INDUSTRY

PROFILE

Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Kraft Papers

Canadä

INDUSTRY PROFILE

KRAFT PAPERS

1988

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

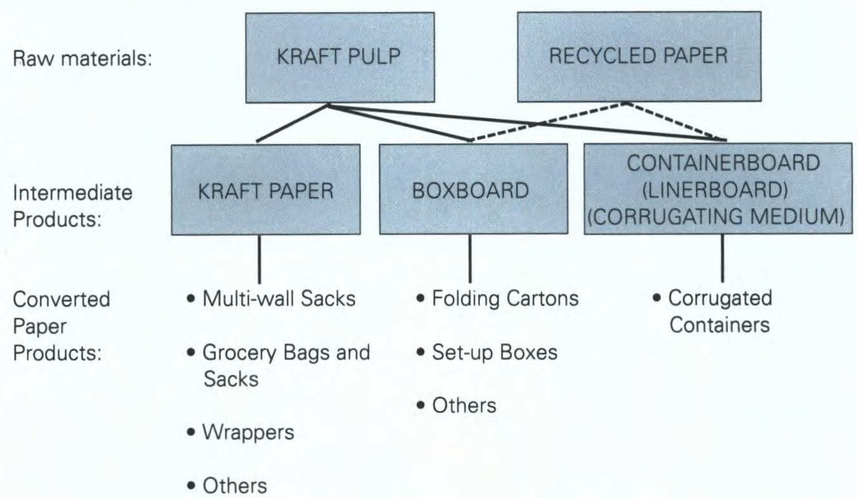
Minister

1. Structure and Performance

Structure

The product of this industry is a heavy, usually brown, unbleached paper made entirely from wood pulp. It is used for wrapping, or for making shipping sacks, grocery bags and other paper products such as gummed tapes and filters. To cater to the many and varied applications, a wide range of grades is produced. The principal one is "sack kraft", used in multi-wall sacks (e.g., cement sacks). In 1986, it accounted for approximately 50 percent of shipments and 71 percent of exports. The relationship between kraft paper and the other paper-based packaging materials is shown below.

PAPER-BASED PACKAGING



The industry consists of eight mills wholly or partially engaged in the production of kraft papers. Some of these mills also produce boxboard, linerboard, market pulp and fine paper. In 1986, kraft paper shipments were estimated at 575 000 tonnes and valued at $440 million, or 3.1 percent of the sales of the Canadian pulp and paper sector.

The regional distribution of the national capacity is 46 percent in British Columbia, 24 percent in Manitoba, 22 percent in Quebec and eight percent in Ontario. In 1986, mill employment was estimated at 1300 persons, and was distributed in roughly the same ratios as was capacity. Based on capacity, some 71 percent of the industry is Canadian-owned.

All Canadian kraft-paper mills have integrated wood-pulping facilities, but only two producers, one in eastern Canada and one in the west, are integrated forward into converting operations. In both instances, the mill capacity and affiliated converting capacity are relatively small.

Canada

Industry, Science and Technology Canada | Industrie, Sciences et Technologie Canada

Imports, Exports and Domestic Shipments 1986

** Estimate*

In 1986, 46 percent of industry output, with an estimated value of $170 million, was exported. The main export markets were the United States, with 47 percent, Asia (mostly Japan), with 25 percent and the European Community (E.C.) with 18 percent. Almost all these exports originate from mills in British Columbia and Manitoba, whereas the eastern mills largely supply the domestic market. Offshore export volumes have remained almost constant over the last five years. The major competitors in the offshore market in the principal grade of sack kraft are Sweden and Finland.

Exports to the United States broke their relatively stable pattern in 1985 with a 38-percent increase in volume over 1984, for a total of about 72 000 tonnes. In 1986, exports rose by another 71 percent, as some 124 000 tonnes were shipped to the United States. In 1987, close to 160 000 tonnes were exported there — representing an increase of 29 percent over the previous year. These increases occurred in response to the closures of several U.S. mills and the shifting of production by U.S. manufacturers to higher-value products.

Within the North American context, U.S. mills are Canada's only real competitors. In 1986, imports accounted for 12 percent of the domestic market, the large majority originating from the United States.

Performance

The 1975-1985 decade has been difficult for the Canadian kraft paper industry, particularly in eastern Canada, as plastics have made solid gains in Canada's paper bag market. The effect of this product substitution has been a decrease of about 35 percent in paper bag demand since 1975. Plastics, and the increasing use of bulk-handling systems in the transportation of dry chemicals such as cement and fertilizers, have also reduced the demand for shipping sacks in Canada. Sack kraft paper shipments have declined by about 28 percent over this period. As well, declining tariff protection and competition from more efficient U.S. producers have compounded the problems of the industry.

Kraft paper shipments peaked in 1974 at about 637 000 tonnes, ending a period of growth that had been sustained, on average, at about six percent per year since the mid-1960s. In the 1980s, the growth of kraft paper shipments was sluggish, following a decline in demand until 1985, when exports to the United States increased substantially. Because of the expected long-term decline in the demand for sack kraft in the U.S. market, it remains to be seen whether this increase will extend beyond the early 1990s. During the last decade, low prices and low profit margins due to sustained competitive pressures by U.S. mills on the domestic market, forced two eastern Canadian mills to cease production of kraft papers. This removed 80 000 to 85 000 tonnes per year of kraft paper capacity from the market. These plants were converted to higher-value products.

Depressed profits of the remaining eastern producers have limited their ability to undertake capital improvements. By contrast, western mills have been more profitable, allowing them to undertake some capital investments that have improved their competitive position.

2. Strengths and Weaknesses

Structural Factors

In general, Canadian mills are older than competitors' mills in the United States, Finland and Sweden. Recent capital improvements in Finland and Sweden have resulted in superior production efficiencies.

Economies of scale and accompanying specialization in a limited range of products are key factors affecting competitiveness in this industry. Eastern mills are not particularly efficient, partly because of a relatively low capacity, but also because of the fragmentation of production into many grades.

They are strongly oriented to grocery-bag and sack grades and specialty kraft papers, which they supply to the major domestic markets of Ontario and Quebec. Their average capacity is only 125 tonnes per day, while world-scale Scandinavian and U.S. mills produce 500 to 600 tonnes daily. By contrast, western mills, while below world-scale, are sufficiently large (300 tonnes per day, on average) to be efficient, given their specialization in sack kraft.

Wood and labour costs are critical to the competitive position of mills. Western mills have a substantial advantage over their eastern counterparts in the cost of wood. Also, because of specialization in the production of sack grade kraft, the labour cost of the product is lower than in eastern mills. Wood costs in Scandinavia are higher than in eastern or western Canada. While the costs of fuel and hydro-electric power are lower in Canada, the cost of energy used is higher due to the age of Canadian equipment.

A significant element of the delivered cost into major markets for this relatively low-value product is the transportation charge. For mills in western Canada this cost approximates 15 to 18 percent of the delivered cost to a northern European port. By contrast, the Scandinavian transportation cost to a northern European port is about four to five percent of the delivered cost. Mills in British Columbia, on the other hand, have a delivery cost advantage into Asian and western U.S. markets against Scandinavian competitors.

Canadian prices for the grocery-bag and sack grades produced by eastern mills are influenced by volatile U.S. market prices. This is due in part to the high proportion of U.S. capacity that is composed of "swing machines" capable of making either grocery-sack paper or kraft liner. This "in-out" capability causes the U.S. market price of grocery-sack paper to fluctuate. When weak demand for kraft linerboard leads to a shift in production to grocery-sack paper, prices fall. This decrease affects Canadian prices.

Trade-related Factors

CURRENT RANGE OF TARIFF RATES FOR KRAFT PAPERS

	Canada	U.S. (percent)	E.C.	Japan
Principal grades	free	free	6	3.5
Specialty-grades	2.5 to 9.2	2 to 4.3	6 or 9	2.5 or 3.5

Under the Canada-U.S. Free Trade Agreement (FTA), the existing tariffs for specialty-grade kraft papers will be phased out in five equal annual stages beginning January 1, 1989.

There are no non-tariff barriers in this industry affecting trade between Canada and its export markets.

Technological Factors

The production technology for kraft paper is available throughout the world through the purchase of pulping and paper-making equipment. For special purpose grades, such as extensible kraft (with built-in stretch and extraordinary toughness) one production process may be obtained under a licensing agreement. Two Canadian producers make use of this arrangement. An alternative production process can be acquired simply by purchasing the proper equipment from one of several machinery manufacturers. One Canadian mill has chosen this option. In general, western Canada mills operate with more modern technology than those in the east.

Other Factors

Currency exchange rates have a major effect on the competitive position of producers. Before 1980, costs of production at western Canadian mills were lower than those of their Scandinavian competitors. The devaluation of Scandinavian currencies in the early 1980s completely reversed this competitive position, which lasted until late 1985. Since then, Scandinavian currencies have strengthened against the Canadian dollar, and inflation has been much higher there. As a result, western Canadian mills are again competitive on both the European Community (E.C.) and Asian markets.

3. Evolving Environment

In general, the kraft papers industry can be described as having passed the mature stage, with little or no prospect for overall growth worldwide. In the domestic market, significant penetration by plastics and alternative bulk-handling systems has occurred. Further inroads by plastics will take the form of a slight but steady annual erosion of kraft paper demand. Over the long term, Canadian domestic demand is expected to decrease, and by the end of the century the demand is expected to be 10 percent below that of 1987.

Under the twin pressures of plastics substitution and expectations of continuing low profits, U.S. producers have been steadily shifting out of sack kraft production since the late 1970s. These withdrawals and conversions will continue, and over the next 15 years a net decrease in U.S. capacity of about 590 000 tonnes is forecast for unbleached kraft paper, with almost half of this decline coming before the mid-1990s.

At the same time, plastics are expected to continue to make substantial inroads into U.S. bag markets. Estimates of the substitution impact vary, but a loss of U.S. demand approaching 660 000 tonnes by the end of the century is likely. A substantial flow-through effect of the decline in U.S. demand for Canadian sack and bag papers can be expected.

Increasingly, Canadian west coast producers will pursue exports of sack kraft paper to Asia instead of to the historical west European markets.

In the offshore market, given no significant changes in the values of currencies, Canadian shipments are expected to increase marginally. This small growth is likely to be accompanied by a geographic shift in markets, as exporters (essentially the western mills) emphasize the Pacific Rim market, rather than the European market where their transportation costs affect their competitive position.

Since the majority of kraft papers move between Canada and the United States without tariffs or non-tariff barriers, the FTA will not have a significant impact. With respect to specialty grades, some readjustment will be required.

4. Competitiveness Assessment

Western kraft paper mills, representing 70 percent of Canadian capacity, are efficient. With the shifts in currency exchange rates since September 1985, they are competitive in all export markets, especially in the sack kraft grades.

Eastern Canadian mills are older, smaller and less efficient than the western and foreign mills, and are not internationally competitive. They concentrate on the domestic market, primarily in grocery-bag grades where competition from low-cost U.S. producers keeps prices depressed. The resulting low profits have limited their ability to undertake needed capital improvements.

Given existing conditions of bilateral free trade, the FTA will not have a major impact on the industry.

For further information concerning the subject matter contained in this profile, contact:

Resource Processing Industries Branch
Industry, Science and Technology Canada
Attention: Kraft Papers
235 Queen Street
Ottawa, Ontario
K1A 0H5

(613) 954-3043

PRINCIPAL STATISTICS

SIC(s) COVERED: 2713 (1980)

	1973	1982	1983	1984	1985	1986
Establishments	11	9	9	9	9	8
Employment[e]	1 570	1 200	1 260	1 200	1 250	1 300
Shipments ($ millions)	158	305	306	340	387	440[e]
(volume '000 tonnes)	616	448	464	467	516	575[e]

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986
Exports ($ millions)	60	118	118	108	125	170
(volume '000 tonnes)	269	187	221	179	211	265
Domestic shipments ($ millions)	98	187	188	232	262	270[e]
(volume '000 tonnes)	347	261	243	288	305	310[e]
Imports ($ millions)	10	23	37	43	41	38
(volume '000 tonnes)	35	27	48	52	48	41
Canadian market ($ millions)	108	210	225	275	303	308[e]
(volume '000 tonnes)	382	288	291	340	353	351[e]
Exports as % of shipments (by volume)	44	42	48	38	41	46
Imports as % of domestic market (by volume)	9	9	16	15	14	12

Source of imports (% of total value)		U.S.	E.C.	Asia	Others
	1982	99	1	—	—
	1983	99	1	—	—
	1984	99	1	—	—
	1985	99	1	—	—
	1986	99	1	—	—

Destination of exports (% of total value)		U.S.	E.C.	Asia	Others
	1982	33	27	24	16
	1983	38	22	28	12
	1984	29	23	35	13
	1985	34	23	28	15
	1986	47	18	25	10

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Employment – % of total	—	28	7	23	42
Capacity – % of total	—	22	8	24	46

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Manfor Ltd.	Canadian	The Pas, Manitoba
Eurocan Pulp & Paper Company	American/Finnish	Kitimat, British Columbia
Prince George Pulp & Paper Ltd. (Canfor)	Canadian	Prince George, British Columbia
Cascades East Angus Inc.	Canadian	East-Angus, Quebec

e ISTC estimate

Note: Statistics Canada data have been used in preparing this profile.

Regional Offices

Newfoundland

Parsons Building
90 O'Leary Avenue
P.O. Box 8950
ST. JOHN'S, Newfoundland
A1B 3R9
Tel: (709) 772-4053

Prince Edward Island

Confederation Court Mall
Suite 400
134 Kent Street
P.O. Box 1115
CHARLOTTETOWN
Prince Edward Island
C1A 7M8
Tel: (902) 566-7400

Nova Scotia

1496 Lower Water Street
P.O. Box 940, Station M
HALIFAX, Nova Scotia
B3J 2V9
Tel: (902) 426-2018

New Brunswick

770 Main Street
P.O. Box 1210
MONCTON
New Brunswick
E1C 8P9
Tel: (506) 857-6400

Quebec

Tour de la Bourse
P.O. Box 247
800, place Victoria
Suite 3800
MONTRÉAL, Quebec
H4Z 1E8
Tel: (514) 283-8185

Ontario

Dominion Public Building
4th Floor
1 Front Street West
TORONTO, Ontario
M5J 1A4
Tel: (416) 973-5000

Manitoba

330 Portage Avenue
Room 608
P.O. Box 981
WINNIPEG, Manitoba
R3C 2V2
Tel: (204) 983-4090

Saskatchewan

105 - 21st Street East
6th Floor
SASKATOON, Saskatchewan
S7K 0B3
Tel: (306) 975-4400

Alberta

Cornerpoint Building
Suite 505
10179 - 105th Street
EDMONTON, Alberta
T5J 3S3
Tel: (403) 495-4782

British Columbia

Scotia Tower
9th Floor, Suite 900
P.O. Box 11610
650 West Georgia St.
VANCOUVER, British Columbia
V6B 5H8
Tel: (604) 666-0434

Yukon

108 Lambert Street
Suite 301
WHITEHORSE, Yukon
Y1A 1Z2
Tel: (403) 668-4655

Northwest Territories

Precambrian Building
P.O. Bag 6100
YELLOWKNIFE
Northwest Territories
X1A 1C0
Tel: (403) 920-8568

For additional copies of this profile contact:

Business Centre
Communications Branch
Industry, Science and Technology Canada
235 Queen Street
Ottawa, Ontario
K1A 0H5

Tel: (613) 995-5771

PU 3084