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# The Lumber Industry: Crucial Contribution to Canada's Prosperity

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## The lumber industry: crucial contributor to Canada's prosperity

*Daniel Dufour*

Canada's economy has always depended heavily on its forests, which cover 418 million hectares as well as comprising about 10% of the planet's entire forested area.

Besides covering almost 45% of the country's landscape, forests are a dominant feature of the Canadian economy, culture and history. Indeed, Canada is one of the world's leading suppliers of wood and paper products.

In 2001, the wood industry contributed nearly \$27 billion to the Canadian economy, or 2.9% of total gross domestic product. That year, exports of Canadian forest products amounted to more than \$38 billion, or almost 10% of national merchandise exports, more than a quarter of which came from the lumber industry.

Historically, forest products have always made a substantial contribution to Canada's trade surplus. In 2001, they generated a surplus of \$36.4 billion, 57% of Canada's total trade surplus. Forest products alone exceeded the surplus generated by automotive products and agriculture and fishing sectors combined.

Canada has a trade surplus in forest products with almost every nation in the world; in other words, it exports more than it imports. The largest surplus is with the United States, which was the destination of nearly 80% of Canada's total forest products exports in 2001.

The contribution of forest products to the Canadian economy vastly exceeds its contribution to GDP. Indeed, forest products play a key role in the development of many regions and rural areas of Canada. Thousands of Canadians live in remote communities where forest is a prime source of employment, and frequently the only source of economic prosperity.

The lumber industry is at the heart of the forest industry. Indeed, unlike other manufacturing industries, the lumber industry uses primarily Canadian inputs. It utilizes logs harvested mostly in Canada and creates thousands of jobs in the logging industry. In addition, the wood chips produced by the lumber industry are the main input used by the pulp and paper sector which employs over a hundred thousands workers. Therefore, the contribution of the lumber industry to Canada's economy extends far beyond the direct jobs it creates.

### What do we mean by "lumber"?

The term "lumber" includes all first-stage wood products sawn from logs by sawmills, such as two by fours, planks, deals and beams. The lumber is then transformed into second-stage wood products such as doors and windows, trusses, particleboard and plywood.

Most lumber is produced from coniferous trees such as spruce, pine, fir and cedar, which make up the bulk of Canadian forests.

Given the importance of forest products for so many communities, trade disputes such as the current softwood lumber disagreement with the United States have a significant impact on Canada.

Canada has disputed a determination made by the U.S. Commerce Department in October 2001 that concluded Canadian softwood lumber producers were "dumping", that is, selling their products in the United-States below fair market value. United-States producers have also long complained that provincial systems of selling timber rights amount to subsidies, a charge that Canada has denied and fought at the World Trade Organization.

In May 2002, the United States slapped countervailing and anti-dumping duties averaging more than 27 per cent on Canadian softwood exports. Ottawa is fighting the United-States allegations and the punishing duties at the WTO and under the North American Free Trade Agreement. The issue is likely to be on the political agenda for quite some time.

This article describes the main characteristics of the Canadian lumber industry and looks at the different impacts of lumber trade disputes. It also puts into perspective the strong dependence of the Canadian lumber industry toward the U.S. market, by far its biggest customer.

### **Regional impact: Lumber industry crucial for hundreds of communities**

Forest products are a crucial part of the economic fabric of hundreds of Canadian communities and the livelihood of thousands of workers. Statistics Canada's Labour Force Survey shows that nearly 1,000 sawmills in Canada employed more than 80,000 workers in 2001, the majority of them in three provinces: British Columbia, Quebec and Ontario.

In 2001, mills in British Columbia had about 35,000 employees, 43% of the total of Canada. In Quebec, there were 25,500 people working in sawmills in 2001, just under one-third of the total, while Ontario sawmills had 7,400 employees, or 9% of the total.

The importance of the lumber industry is often greater in rural communities. Like in British Columbia, one-third of all rural communities depend on forests for between 10% and 46% of their total income<sup>1</sup>. In addition, the lumber industry is generating many indirect jobs in remote communities. According to a British Columbia study<sup>2</sup>, the lumber industry provided about 123,600 direct and indirect jobs in 1996, nearly 8% of the province's total employment. As well, processing forest resources in Quebec anchors the economies of more than 250 municipalities, providing 100% of the manufacturing jobs in 135 towns and villages<sup>3</sup>.

### **Lumber industry mostly export-oriented**

The Canadian lumber industry exports most of its production to external markets. In 2001, the industry's exports accounted for 71.4% of its total shipments. In fact, that ratio has remained above 67% throughout the last decade. Clearly, the Canadian lumber industry is heavily dependent on its foreign markets.

In 2001, Canadian companies exported over \$11 billion in lumber, more than half of which (53%) came from British Columbia. One-fifth (20%) of these exports were from Quebec, and about 9% from Ontario. The Prairies and the Atlantic provinces each accounted for about 9% of total Canadian exports.

Although British Columbia remains the largest exporter of lumber, as shown in Figure 1, its market share has been shrinking significantly since 1992. Indeed, while most provinces enjoyed a healthy increase in lumber exports between 1990 and 2001, resulting in a 34.5% advance for Canada as a whole, British Columbia recorded a mere 6.7% gain and a minuscule average annual growth rate of 0.5%.

Ontario also posted a lacklustre performance, with an annual variation rate of -0.1%. The other provinces, in contrast, enjoyed strong advances in lumber exports, like Quebec who had an annual growth rate of 7.8%. The Atlantic provinces showed an annual growth rate of 10.8% and the Prairie provinces showed a 6.2% growth rate. Within these provinces, the high growth rate was related to the fact that most of these provinces were not covered by the restrictions in the Softwood Lumber Agreement (except the province of Alberta).

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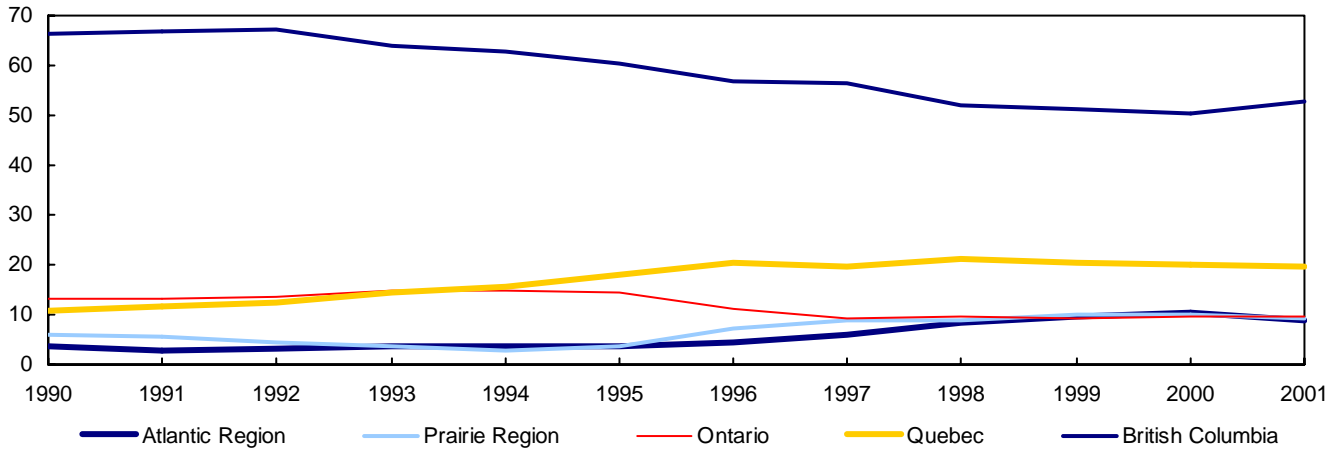
<sup>1</sup> Council of Forest Industries.

<sup>2</sup> The softwood lumber dispute, BC Stats.

<sup>3</sup> Economic profil of the industry, AMBSQ.

Figure 1  
**British-Columbia national market share is shrinking**

Provincial lumber exports/ National lumber exports (%)



Source: International trade division (custom basis) - Statistics Canada

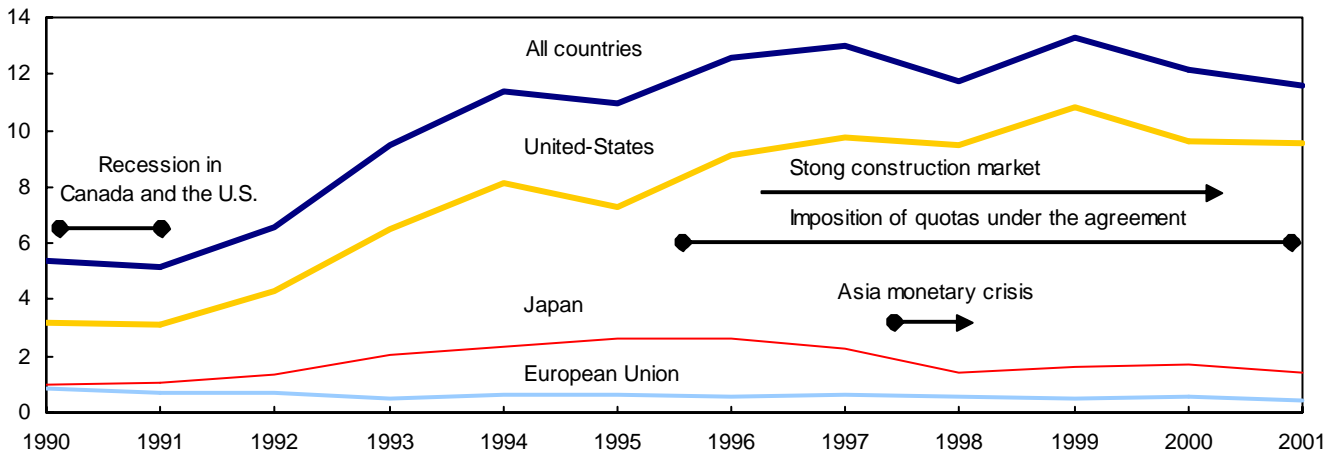
Some Canadian provinces are more export-dependent than others. The Atlantic provinces and British Columbia are cases in point. In 2001, exports accounted for 89% of total shipments for the Atlantic provinces and 86% for British Columbia. The proportion was also high, though not as extreme, for the Prairies (62%), Ontario (59%) and Quebec (52%).

**Heavy dependence on the United States markets**

The main export market for Canadian lumber is clearly the United States. In 2001, the value of lumber exports totaled \$11.6 billion, 82% of which went to the United States, 12% to Japan, and just over 3% to the European Union.

Figure 2  
**Canadian lumber exports hinges on the United States markets**

Billion \$



Source: International trade division (custom basis) - Statistics Canada

Figure 2 shows that the fluctuations in Canadian exports follow much the same pattern as the fluctuations in exports to U.S. markets. In fact, under the current market structure, the Canadian lumber industry's survival hinges largely on the United States, by far the biggest importer of lumber from Canada.

The significant increase that occurred in the beginning of 1996 was due to the fact that a large number of transactions were completed quickly in early 1996 in anticipation of trade restrictions. Starting in 1997, the imposition of quotas under the Agreement limited exports to the U.S. markets. As a result of the Agreement, the provinces that were not subject to it enjoyed faster export growth than the provinces that were covered (British Columbia, Quebec, Ontario and Alberta).

Furthermore, demand for lumber remained fairly strong throughout the decade, as construction starts increased steadily from 1990 on, peaking in 1999. While Canadian lumber exports to the United States reached \$9.5 billion and accounted for more than 80% of total Canadian lumber exports in 2001, they amounted \$3.2 billion and represented less than 60% of the total Canadian exports in 1990.

### **Alternative export markets shrinking**

The second-largest export market for Canadian lumber is the Asia-Pacific region, with Japan by far the leading market in the region. Exports to Japan rose substantially through the middle of the last decade. The 1997 economic crisis in Asia caused a sharp decline in their lumber imports from Canada.

In 2001, the value of Canadian exports to Japan was still well below what it had been in 1996. This is one of the reasons for the substantial drop that occur in British Columbia's share of Canadian markets in the last decade. The Asian crisis, combined with the restrictions in the Softwood Lumber Agreement, hurt many West Coast producers. Indeed, when the crisis hit, the coastal industries, that exported primarily to Japan, had very little quota for the U.S. markets and therefore, suddenly found themselves without a market.

Europe is the third-largest market for Canadian lumber exports, much of which goes to the United Kingdom. There was a major slump in Canadian lumber exports to Europe during the last decade. In 2001, Canadian exports to Europe dropped to \$394 million and accounted for a mere 3.4% of total Canadian lumber exports while in 1990, the corresponding figures were \$880 million and 16.4%.

A number of factors are responsible for the decline. Phytosanitary restrictions were placed on lumber imports from North America, limiting both U.S. and Canadian exports. The decrease in imports was exacerbated by a downturn in construction in European countries. In addition, the accession of Finland, Sweden and Austria to the European Union in 1995, together with increased production in other member countries, made Europe nearly self-sufficient in many types of forest products, resulting in a reduction in imports from Canada.

### **Lumber industry depends on residential construction**

The residential construction industry is unquestionably the biggest end user of Canadian lumber. In fact, there is a close correlation between residential construction activity in the United States and Canada and the consumption of softwood lumber. Indeed, since 1996, imports from Canada have made up more than one-third of total U.S. lumber consumption.

As shown in Figure 3, an increase in the number of construction starts generally translates into higher demand for lumber, while fewer construction starts means a decline in lumber demand. While new residential construction accounts for 40%<sup>4</sup> of lumber consumption in the United States and Canada, residential repairs and renovations and industrial construction are also major end uses.

As a result, the prosperity of the Canadian lumber industry is heavily influenced by the business cycle, which particularly affects the construction market.

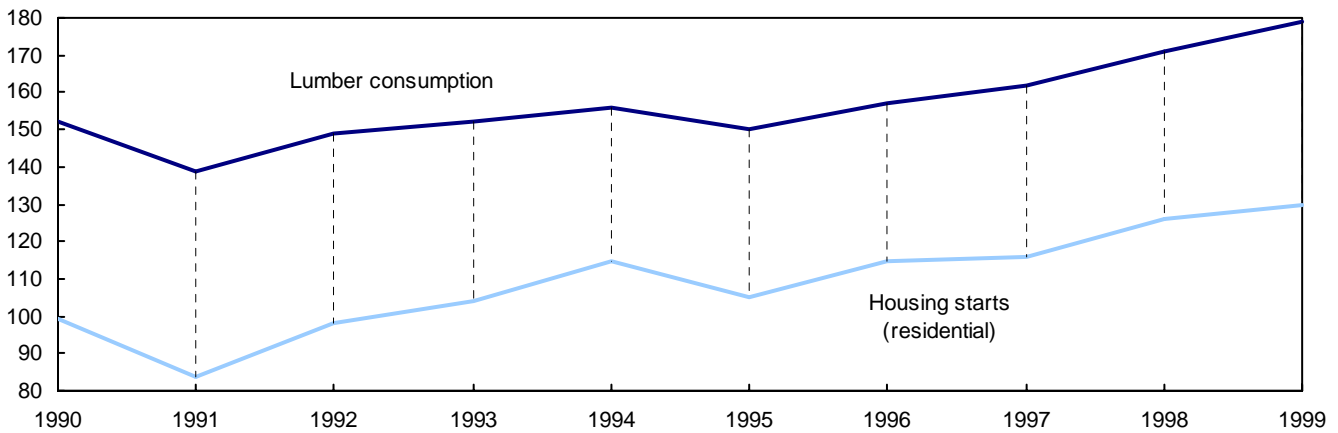
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<sup>4</sup> *American forest and paper association.*

Figure 3

**There is a close correlation between the consumption of lumber and residential construction activity in Canada and the US**

Index: 1975 =100



Source: Resource Information Systems, Wood Products Review Canada Mortgage and Housing Corporation (CMHC) United States Department of Commerce

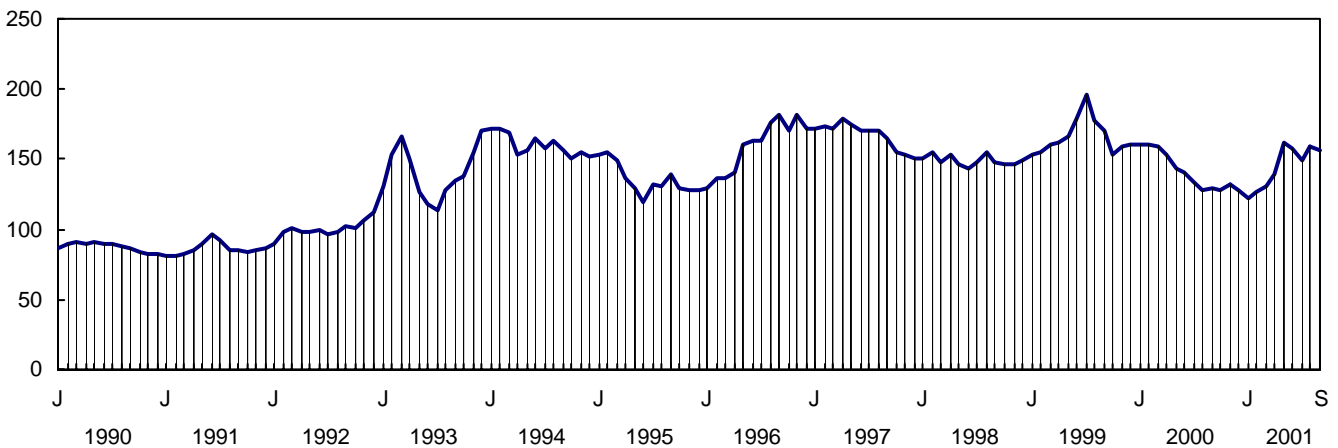
**Sharp fluctuations in selling prices**

The cyclical nature of the lumber industry is reflected in wide variations in lumber prices. Those variations are amplified by a number of factors, such as reduced logging, higher stumpage fees, trade restrictions, environmental pressures and Aboriginal land claims. Particularly in the last decade, as shown in figure 4, those factors helped restrict the supply of wood and thus generated substantial increases in lumber prices.

Figure 4

**Lumber prices are showing sharp fluctuations**

Index: 1992=100



Source: Industrial Product Price Index - Statistics Canada

During 2001, the fluctuations in lumber prices were closely related to the expiry of the Canada-U.S. Softwood Lumber Agreement. The accord limited Canadian lumber manufacturers' access to the U.S. market by applying a tax if their exports to the United States exceeded 14.7 billion board feet per year.

When the Agreement ended in April 2001, it left palpable uncertainty in the markets, and prices went up and down with the intensity of the dispute. The looming threat of export penalties, which in fact materialized later in the year, forced many companies to cut back their operations.

### **What is ahead?**

Canada became substantially more dependent on the United States during the last decade. This heavy dependence, combined with the gradual decline in alternative foreign markets, has left the Canadian lumber industry extremely vulnerable to protectionist measures imposed by its biggest customer.

It seems the Canadian industry is making efforts to shift to higher value-added products such as OSB particle board, so that it can attempt to diversify its markets. However, even though the wood industry has boosted its production of such commodities over the last decade, the volume remains marginal in comparison with the quantity of lumber it produces.

The current dispute involves a number of important issues, including restrictions on logging rights, access to Canada's rich forests and types of land management. These issues are unmistakable signs that it is important to have a clear understanding of the Canadian lumber industry, the impact that the business cycle and the structure of the economy have on it, and the effects that it has on the Canadian society.

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