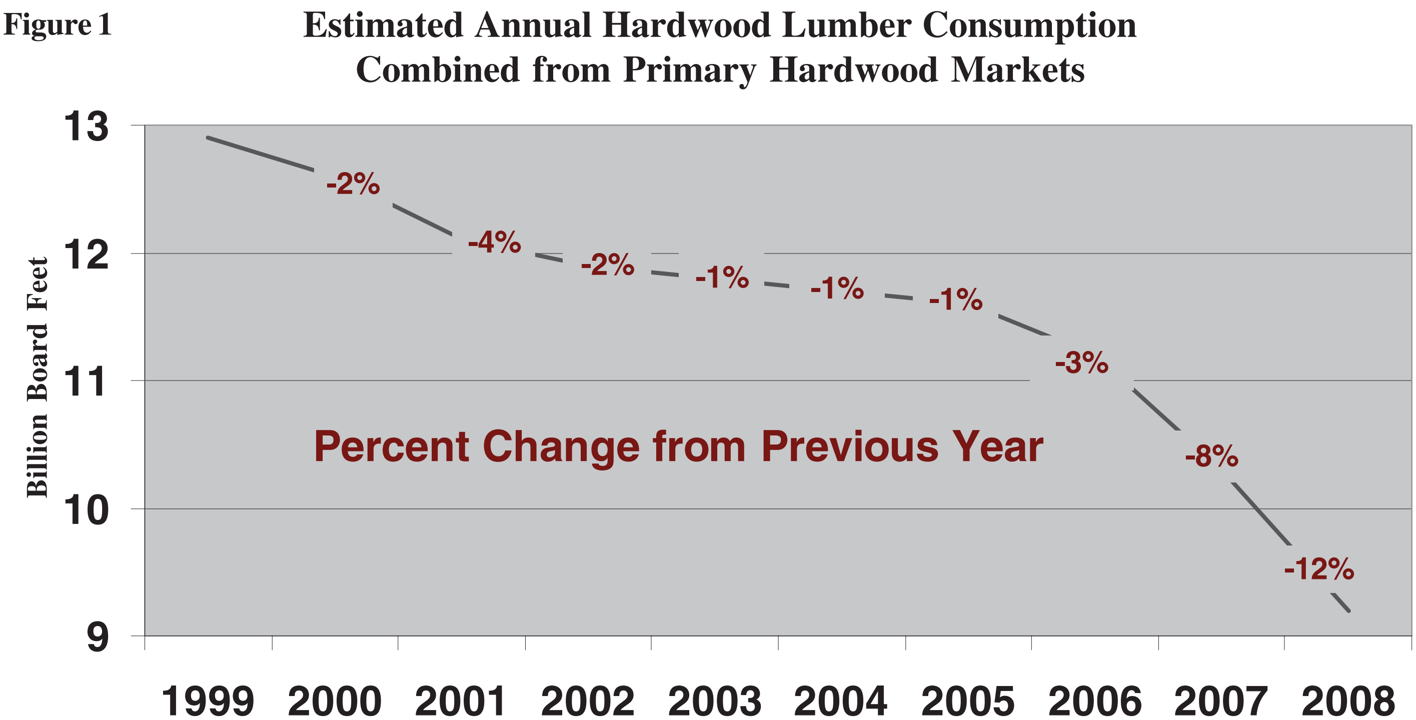
[1] Adapted from "The US Lacey Act: Frequently Asked Questions about the World's First Ban on Trade in Illegal Wood." To view a copy, see www.eia-global.org/lacey.

[2] PPQ Form 505. See http://www.aphis.usda.gov/plant_health/lacey_act/index.shtml for a link to the form.

[3] For this and other facts on illegal logging, read EIA's report, "No Questions Asked," available at www.eia-global.org/lacey.

Supply: The product of Demand, *continued from page 2*

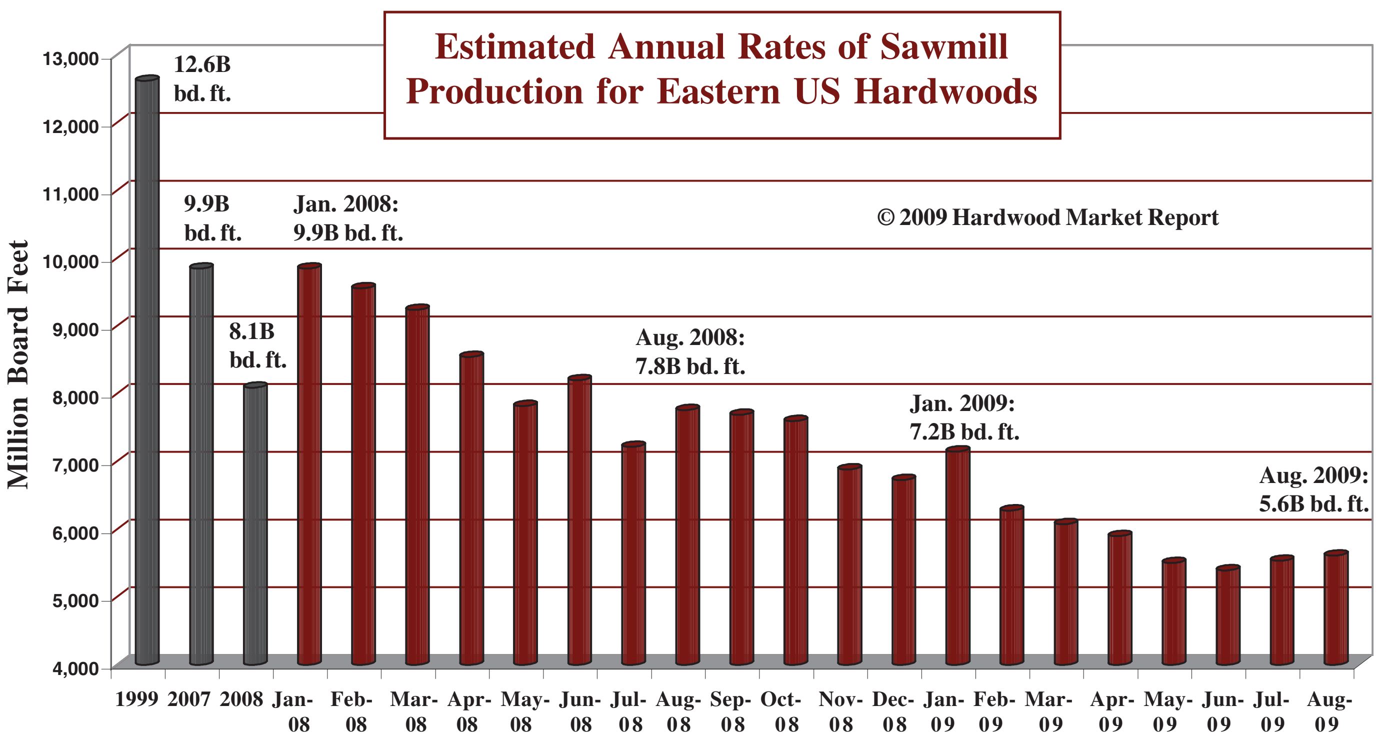
Figure 1



Data Collected from a Variety of Industry, Academic, and Government Sources

Graph: Hardwood Market Report

Figure 2



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