

Paper Industry Economic Cluster Initiative

Part II

The State of Wisconsin's Paper Industry: Recommendations for Action

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Prepared by the Wisconsin Paper Council**

The State of Wisconsin's Paper Industry: Recommendations for Action

Introduction

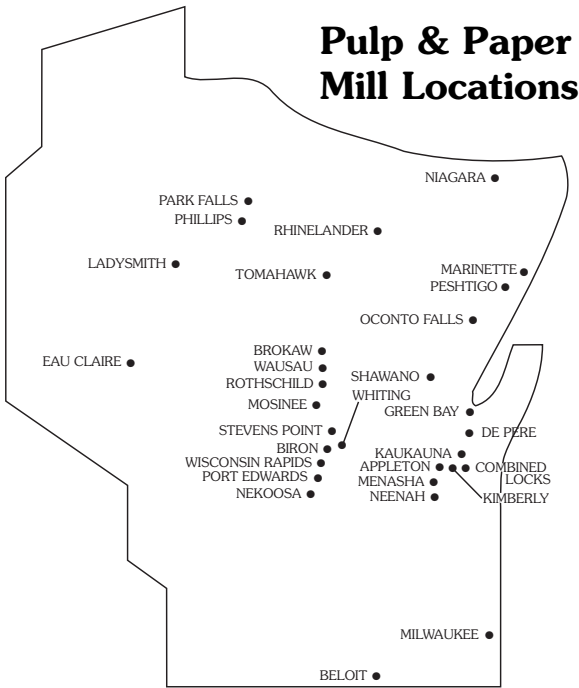
The Wisconsin Department of Commerce is coordinating the implementation of a “cluster-based” approach to economic development. This strategy targets and supports industries that create quality, high paying jobs in Wisconsin. This nationally recognized development strategy will help drive Wisconsin’s economy and will help to create better jobs and a stronger economy.

Industry clusters are geographic concentrations of interconnected companies, specialized suppliers, service providers, and associated institutions in a particular field. Eleven industrial and regional clusters have been identified in Wisconsin, including a paper industry cluster.

The Wisconsin Paper Council is working with the Department of Commerce and other interested stakeholders, including other state agencies, the University of Wisconsin, suppliers and customers, to develop a set of recommendations intended to help protect and enhance the economic health of the pulp and paper industry in Wisconsin.

The State of Wisconsin’s Paper Industry was the first document prepared as part of the paper industry economic cluster initiative. It provided a general overview of the pulp and paper industry nationally and in Wisconsin and highlighted some of the key factors affecting the economic health of the industry at this time.

The State of Wisconsin’s Paper Industry: Recommendations for Action follows up on the initial report and provides general recommendations for action by the industry and/or government. These recommendations were developed cooperatively with other stakeholders and are intended to provide a strategic plan for maintaining and enhancing the economic health of Wisconsin’s paper industry.



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Executive Summary

Participants in the paper industry economic cluster initiative identified seven general areas of importance to maintain and enhance the economic health of the paper industry in Wisconsin. These seven general areas are – Government, Public Relations, Partnerships, Infrastructure, Research & Development, Economics, and Education. The Wisconsin Paper Council was charged with developing specific recommendations encompassing these seven areas. Those recommendations are described in detail in this report.

It is important to recognize that there is no single recommendation or small set of recommendations – no “silver bullet” – that will immediately improve the economic conditions facing the paper industry. Ultimately,

Wisconsin's paper industry must, and will, fight its way through the current challenges to succeed as global competitors. However, the importance of the paper industry to Wisconsin's economy requires that all stakeholders, public and private, be part of the solution.

There are, however, three priority issues that have been identified. They include reforming the tax structure, streamlining the environmental regulatory system and creating a low-cost, reliable energy system.

By adopting reasonable measures within these three issue areas, we believe the process can begin to ensure the viability of the paper industry in Wisconsin.

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Background

Paper Industry

The first economic cluster initiative report on the paper industry – ***The State of Wisconsin's Paper Industry*** – provided extensive background on the current economic conditions and challenges facing the paper industry. The following provides a brief summary of the issues raised in that report. Readers are encouraged to read both reports in order to properly place the recommendations in context.

Wisconsin is the #1 papermaking state in the nation and has been the leader for 50 years. More than 5.3 million tons of paper and over 1.1 million tons of paperboard are produced in Wisconsin annually. The value of shipments from Wisconsin's paper companies tops \$12.4 billion annually.

Pulp, paper and allied firms have, in recent years, employed approximately 50,000 men and women, representing about one in every 11-12 manufacturing jobs. Labor statistics show papermakers to be the highest paid manufacturing workers in the state. The average paper mill worker earns approximately \$49,000 annually. Over \$2.55 billion in wages are earned annually by the industry's workforce. These wages turn into a \$4.38 billion benefit that surges through Wisconsin's economy.

In addition to direct employment, papermaking indirectly supports jobs for approximately 125,000 more people. In 28 counties, the paper and forest products industry is the

largest employer; in fourteen more counties it is among the top three employers.

The paper industry has been and continues to be one of the foundations of Wisconsin's economy. However, a number of challenges face the industry, including stagnant demand, over-capacity, depressed prices, industry consolidation, globalization and foreign competition, and aging assets. The results have been mill closures, machine shutdowns, employment reductions, falling profits, and limited capital spending. Wisconsin mills continue to respond to these challenges by aggressively cutting costs and reducing capacity, consolidating (where appropriate), and developing new products and markets.

Within this environment, the ability to control costs in the face of lower-cost global competition and attract new investment to upgrade assets and improve efficiency is critical. The paper industry and its cluster partners, including the state, must work together to maintain the positive aspects of Wisconsin's overall business environment and improve those aspects that hamper the ability of companies to be the low-cost producer and attract new investment.

Recommendations

The recommendations in this report are the result of a three-step process that builds on the "cluster" concept of economic development being pursued by the Wisconsin Department of Commerce. The paper indus-

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try is one of the key cluster industries identified by the Department of Commerce.

The first step was a stakeholder's meeting held in Green Bay in October, 2002 that was sponsored by the Department of Commerce, the Green Bay Chamber of Commerce, and Congressman Mark Green. This one-day brainstorming session identified seven general areas of importance to maintain and enhance the economic health of the paper industry in Wisconsin. These seven general areas are – Government, Public Relations, Partnerships, Infrastructure, Research & Development, Economics, and Education. The Wisconsin Paper Council was charged with developing specific recommendations encompassing these seven areas.

The second step was development of background data and specific recommendations by the Wisconsin Paper Council. The Paper Council prepared a report on the economic condition of Wisconsin's paper industry entitled ***The State of Wisconsin's Paper Industry*** that was published in February, 2003. This report outlined the recent economic history of the paper industry and identified key factors affecting its economic health.

The overriding theme of that report was the need to control costs. Wisconsin and U.S. papermakers are, for the most part, high-cost producers in the global marketplace. The report identified specific cost drivers - Fiber (raw materials), Energy, Labor, Environmental Regulation, and Taxation - that have a major effect the industry. The report concluded that "the paper industry and its cluster partners, including the state, must work together to maintain the positive aspects of Wisconsin's overall business environment and improve those aspects that hamper the ability of companies to be the low cost producer and attract new investment."

The second step also included a review and identification by paper industry officials, through the Paper Council, of specific recommendations that, if implemented, would enhance the ability of Wisconsin's paper industry to compete and attract new investment.

The third step in the process was review and modification of the initial Paper Council recommendations by stakeholders at a May, 2003 meeting in Kimberly. This report reflects the views of the paper industry with valuable input from stakeholders expressed at the October 2002 and May 2003 meetings.

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Recommendations for Action

Some factors affecting the economic performance of the paper industry are beyond the ability of individual companies or state government to control. Other issues are appropriately left within the realm of individual company decision-making. The recommendations discussed here focus on issues that individual companies and/or state government can influence.

It is important to recognize that there is no single recommendation or small set of recommendations – no “silver bullet” – that will immediately improve the economic conditions facing the paper industry. Ultimately, Wisconsin's paper industry must, and will, fight its way through the current challenges to succeed as global competitors. However, the importance of the paper industry to Wisconsin's economy requires that all stakeholders, public and private, be part of the solution.

The following recommendations should be viewed as a starting point for future actions that will maintain and enhance the economic ability of Wisconsin's paper industry to compete and attract new investment.

These are working recommendations and it is anticipated that they will be expanded, con-

tracted, and modified as future efforts add substance and detail to the direction that has been set. Some recommendations are specific, while some are general and call for more research. In general, the recommendations focus on issues that tend to have a larger impact on competitiveness and investment. As a result, not every issue affecting the industry is included. The recommendations are organized by the general issue areas identified at the October, 2002 stakeholders meeting.

Because of the number of recommendations, three high priority issues have been identified:

- *Adoption of a sales tax exemption for fuel and electricity used in manufacturing,*
- *Rapid implementation of regulatory reform initiatives, including New Source Review air quality regulatory changes, permit streamlining, and innovative alternatives to the “command and control” system, like the Paper Council's Systems Approach, and*
- *Initiatives relating to the cost, availability and reliability of energy.*

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Government

Taxation

Background:

Corporate taxes in the U.S. appear to be higher than in paper industry competitor nations. Wisconsin appears to have a corporate taxation climate that is competitive with other states in the U.S. However, simply being competitive may not be good enough. Wisconsin must continually improve its corporate tax climate to meet competition from other states and countries.

Recommendations:

The paper industry and the State of Wisconsin should:

- Work cooperatively to replace the current income tax credit for sales taxes paid on fuel and electricity used in manufacturing with a sales tax exemption. Energy is a major cost for paper companies. Replacing the current credit with an exemption would reduce energy costs for paper companies and other manufacturers, make Wisconsin tax policy consistent with the majority of states, and resolve shortcomings with the current policy that limits its effectiveness.

High Priority Issue. See Attachment 1.

The State of Wisconsin should:

- Adopt a single sales-factor corporate income apportionment formula. See Attachment 2.
- Critically examine the fees that are charged for various programs with the intent of reducing or eliminating (where feasible) fees. The streamlining of programs funded

by fees must be a part of this effort.

Wisconsin paper companies pay millions of dollars in fees to a variety state programs. Fees are a significant cost issue for many companies and must be addressed with the same critical eye as other taxes.

- Encourage regional and national cooperation regarding tax policy.

Investment and Development Programs

- The competition between states for new investment has always been strong. In these difficult economic times the competition is even more fierce. Other states are currently packaging incentive programs to persuade corporate leaders to invest in their states. Wisconsin should review its incentive and development programs relative to other states and create a package of incentives to broadcast to corporate leaders to encourage investment here. Incentives should include any governmental programs available in Wisconsin, new incentives that could be adopted, as well as publication of the internal assets we have including a high quality workforce, a strong education system and abundant natural resources.

Recommendations:

The State of Wisconsin, the paper industry, and the broader business community should:

- Work together to heighten the profile and aggressiveness of Wisconsin's business development and incentive programs.
- Study the incentives for investment in Wisconsin that are contained in the tax

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code and other programs, compared to other states. The paper industry is very capital intensive. New investments that are needed to maintain and enhance the economic health of the paper industry can cost tens of millions of dollars. The state must assure that its incentive programs are competitive, compared to other states.

Environmental Regulation

Background:

The paper industry is a natural resource-based industry. Paper mills are highly regulated and environmental regulations can have a significant impact on costs. Mills spend million of dollars annually to comply with a variety of state and federal rules. Concerns relating to environmental regulation are not about the standards that companies must meet. The paper industry is committed to protecting the environment and has a long track record of environmental stewardship. Concerns relate to the process and procedures that companies must follow to comply with the standards. A regulatory system that is slow to respond to proposed capital projects and that causes companies to incur disproportionately large compliance costs directly affects the willingness of companies to invest needed capital in Wisconsin. Comparisons of international and interstate regulatory climates are difficult, primarily because of a lack of standard measures of comparison. However, the general industry view of the U.S. environmental regulatory system is that it is less cost-effective than systems in other countries. The main reason for this view is the high costs associated with the highly legalistic and adversarial regulatory system in the U.S. Within the U.S., the industry view is that Wisconsin is less cost-effective than most states because of higher "transaction" costs – legal, consulting, and other costs – associated

with our regulations. The regulation of air quality is particularly important because of its ability to affect almost any capital project, no matter how small. **High Priority Issue.**

Recommendations:

The State of Wisconsin should:

- Move to quickly implement New Source Review changes in Wisconsin as required by the federal government, and
- Support future New Source Review changes that reduce regulatory burdens while protecting the environment. See Attachment 3.

The paper industry, the State of Wisconsin, and other interested stakeholders should work cooperatively to:

- Conduct a detailed review of air permitting requirements and other air quality issues with the goal of streamlining procedures and creating a regulatory climate that is business-friendly, responsive, and environmentally protective. DNR should form a task force that includes the paper industry and other interested stakeholders to review statutory and administrative rule requirements, guidance, and internal procedures with the goal of reducing the need for permitting, where appropriate, and significantly reducing the cost and time associated with permitting, where permitting is necessary. The concept of continuous quality improvement should be built into DNR procedures.
- Develop, in cooperation with the U.S. Environmental Protection Agency, an innovative "systems" approach that will replace the current "command and control" regulatory system with a flexible system intended to result in continued environmental improvement at the least cost to the paper industry. See Attachment 4.

Infrastructure

Energy

Background:

The paper industry is the largest energy consumer in the manufacturing sector. Energy costs have traditionally been one of the top cost items for the industry. U.S. energy costs appear to be competitive with other countries. Within the U.S., Wisconsin has traditionally had lower cost energy. However, the paper industry in Wisconsin is confronting steadily climbing prices for natural gas and electricity, compounded by serious concerns over the reliability of electric generation and transmission, and natural gas delivery. **High Priority Issue.**

Recommendations:

The State of Wisconsin should:

- Assure that regulated wholesale and retail electric and natural gas supplies are as affordable and cost-based as practical (while recognizing that both are subject to federal and state regulatory authority), and
- Assure reliable electricity and natural gas supplies through timely and cost-effective improvements to and expansion of their respective generation/production, transmission and distribution systems. See Attachment 5.

The paper industry and the State of Wisconsin should:

- Work cooperatively to develop an energy efficiency initiative designed to: (1) Remove environmental regulatory disincentives that

exist for some types of energy efficiency projects (see New Source Review discussion in Attachment 5), and (2) Provide financial incentives for energy efficiency projects. Tax policies should be reviewed in comparison to other states. The paper industry should work closely with the state's Public Benefits Program to target available funds for industry energy-saving projects.

- Work cooperatively, along with utilities, to allow excess electricity generated at one manufacturing facility to be used at a different manufacturing facility owned by the same company.

The paper industry and public utilities should:

- Examine opportunities for partnering on innovative projects that would allow older industry boilers to be retired and replaced with new, cleaner coal, biomass, or refuse boilers.
- Increase education and outreach efforts on energy issues with employees, economic development organizations, local governments, regulatory agencies, environmental groups, and the general public.

Fiber Supply

Background:

Wood fiber costs are one of the most important factors in determining the competitiveness of the paper industry, accounting for 20-60% of the cost of goods produced. A predictable and economical supply of pulp-

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wood is needed from public and private (non-industrial) land. Effective management practices have resulted in forest growth far exceeding timber harvesting. However, private pulpwood supplies are and always have been fragmented among many small landowners, who manage about 57% of the forest land in Wisconsin. By comparison, the forest products industry owns only 7% of this important resource (a level that is consistent with historical trends), while federal, state and county agencies manage about 30%. Direct comparisons are difficult, but costs may be slightly higher than other parts of the U.S. and other countries.

Wastepaper is extensively used in Wisconsin as a fiber resource. The state, led by paper mills, recycles about 2.6 million tons of wastepaper annual, making it a national leader. Wastepaper is a globally traded commodity that can vary widely in price over time. However, the quality of wastepaper is also important. Clean, high quality wastepaper requires less effort to remove contaminants and can be used to make a wider variety of paper products. The recent trend toward co-mingling recyclable materials works against the need for clean, high quality wastepaper.

Recommendations:

The State of Wisconsin should:

- Maintain its commitment to multiple uses of public forest resources, and
- Maintain incentives, like the Managed Forest Program, that encourage sustainable, productive forest management by private and public landowners.
- Create a group of interested stakeholders that would study and make recommendations regarding forest management and forestry incentives for the purpose of reducing fiber costs, consistent with the overall economic health of the forest products industry.
- Work cooperatively with the paper industry and the broader forest products industry to promote uniformity in forest management certification programs.

The paper industry, recycling industry, and State of Wisconsin should:

- Examine options to increase the availability of clean, high quality wastepaper, with particular attention on the recent trend to co-mingle recyclable materials.

Research and Development

Background:

Research and development covers many areas, from how paper is made to what products are manufactured, from raw material use to the beneficial reuse of wastes, and everything in between. Faced with significant economic pressures, the industry in general has cut back on research and development spending. However, a number of companies have, in recent years, re-focused their efforts on developing new products and new markets.

Wisconsin has a strong public research and development base with the U.S. Forest Products Laboratory and other programs. And while the Institute of Paper Chemistry moved from Appleton to Georgia Tech in Atlanta to become the Institute of Paper Science and Technology, Wisconsin companies still have access to this resource.

With limited research and development funding, it is important that technical developments are monitored and information disseminated within the industry. Some mech-

anisms exist that focus on technology transfer and others are being considered. These efforts need to be coordinated so that the technology solutions that are being developed fit the needs of Wisconsin's paper industry.

Recommendations:

The paper industry, State of Wisconsin - particularly the University of Wisconsin and Vocational and Technical College systems, and public and private research and technology transfer organizations should:

- Identify the immediate, short-term, and long-term research needs for the development of products and processes needed for the pulp and paper industry to prosper in Wisconsin.
- Cooperatively develop a mechanism, such as a "virtual" center, for facilitating, collecting, disseminating research and development information from all universities and private institutions that meets the needs of Wisconsin's paper industry.

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Public Relations

Background:

Participants in the October 2002 stakeholders meeting characterized the paper industry as having an image problem. It was pointed out that image makes life easier or harder and that the paper industry needs to enhance its image as viewed by investors, employees, students, and government. It was suggested that the industry undertake an image campaign aimed at various audiences.

Wisconsin's paper industry is very concerned about its public image. The industry takes the view that "PR" is not just public relations, it is documented "performance" and appropriate "recognition". On the environmental front, paper mills are very visible and this has not always been positive. However, the industry has taken its responsibility for environmental stewardship very seriously for many years. Significant progress has been made in reducing releases to the environment.

In 1992, the Wisconsin Paper Council initiated the **Pollution Prevention Partnership** with the Wisconsin Department of Natural Resources. This program documented dramatic reductions in releases to air and water, as well as the need to landfill solid waste. These reductions were mostly voluntary and beyond regulatory compliance requirements. Wisconsin's paper industry issues an annual

report on progress under the **Pollution Prevention Partnership**. No other industry has demonstrated such a willingness to put its environmental performance on the line publicly in this way. Similarly, Wisconsin's paper industry participates in a sustainable forestry initiative called the **Green Guarantee**. Again, an annual report is issued documenting achievements. In 1999, the Wisconsin Paper Council initiated the **WPC Environmental Management System** and Wisconsin's paper industry became one of the first industry-wide groups in the country to adopt the internationally recognized standard for environmental management.

To better explain papermaking and the paper industry to students, the Paper Council developed the **Paper Makes Wisconsin Great** program for fourth-grade students. This program provides a video overview of the industry, plus hands-on projects for students. The paper industry also participates actively in the Project Learning Tree educational program for K-12 students.

Recommendations:

The paper industry should:

- Work with interested stakeholders to develop a local, regional, and statewide network of support for the industry.

Education

Background:

The availability of well-educated workers is important to any industry. Wisconsin has one of the finest education systems in the nation. It has a strong elementary-secondary system, an excellent vocational-technical system – with high quality paper industry technical training programs, and a world-class university system – including a very valuable paper science program at the University of Wisconsin – Stevens Point. The paper science program provides a valuable role in providing knowledgeable employees to the paper industry. This program should be supported and enhanced, as necessary, to assure a continuing supply of high-quality employees.

Paper companies in Wisconsin have not identified any significant educational needs. However, one area that could be explored to improve the recognition and understanding of

the paper industry is for the paper industry to form a more direct relationship with educators, so they will have a better understanding and ability to accurately convey information about the industry to students.

Recommendations:

The paper industry should:

- Formalize relationships with educational institutions to increase the interest of students in pursuing a career in papermaking, increase educational programs, and retain pulp and paper program strength.
- Explore the development of a summer work/education program that brings educators into paper industry facilities and field resources for hands-on experience that directly relates to subject areas that are taught – math, science, etc.

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Economics

Labor

Background:

Wisconsin's paper industry has a highly qualified, dedicated workforce. While this is an asset, it is also a significant cost of doing business in the paper industry. U.S. paper industry labor costs are estimated to be the highest among competitor nations. A key factor in labor costs is the technological advancement of machines being operated. The U.S. has an older asset base requiring more workers and Wisconsin has one of the oldest asset bases in the U.S. Within this context, costs that are increasing across all business sectors, such as health care costs, exacerbate the situation.

Issues relating to wages, conditions of employment, and workforce size are properly left with individual companies and their employees. However, some issues may be appropriate for industry-wide or industry-government action.

Recommendations:

The paper industry, including labor, and the State of Wisconsin should:

- Cooperatively evaluate the employee training needs of the paper industry, the options for meeting these needs, and government training assistance programs compared to other states.

Partnerships

Background:

This issue was identified at the October, 2002 stakeholders meeting. It confirms a long-standing approach toward public policy problem solving that has been followed in Wisconsin. Many of the recommendations contained in this report specifically identify a cooperative or partnership approach to addressing issues. This is an approach that is strongly supported by the paper industry. Further, many states have become more aggressive in promoting their state's competitive advantages (either private or public) to business leaders in order to enhance the image of their state and attract capital investment. Wisconsin lags in this area and every effort should be made to work with interested parties at every level of industry and government to promote Wisconsin as a state that is friendly to business with a climate that invites corporate investments.

Recommendations:

- Cooperation, consensus, and partnering should be pursued to the maximum extent possible when addressing the issues raised in this report. All stakeholders with a constructive interest in an issue should be encouraged to participate.
- Working with local chambers of commerce, economic development agencies and local and state elected officials, efforts should be taken to contact corporate headquarters of industries with paper facilities in Wisconsin to inform corporate decision makers of the advantages the paper cluster provides and to provide information about potential incentives and opportunities to invest in Wisconsin.

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Attachment 1: Income and Franchise Tax Credit for Sales Taxes Paid on Fuel and Electricity Used in Manufacturing

Background:

Current law provides a nonrefundable credit against corporate income taxes due for the amount of sales taxes paid on fuel and electricity consumed in manufacturing tangible personal property. Unused amounts can be carried forward for 15 years.

Most states allow manufacturers an exemption from sales taxes for various materials and equipment used in manufacturing, such as raw materials, utilities (fuel and electricity), and machinery. In Wisconsin, fuel and electricity used in manufacturing is subject to the sales tax.

However, Wisconsin provides a nonrefundable credit against income taxes due that is intended to be equivalent to a sales tax exemption. If the amount of sales taxes paid exceeds taxable income in any year, the difference can be carried forward and claimed during the next 15 years.

Although Wisconsin's income tax credit is intended to be equivalent to the sales tax exemption provided by most other states, it falls short in a key way – manufacturers do not generate sufficient income in order to fully utilize the credit. The Department of Revenue estimates that, on average, the current credit is worth about \$22 million annually to Wisconsin manufacturers, while a sales tax exemption would be worth about \$31 million annually. Wisconsin manufacturers face an average annual tax penalty of \$9 million compared to most other states. This has grown dramatically over the years to the point that DOR estimates that Wisconsin manufacturers

are owed approximately \$175 million in credits that have not been able to be utilized.

This problem is particularly severe for energy intensive industries and industries that are facing difficult economic challenges, like the pulp and paper industry. Despite a 30% reduction in energy use per ton of production, the industry remains a large energy consumer. Because of fierce global competition, industry profits – and the ability to claim income tax credits – have been limited. Increases in energy costs have exacerbated the problem. The result is that paper companies pay millions in sales taxes on fuel and electricity that cannot be recovered through the current income tax credit mechanism. This penalizes Wisconsin's paper industry, and other similar industries, compared to our competitors in other states.

Recommendation:

The income tax credit should be repealed and replaced with a sales tax exemption. In addition, manufacturers should be allowed to recover any unused credits that are owed to them. These changes would allow manufacturers to fully avoid the cost of sales taxes on fuel and electricity, as originally intended, and would improve the competitive position of Wisconsin companies.

The pulp and paper industry is sensitive to the state's current fiscal condition and the potential impact this proposed change could have. We are committed to working cooperatively with the Legislature and administration to develop a proposal that minimizes state fiscal impacts while meeting the needs of the paper industry and other corporate taxpayers.

Attachment 2: Corporate Income Tax Single-Factor Apportionment

Background:

Most states, including Wisconsin, use an apportionment formula including business property, payroll, and sales when determining the taxable income of multi-state corporations. To avoid increasing taxes on companies that expand in the state, Wisconsin double-weighted the sales factor beginning in 1974. This favors in-state development by placing greater tax emphasis on out-of-state (sales) activity.

The trend in recent years has been for states – particularly states bordering Wisconsin – to shift to a single-factor apportionment system based only on sales. These states give as much advantage as possible to in-state companies and shift as much tax burden as possible to out-of-state companies. As a result, Wisconsin is at a corporate income tax disadvantage compared to single-factor states.

Recommendation:

Wisconsin should adopt a single-factor apportionment system for the following reasons:

- The more heavily the sales factor is weighted in a business's home state, the greater the incentive for the business to expand in

the home state. A single-factor system provides the maximum incentive for businesses to expand in Wisconsin.

- Corporations that are headquartered or that have the majority of their facilities in a single-factor state will have a lower effective tax rate than businesses located in three-factor states, giving these corporations a competitive advantage.
- Conversely, Wisconsin corporations are at a tax and competitive disadvantage compared to corporations in states that already have single-factor systems, like Illinois, Michigan, and Iowa.
- Independent studies have shown that there is a direct correlation between enactment of a single-factor system and increased business growth and employment.

Although Wisconsin remains the #1 paper-making state in the nation, the paper industry in the United States has been in a prolonged recession due to fierce global competition. Adoption of a single-factor apportionment system would help improve the competitiveness of Wisconsin's paper industry and help insure that Wisconsin remains #1 in the future.

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Attachment 3: New Source Review

The State of Wisconsin should move to quickly implement the New Source Review (NSR) changes in Wisconsin as required by the U.S. Environmental Protection Agency on December 31, 2002. The result of these rules should be a more clearly defined, flexible, and fairly enforced NSR program that will remove the current disincentives for paper companies and other businesses to improve process efficiency and become more competitive, while reducing emissions.

The NSR program, first established under the 1977 Clean Air Act Amendments, is a pre-construction permitting program for large industrial sources intended to prevent significant air emission increases that could result from major expansions or modifications at a facility. Instead of having clear regulations to implement the program, EPA has amassed more than 4,000 pages of confusing and often conflicting guidance. Over the years, particularly in the last few years, the program has evolved to cover nearly anything industry does to expand or improve operations - even when these changes reduce air emissions and improve efficiency.

Perhaps the most fundamental flaw in the current program is the way EPA measures an emission increase for the purpose of determining if stringent controls are needed at industrial facilities. The NSR program requires these stringent controls if emission increases exceed specified thresholds for certain substances. Instead of using a straightforward measure of actual emissions before and after a project, EPA compares actual

emissions before a project to the maximum potential emissions after a project.

This "actual-to-potential" test can have the effect of triggering stringent controls on insignificant emission increases - even emission decreases. How? If a facility is operating at less than maximum conditions (the normal situation) and the difference between actual emissions and maximum potential emissions of a covered substance is greater than the NSR threshold (very common), *any change in emissions will automatically exceed the NSR threshold and will trigger an expensive review of control options and the potential installation of these controls - even if emissions resulting from the project would decrease.*

Another major flaw in the program relates to activities at facilities that are considered routine maintenance, repair, and replacement. EPA proposed changes to address this issue at the same time it finalized rules relating to the "actual-to-actual" test. The NSR program includes an exemption for routine maintenance and similar activities, intended to avoid regulatory review of minor changes at a facility. This is consistent with the intent of the program to focus on significant changes. However, in recent years EPA has revised its interpretation of this exemption to the point that it is available in only extremely limited circumstances (e.g. - replacement of a worn out 30 year old part with an identical part - not a similar or functionally equivalent part, the exact same part that was in use 30 years ago). This results in virtually any maintenance

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activity becoming subject to NSR review and substantial additional cost.

What are the practical impacts of these and other flaws in the NSR program? Companies avoid changes that would improve process efficiency and competitiveness, increase energy efficiency, and/or reduce emissions because the cost of the NSR review and the potential controls that could be imposed as a result of this review would be too expensive. Our manufacturing base slowly loses competitiveness as needed investments are not made by U.S. companies or shifted to other countries by global companies. Voluntary emission reductions – sought by both industry and the DNR – are frustrated for the same reason. NSR has turned into a program that stymies both industrial competitiveness and environmental improvement.

While these concerns are stated in terms of international investment and competitiveness, they also apply on a regional basis. Several of our neighboring states are already beginning to implement the new NSR changes. This provides a distinct competitive advantage for these states compared to Wisconsin.

The recent changes to the NSR program are long overdue and should be allowed to take effect as quickly as possible. The paper industry and other industries are not seeking to roll back environmental protections or end the NSR program – and the EPA rules would not do this. We simply want a clearly defined, workable, and fairly enforced NSR program that allows companies the flexibility to operate efficiently and maintain and improve mills in order to stay competitive in the global marketplace – while meeting environmental obligations.

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Attachment 4: Systems Approach for Pulp and Paper Air Emissions Sources

The traditional command-and-control system for protecting and improving the environment has accomplished much over the past thirty years. The system, however, is out-dated. It is not cost-effective.

The paper industry, for example, continues to spend millions of dollars annually to comply with an array of federal and state environmental regulatory initiatives. We are spending more and more to produce smaller and smaller results.

The paper industry cannot afford to continue to spend valuable and limited capital in such a manner and remain competitive in a global marketplace. Our industry is already saddled with higher fiber, fuel and labor costs than our foreign competitors.

During the next several years, the paper industry will be facing several new state and federal regulatory initiatives related to air emissions, particularly from combustion sources. These initiatives include industrial boiler MACT, nitrogen oxide reductions, mercury reductions, NR 445 revisions, and global climate change issues.

Rather than address these issues singularly, or incrementally, the members of the Wisconsin Paper Council are recommending the development of a "systems approach" – an innovative process that will provide meaningful environmental improvement through the cost-effective use of capital and technology. The goal, in other words, is to achieve the opti-

imum environmental improvement at the least cost to the paper industry.

The systems approach incorporates the implementation of upcoming environmental requirements in a manner consistent with the capital planning cycle of individual paper companies.

Under this approach, regulatory authorities and paper industry representatives will design and establish both short term and long term priorities for the industry's air emission sources, particularly its combustion sources

The establishment of these priorities will lead to the greatest environmental improvement with the most cost-effective use of capital and technology for the industry to remain competitive in a global marketplace.

Under this "systems approach," the Wisconsin Paper Council is proposing the following key concepts:

- Primary attention will focus on combustion sources; however, the scope of the effort would include all air emissions sources, i.e. companies could include other sources, such as paper machines, on a site-specific basis.
- Primary attention will focus on nitrogen oxides, mercury, carbon dioxide, and hazardous air pollutants; however, other emissions could be considered on a site-specific basis.

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- Implementation of a clean unit technology concept that would be defined on a case-by-case basis. Firms installing the clean unit technology would not have to install additional or new technologies for an agreed upon and specified period of time, 15-20 years, i.e. the useful life of the clean unit technology. This is similar to the clean unit provision in the recently announced new source review changes, but broader in that it would apply to all regulations.
- Use of a bubble or emissions trading concept that could be facility-wide, company-wide, industry-wide, or regional. For example, a firm with multiple operations within the state could “bubble” its entire operation thereby spending capital on those projects that would be economically feasible and environmentally beneficial. As with the clean unit concept, this is similar to, but broader than the announced plantwide applicability limits under the new source review program.
- Flexibility or deferral of compliance deadlines to accommodate capital planning cycles and the development and/or implementation of “clean unit” or emerging technologies.

In addition to these key concepts, the paper industry also recommends this systems approach include:

- Flexibility/relief from burdensome PSD new source review requirements (EPA's recently announced changes appear to make good progress on this front);
- Flexibility/relief from state and federal administrative burdens during permitting and when complying with regulations; and

- Expansion of government assistance programs, such as industrial revenue bonds, to include consideration of environmental improvement.

Implicit in the development of this systems approach is implementation of an environmental management system on a company-by-company basis, and continued emphasis on pollution prevention.

Constructive third-party involvement is a necessary part of the process. The public needs to understand and support this type of innovation.

We envision that this systems approach, accomplished via “pact” or covenant, or other such mechanism, would be legally binding.

This innovative systems approach will provide enhanced, cost-effective environmental improvement and create an incentive for companies to try new technologies with limited risk. In other words, more meaningful environmental improvements and technology development will be achieved through this system than through the traditional incremental, or rule-by-rule approach.

It is also important to note that emission reductions will potentially occur not only from regulated pollutants, but also from non-regulated pollutants. This systems approach, like the **Pollution Prevention Partnership (P3)** is “beyond compliance.”

The development of this systems approach should also result in a reduced DNR workload. Companies, for example, might opt to write their own Title V permit for agency consideration.

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Attachment 5: Energy Supply, Reliability and Transmission/Delivery

Background:

Papermaking is very energy intensive. The paper industry is the largest energy consumer in the manufacturing sector. The industry relies primarily on coal, natural gas, and electricity to meet its purchased power needs. These needs include process heat and power for motors, pumps, controls and drives throughout paper installations, along with environmental protection equipment, lighting, computers and other computerized devices. This power must be available in adequate, affordable supplies that can be delivered reliably on a 24-hour per day, seven day per week basis throughout the year. Insufficient or unreliable supplies and delivery systems can result in the shutdown or slowdown of paper mills and other manufacturers.

Wisconsin's economy expanded significantly in the 1990's. While the economic boom occurred, there was little growth in electric generating capability. When the problem became apparent, the governor, legislature, Public Service Commission, and end-user groups cooperated to develop prompt and prudent steps to address the issue. Two bills were enacted into law that included a mandate for utilities to add generating capacity, encouragement for independent companies to build power plants, and streamlining of the energy permit process. Capacity has increased, but additional base-load generating capacity is needed if the state is to maintain prudent reserve margins in coming years.

Delivery systems also remain a concern. Compared to neighboring states, Wisconsin has a critical shortage of transmission links to the regional power grid. This limits the state's ability to access the broader, regional supply of electricity in times of peak demand. To address this situation, the legislation that mandated additional generating capacity also required a comprehensive study of the state and regional transmission systems. The transmission study documented that Wisconsin's single east-to-west, high-voltage line is seriously constrained. Additional steps targeting reliability are needed. A critical step is the construction of at least one additional east-west, high-voltage transmission line. Numerous transmission and distribution system upgrades are also needed across the state.

Wisconsin Public Service Corporation and Minnesota Power applied for permission to construct one east-west, high voltage line linking Duluth and Wausau. The approval process for this project, now under the auspices of the American Transmission Company, is in progress.

Similarly, the expansion of natural gas usage has overburdened the existing pipeline system. Companies in Northeastern Wisconsin have been forced to shut down or cut back production because they could not get access to natural gas in the winter months.

Recommendations:

- Continuing expansion in the state's ability to generate electricity is needed in a timely

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manner to satisfy steadily increasing demand.

- A second east-west, high voltage electricity transmission line should be constructed as soon as it is feasible, with additional
- Natural gas pipeline capacity should be expanded quickly to avoid future reliability problems.

improvements in the power grid following on an as-needed basis.



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