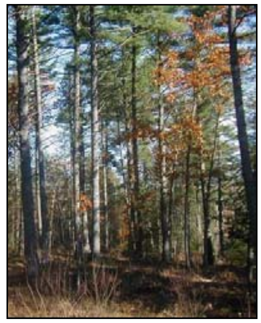
MAINE'S BUSINESS CLIMATE

MAINE FUTURE FOREST ECONOMY PROJECT



CURRENT CONDITIONS AND FACTORS INFLUENCING THE FUTURE OF MAINE'S FOREST PRODUCTS INDUSTRY

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PREPARED FOR:

DEPARTMENT OF CONSERVATION – MAINE FOREST SERVICE
AND
MAINE TECHNOLOGY INSTITUTE

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MAINE'S BUSINESS CLIMATE

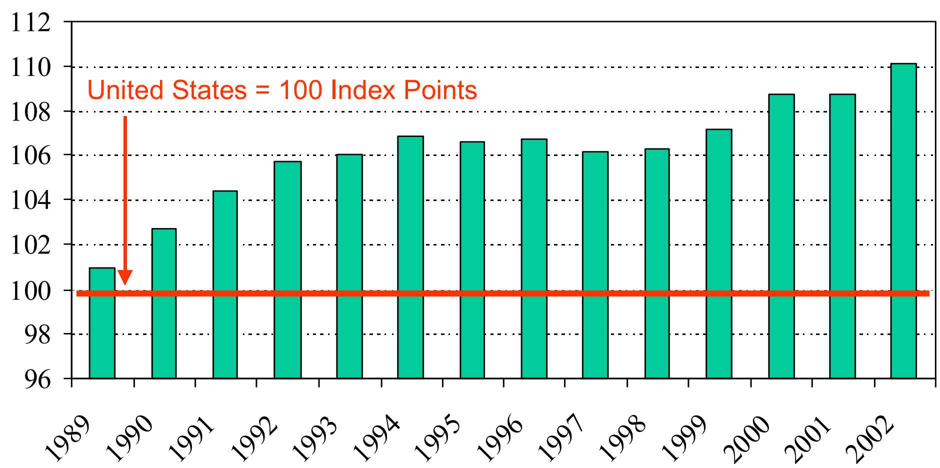
Maine's Business Climate

All sectors of Maine's forest industry compete in a challenging global, regional and often local competitive environment. As the forest industry becomes increasingly global, the "hosting conditions", or business climate, of a state become more important. Forest industries now have the ability to invest capital in all parts of the world, and are doing so. The business climate of a state impacts different types of business structures in different ways. For "captive" firms[158] – those that are a single facility located in Maine – it impacts a firm's ability to borrow money, invest in new equipment, and earn a profit. For existing firms with facilities in multiple jurisdictions[159], the business climate impacts decisions about which facilities receive capital investment and which do not. For business looking to move to Maine, the business climate impacts whether they make a decision to locate in Maine or not. The business climate in Maine – or any state – is certainly not the only factor that goes into making a decision on where to locate or invest in a forest products manufacturing facility, but it is often weighed heavily in a firm's decision-making.

[158] A typical example of a captive firm is a family-held lumber mill with one location.
[159] An example of such a firm is a paper mill held by a large company with mills in other states or countries.

According to data provided by the Maine State Planning Office, Maine's cost of doing business has been higher than the national average since at least 1989. For the purposes of this data, the "cost of doing business" is calculated using an average labor & benefits cost (65%), energy costs (15%), and tax burden (10%). Maine's cost of doing business in 2002, the latest year for which Maine data is available, is 110% (110 index points) of the national average. As noted by the Maine Development Foundation, "This represents a serious competitive disadvantage for Maine-based businesses … it is difficult to overstate the importance of this measure to the state's business climate."[160]

Figure 129. Cost of Doing Business in Maine, 1989 - 2002



Data Source: Maine State Planning Office

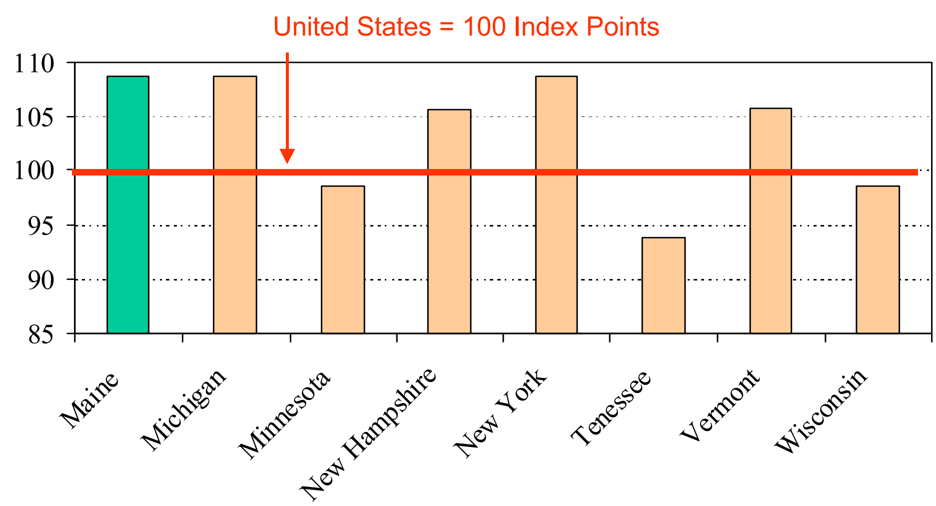
[160] Maine Development Foundation. *Measures of Growth 2004 Performance Measures and Benchmarks to Achieve a Vibrant and Sustainable Economy for Maine.* February 2004

The cost of doing business in Maine is trending upward when compared to the national average. At a 2003 forum, Maine State Economist Laurie LaChance indicated that it was a state goal to have the cost of doing business in Maine decrease to 103% of the national average (or 103 index points) by 2005[161]. Achieving (or approaching) this goal will require Maine to change current trends of rising "cost of doing business". *If* Maine were to continue on the course it has been on since 1989 relative to the rest of the country, with comparative costs steadily rising, one would expect that Maine's cost of doing business would rise to 121.5% of the national average (121.5 basis points) by 2025.

Year	**2005**	**2010**	**2015**	**2020**	**2025**
***Projected* Cost of Doing Business (using trend since 1989)**	111.0	113.5	116.1	118.6	121.2

It should be noted that not all factors that contribute to the cost of doing business are under the direct or complete control of Maine state government. Other states in Northern New England – New Hampshire and Vermont – also have a "cost of doing business" index above the national average, though lower than Maine's.

Figure 130. Cost of Doing Business, Maine and Selected States[162], 2000



Data Source: Maine State Planning Office

[161] LaChance, Laurie. "Maine's Paper Industry: In Perspective." Conference presentation at *The Current State of Maine's Pulp & Paper Industry.* April 4, 2003.
[162] The states of MI, MN, NH, NY VT and WI were selected to provide a look at other states with a similar forest type; TN was selected to represent a southern state.

Taxes

When compared to other states and regions, Maine is a high-cost state for many forest industries. State and local taxes comprise a significant portion of this cost, and one that the State has direct control over. In a tax study of fiscal year 2003 state and local taxes on businesses, Maine was ranked as having the highest taxes in the nation as a percentage of capital income, fourth as a percentage of total private sector economic activity, and nineteenth in the business share of all taxes[163]. Other studies have also indicated that Maine has a relatively high business tax burden when compared to other states. Questions have been raised about the details of and appropriateness of methodologies used in this and other tax ranking studies[164]. However, the general finding of importance to this work – that Maine forest industries face a comparatively high tax burden when compared to other states and regions -- is not generally disputed. As noted by the Maine Development Foundation, "National indices and many experts place Maine in the top tenth percentile of states with the highest tax burden, which is cited by many Maine businesses as a disincentive to do business in the state."[165]

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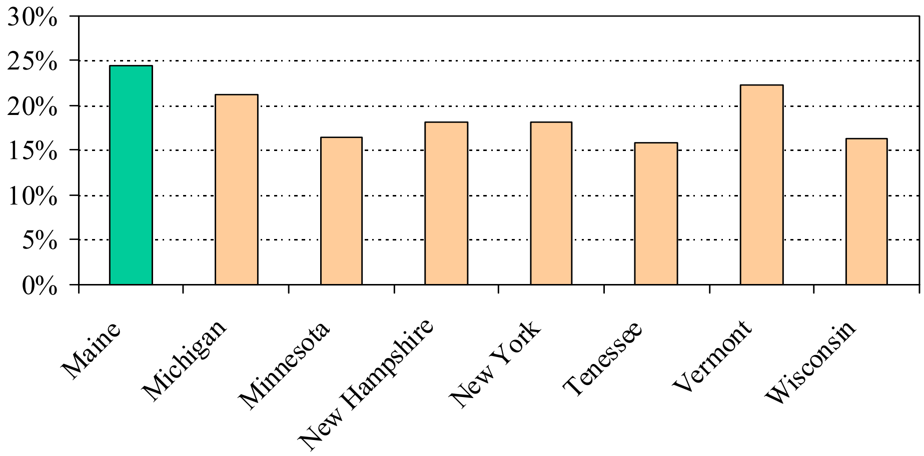
[163] Cline, Robert; William Fox, Tom Neubig and Andrew Phillips. *Total State and Local Business Taxes: A 50-State Study of the Taxes Paid by Business in FY2003*. Prepared for the Council on State Taxation. January 2004.

[164] Lawton, Charles and Frank O'Hara. *Ranking Maine's Business Climate*. Prepared for the Maine Center for Economic Policy. July 2004.

[165] Maine Development Foundation. *Measures of Growth 2004 Performance Measures and Benchmarks to Achieve a Vibrant and Sustainable Economy for Maine.* February 2004

According to information developed for the Council on State Taxation, the taxes on capital income are higher in Maine than elsewhere in the nation[166]. Capital income represents the returns to capital (plant, equipment, land, inventory, working capital, and other capital) used in a state. This is an important measure for capital-intensive sectors of the forest products industry, such as paper or engineered wood.

Figure 131. State & Local Tax on Capital Income, Selected States, 2003

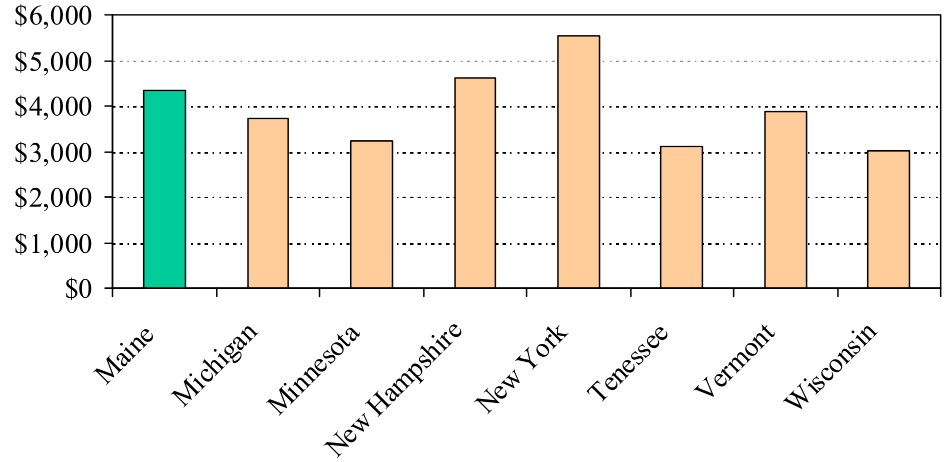


Data Source: Council on State Taxation

[166] Cline, Robert; William Fox, Tom Neubig and Andrew Phillips. *Total State and Local Business Taxes: A 50-State Study of the Taxes Paid by Business in FY2003*. Prepared for the Council on State Taxation. January 2004.

Again using information developed for the Council on State Taxation, taxes on a per-employee basis are high compared to other states, with Maine ranking as the eleventh highest cost state in the nation. For labor-intensive sectors of the state's forest industry, such as some secondary manufacturing, this is the important measure.

Figure 132. State & Local Taxes per Employee, Selected States, 2003



Data Source: Council on State Taxation

Personal Property Tax and Business Equipment Tax Reimbursement (BETR)

In Maine, the property tax applies to both real property (land and buildings) and personal property (for forest industries, this includes the machinery and other equipment used as part of the manufacturing process). At one point in history, when companies were tied to the local resource and transportation networks were not as extensive and inexpensive as they are today, this tax likely made sense. However, the personal property tax now serves as a major disincentive to new investment in Maine's forest industries, which is a key to their future success and prosperity in the state.

In an effort to address the negative impacts of the personal property tax, the legislature established the Business Equipment Tax Reimbursement (BETR) program, which provides companies with a state reimbursement for personal property taxes paid at the local level. This program has been critical in the decision of a number of forest products industries to make significant investments in Maine[167], and its importance cannot be underestimated. However, since its inception, the BETR has come under almost constant legislative attack. These attacks have been largely unsuccessful, but they have made both investors and company managers question the stability and longevity of the program.

In addition to concerns about the level of taxation, businesses have a concern about the stability of tax policy in Maine. Maine businesses make capital investments that last decades, but the BETR program is year-to-year, with no firm guarantee of continued existence. As noted in a report prepared for the Maine Center for Economic Policy:

> "[The] Business Equipment Tax Reimbursement (BETR) program was initiated to offset the negative effects on investment of local property taxation on business equipment. In theory, the state reimbursement does just that. However, continuous debate both about the merits of the program and delays in its funding have raised questions among some businesses about its continuity. This lack of predictability thus has an effect on investment quite apart from the rate of taxation or reimbursement."[168]

In the global environment, where capital investment is critical to continued competitiveness of the forest products industry, a tax on manufacturing equipment is a public policy that hinders the success of Maine forest industries.

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[167] Personal communication with John Williams, Maine Pulp & Paper Association, August 26, 2004.
[168] Lawton, Charles and Frank O'Hara. *Ranking Maine's Business Climate*. Prepared for the Maine Center for Economic Policy. July 2004.

Impact of State & Local Taxes on Commodity Products

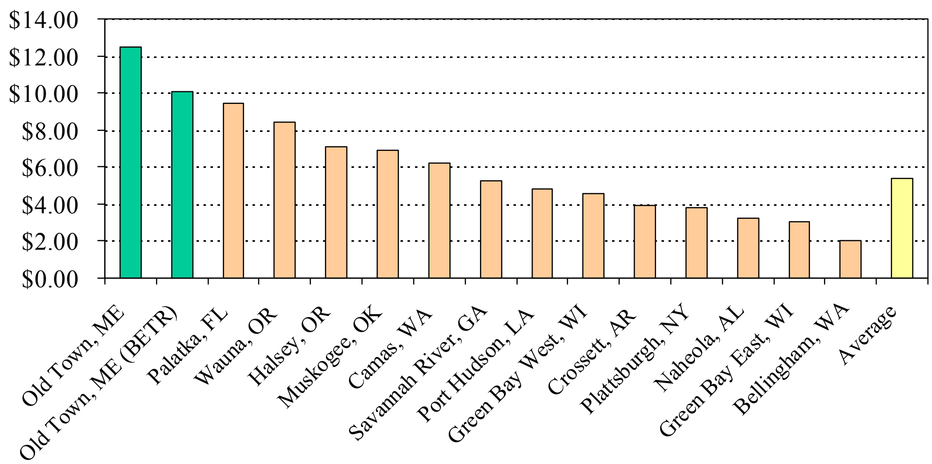
While important, state and local taxes are certainly not the only factor that impacts business costs. There are some that argue that business taxes are not as important as other factors in the location, reinvestment or success of a forest industry. However, they are a cost that state and local jurisdictions have *direct* control over, and can have a meaningful impact on the competitiveness of a forest industry.

Some recent data shows that for all Maine businesses, taxes collected at the state and local level are equal to 1.5% of the sales of all Maine businesses.[169] The implication that many draw from this is that taxes are not an important factor for the success of Maine businesses, including forest industries. This would be an incorrect conclusion. For commodity products, the vast majority of production from Maine's forest industry, price swings of a single percent or two can turn a venture from profitable to unprofitable. In the course of this work, we spoke with a number of firms that indicated that they had lost customers over less than a one percent change in price.

[169] Lawton, Charles and Frank O'Hara. *Ranking Maine's Business Climate*. Prepared for the Maine Center for Economic Policy. July 2004.

Georgia-Pacific, a paper company with mills in Old Town, Maine and around the country, prepared the following information on the taxes *per ton* of product produced at each of their facilities in 2001. This shows that, for the locations where Georgia-Pacific has operations, the taxes at the Old Town, Maine mill are higher *per ton of product produced* than anywhere else. This is true even when the impacts of the BETR program are accounted for. INRS has not independently verified this information, but believes it to be accurate and instructive on the comparative impact of taxes on Maine forest products.

Figure 133. Cost of State & Local Taxes *Per Ton*, Georgia-Pacific Facilities, 2001



Data Source: Georgia Pacific Corporation

In 2001, the cost of state and local taxes were $4.24 per ton higher than their average per ton tax. In a commodity market, where undifferentiated products are sold based largely on the price, a cost difference of this magnitude can impact the success of a facility.

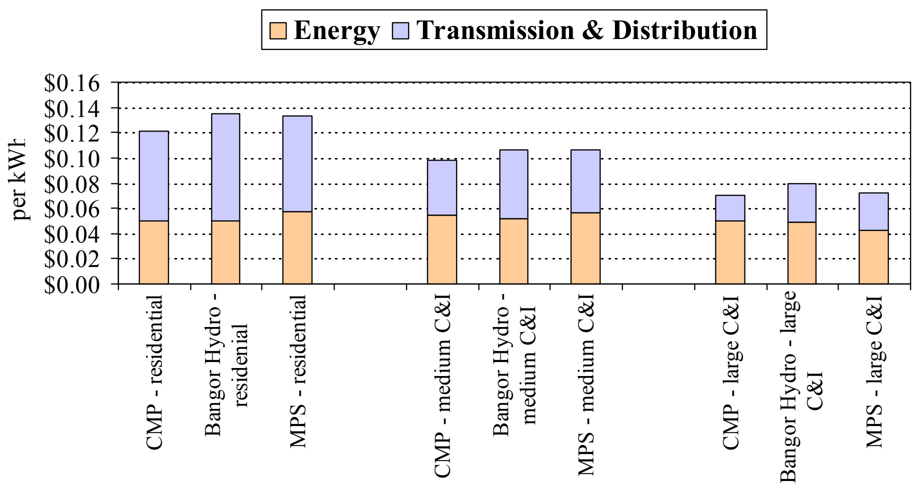
Energy Costs

New England has relatively high electricity costs when compared to the rest of the nation, and Maine is no exception. Maine has a restructured electric industry, where the Public Utilities Commission (PUC) regulates the transmission and distribution of electricity and consumers are free to select an energy supplier based on price or other factors.

For the regulated portion of a customer's electricity bill (transmission and distribution), the PUC approves rates that include the costs of building and maintaining the infrastructure needed to move electricity in and out of Maine and to consumers, as well as "stranded costs". These "stranded costs" are the cost recovery mechanism for uneconomic investments made during a time when electricity generation and distribution was wholly regulated. These costs vary by service territory (the company that provides transmission and distribution service), and are expected to decline in coming years.

Electricity rates can be determined by the volume of electricity used, the "shape" of the load (for example, is the electricity use steady, or does it vary over time in predictable or unpredictable ways), time of use, the source of the energy (for example, is it derived from a coal-burning facility or a wind farm), and other factors. The following shows 2004 rates by customer type and service territory. The energy costs are average; many forest industries may pay rates above these levels if they purchase the bulk or all of their energy during times of peak generation. It should be noted that the transmission and distribution rates are fixed, but customers may seek to purchase the energy from a number of sources, so that portion of the costs is subject to some level of variation. Most, though not all, forest industries would be considered medium or large commercial / industrial customers.

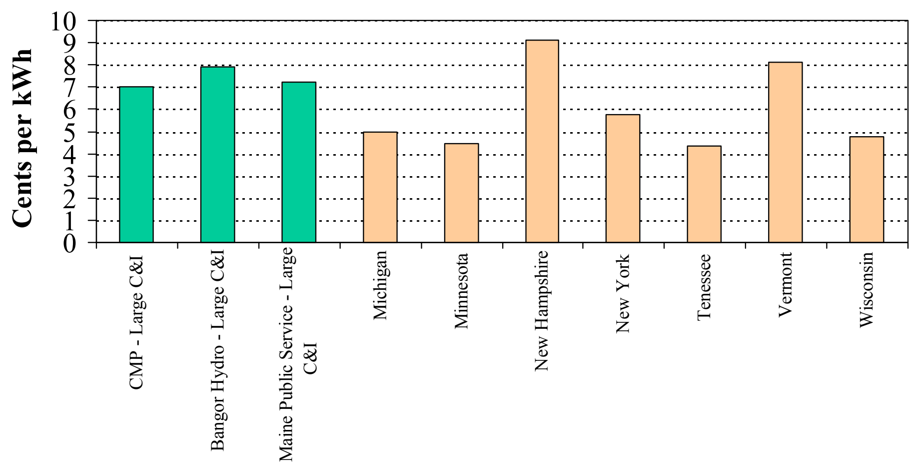
Figure 134. Maine Electricity Rates, by Service Territory and Customer Class, 1Q 2004



Data Source: Maine Public Utilities Commission

The rates paid for electricity in Maine are high compared to the national average, though are certainly not the highest in the region. Factors that contribute to the high cost of electricity in Maine and New England include the generation mix in the NEPOOL and NMISA regions, insufficient transmission capacity to most economically move electricity into and out of Maine and past investments in energy generation ("stranded costs"). The average rate paid by industrial consumers of electricity is reported regularly by the U.S. DOE Energy Information Agency. Comparing this data to rates paid in Maine service territories, Maine's electricity rate is higher than most regions and lower than some nearby states.

Figure 135. Industrial Electricity Rates[170], Maine Service Territories and Selected States, 2004



Data Sources: U.S. DOE, Energy Information Agency and Maine PUC

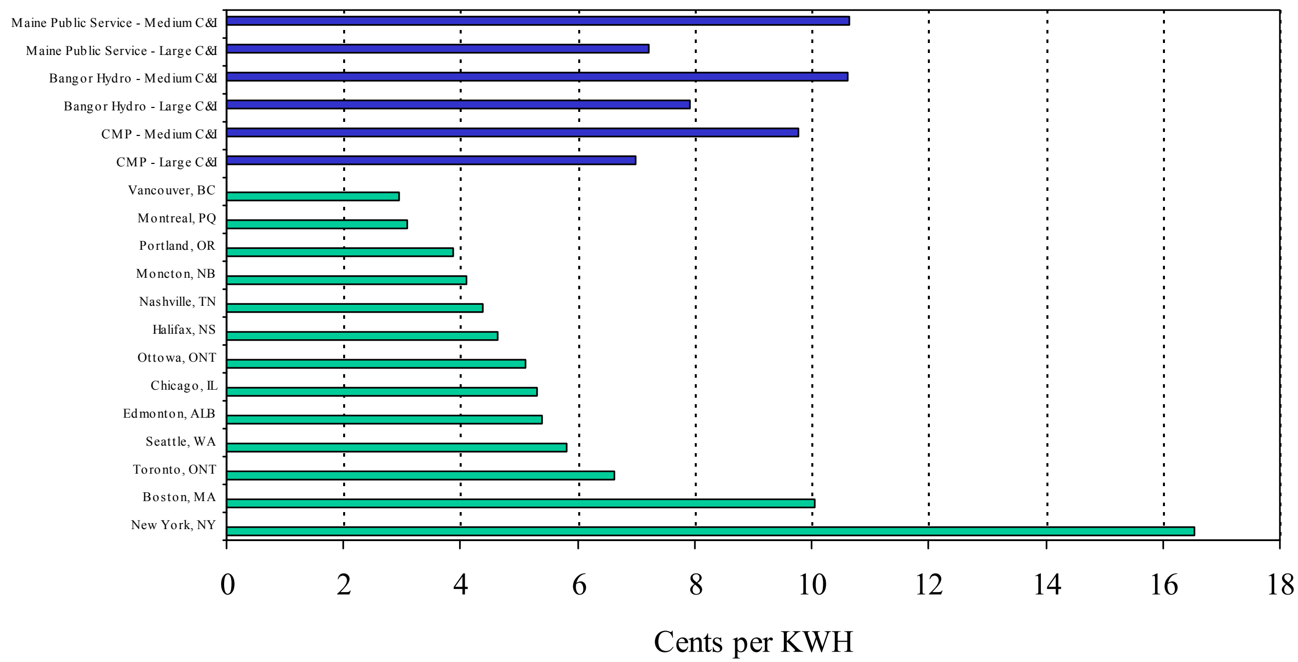
170 "Electric Rates" includes energy, transmission and distribution costs.

Maine forest industries compete directly with a number of Canadian firms, both for raw material and in the marketplace. This is a cause of enormous frustration to many Maine industries, and the cost of electricity is often pointed to as one significant competitive advantage Canadian firms enjoy. This is particularly true of producers located in Quebec; due to its significant hydroelectric resources, Quebec enjoys the third lowest electric rates in North America[171].

The following chart shows how Maine electric rates for medium and large commercial and industrial customers compare to industrial electric rates in Canada and the United States.

[171] Transmission and Distribution World Magazine. *Hydro-Quebec: Brief Article.* December 2000.

Figure 136. Cost of 2003 Industrial Electric Rates[172], Selected U.S. and Canadian Locations (US$)



Data Sources: Maine Public Utilities Commission *and* BC Hydro

[172] "Electric Rates" includes energy, transmission and distribution costs.