Testimony of

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"Impact of High Energy Costs on the Competitiveness of America's Pulp and Paper Industry"

Committee on Resources
Subcommittee on Energy and Mineral Resources and
Subcommittee on Forests and Forest Health
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Mr. Chairmen and Members of the Subcommittees, my name is Donna Harman. I am Vice-President of Government Affairs at the American Forest & Paper Association (AF&PA). AF&PA represents more than 240 member companies and related associations that engage in or represent the manufacturers of pulp, paper, paperboard and wood products. America's forest and paper industry ranges from the state-of-the-art paper mills to small, family owned sawmills and some 9 million individual woodlot owners.

The U.S. forest products industry is vital to the nation's economy. We employ approximately 1.3 million people and rank among the top ten manufacturing employers in 42 states with an estimated payroll of $50 billion. Sales of the paper and forest products industry top $230 billion annually in the U.S. and export markets. We are the world's largest producer of forest products. There isn't a day or a minute that goes by when a forest product isn't part of our lives. The newspapers we read in the morning; the tables where we eat our breakfast and the box that holds the cereal; the desks we work at and the paper in the copying machine; our children's school books; the beds we sleep in and the houses that shelter us – all are forest products that are woven into our everyday lives. Abundant and affordable energy is needed to support the jobs of those who produce the forest products our nation depends on.

Five years ago, the American Forest & Paper Association conducted research to determine the competitive position of U.S. manufacturers of paper and wood products as compared to our primary international competitors. Energy was the one area where our cost of production was slightly better than our competitors. Today, that situation is just the opposite. According to the futures markets, the wellhead price of natural gas will hover between $6 and $7 per million British thermal units (BTUs) in the U.S., prices in the rest of the world are noticeably lower. (See attached chart.) Prices of natural gas our competitors pay in Western Europe are in the $5 range. Prices in Asia range from $2 to $3, and in Russia the

price for natural gas is less than $1 per million BTU, putting our industry at a significant competitive disadvantage.

This energy disadvantage is on top of other competitive disadvantages we face. Our taxes are higher than those of competing nations, and there are unfair trade barriers to the export of our products. The cost of compliance with our nation's environmental laws are high, and transportation costs are increasing while service is declining, thus negatively impacting our ability to get our product to market in a cost competitive manner. Government restrictions are also limiting our access to fiber – even though our forestry stock has increased by 39 percent since 1952. If we cannot successfully address these challenges, the public demand for forest products will increasingly be filled by other nations who do not adhere to our high standards.

Today, the U.S. forest products industry is facing serious domestic and international challenges. In the past five years, 92 pulp and paper mills have closed in the U.S., resulting in a loss of 47,000 jobs, or 21% of our workforce. An additional 75,000 jobs have been lost in the wood products industry in the last three years alone. New capacity growth is now taking place in other countries, where forestry, labor, and environmental practices may not be as responsible as those in the U.S.

Energy is the third largest operating cost for the forest products industry. In the pulp, paper and paperboard sector of the industry, energy makes up 10-15 percent of the total operating costs. Since 1972, our industry has reduced its average total energy usage by 17 percent through increased efficiencies in the manufacturing and production process. In addition, we have reduced our fossil fuel and purchased energy consumption by 38 percent, and increased its energy self-sufficiency by 46 percent. Although the industry is nearly 60

percent self-sufficient (using mostly biomass), we also use natural gas, coal, fuel oil, and purchased electricity to meet the balance of our energy needs.

Forest products companies purchase about 400 billion cubic feet of natural gas annually. The price of natural gas in 2004 was nearly triple the average price in 2002 which reflected the historical average price of the previous decade. That means the forest products industry has been forced to spend an additional $2 billion annually for the same amount of fuel. Thus far, 2005 appears to have similar pricing as 2004. Given the global competition for our products, it has been impossible to fully pass on these costs to our customers. Like other manufacturing industries, forest products companies have responded to the high cost of energy and other competitive factors by downsizing, changing product mix and making other difficult business decisions.

The Congress can play a vital role in helping secure the long-term future of U.S. manufacturers and the jobs they provide by enacting energy legislation that expands energy supply – particularly natural gas, promotes energy efficiency, and encourages the development of new technology. Environmental rules and regulations have driven industry toward increased gas consumption without providing for increased access to the supply that is needed to keep natural gas costs competitive. AF&PA believes that 2005 energy legislation should result in substantially more access to natural gas on federal lands (both on and off shore) that can be developed in an environmentally conscientious manner.

The Rocky Mountain basin is a rich resource of natural gas, but the process of developing and getting this gas to market is often held up by a litigious permitting and review process. Legislation should minimize restrictions and consolidate the process for approval of drilling permits. Infrastructure to bring natural gas to market should be likewise improved in

an expedient manner. Reserves can thus be brought to market using existing environmentally-friendly technologies without undue delay.

We also support codification of Executive Orders 13211 and 13212 which require assessments of how new regulations impact energy supply, distribution and use, and establish accountability for agencies to process permits efficiently. In addition, Congress should ensure that the Bureau of Land Management and the U.S. Forest Service have adequate funding resources and clear direction to lease available areas and process permits in a timely manner. This includes regular updates of land use plans, more efficient processing of NEPA requirements and efforts to resolve appeals and protests in a timely fashion. Congress recently took steps to streamline the appeals process in the Healthy Forests Restoration Act. A similar approach may be warranted for energy exploration and development on federal lands.

Recent Minerals Management Service figures on natural gas estimates indicate that significant amounts of gas are available and recoverable in the Gulf of Mexico and off of the Alaska coast. We should allow the Department of Interior to conduct an inventory of OCS resources. Such an inventory could give the country more information about the resources that may exist and help inform decisions as to where additional environmentally conscious production could occur. Another creative idea for consideration by the Committee is legislation to allow states to decide whether their coasts are appropriate for additional exploration and development. Some states may decide there are areas of their coast line that could be appropriate for more oil and gas development in exchange for a greater share of the revenues. This approach would be responsive to regional needs and could allow more access to reserves that are currently locked up. Consistent with that is implementation of revenue sharing formulas and royalty payments that encourage additional development of these

resources. Consideration and implementation of even a few of these ideas could be part of a national strategy to close the gap between demand and domestic supply of natural gas that is critical to maintain manufacturing jobs in the U.S.

Imported Liquefied Natural Gas (LNG) can also play a role in the development of increased gas supply and help smooth out price volatility. The Congress should promote capacity to import LNG by adopting legislation that will result in a faster, more streamlined processing of permits, that recognizes the Federal Energy Regulatory Commission as the lead agency for LNG project siting. Additional LNG offers the opportunity to increase the short-term energy supply picture for our nation and for the forest products industry. Congress should also recognize, however, that imported LNG is only part of the solution to our national energy supply needs.

An important long-term solution to our natural gas supply problem is the development and deployment of new sources of energy and energy related technologies. Federal research and development dollars are critical to the development of breakthrough manufacturing and energy production technologies using fuel sources such as gasification of biomass and black liquor, a byproduct of the pulping process. For decades, many paper and wood products mills have provided the majority of their own energy production. Many pulp and paper mills, for example, have run their paper machines using electricity largely supplied by mill-operated, on-site electric generators.

The industry has used biomass fuels (such as spent pulping liquor, hog fuels, bark, and wood chips) and purchased fossil fuels to produce steam and electricity used in its manufacturing processes. Our mills produce 42.7 percent of all on-site generation of electrical power in the manufacturing sector. Timely and successful development and full implementation of black liquor and biomass gasification programs could make our industry a

net exporter of renewable electricity — removing some 35 million tons of carbon emissions from the air and generating 18-22 gigawatts of electricity by 2020. In addition, it could result in freeing up as much as 900 billion cubic feet of natural gas per year (almost 1 Tcf) for other uses in the economy simply as a result of better utilization of biomass fuels. This technology, however, will not be developed without a public-private partnership. The costs of development and the risk of failure are too high for private industry to bear alone. Considering the tremendous potential national benefits of increased energy supply from a carbon neutral fuel such as biomass, it is most appropriate for the federal government to provide support for this pre-commercial research.

Additionally, we realize the forest health crisis has brought much attention to the need for restoration work in the national forests. This committee's work on the Healthy Forests Restoration Act and now on subsequent issues related to restoration from catastrophic events is very important to the ecology of our forests. Wildfire, insect infestation, disease, blow downs and other destructive forces don't respect property boundaries. Many private forests share boundaries with national forests. Consequently, the health of the national forest can directly affect the health of some private forests. Restoration work on private forests occurs much more quickly than on national forests. As a result, the value of the "product" and the cost of restoration can be much lower on private forests.

The challenges for the Forest Service to be able to treat the almost 60 million acres of unhealthy forests are immense. Some estimate that the Forest Service would need to hire at least three times its current staff and quadruple their existing budget to effectively treat this acreage. In these times of budget deficits that alternative is unlikely. That means the government will need to come up with a way to create an incentive for the debris to be removed from the forest through a public-private partnership. The material being removed is

small diameter woody debris and what we refer to as "salvage" – wood that has been damaged by insect, disease, fire or some other natural occurrence. While some uses exist for this material, there isn't always an infrastructure in place to receive and economically use the "product." The downsizing of the forest products industry over the past two decades has left many communities near national forests with little or no capacity for use of the resource, or the wood has been left on the ground so long that its commercial value is gone.

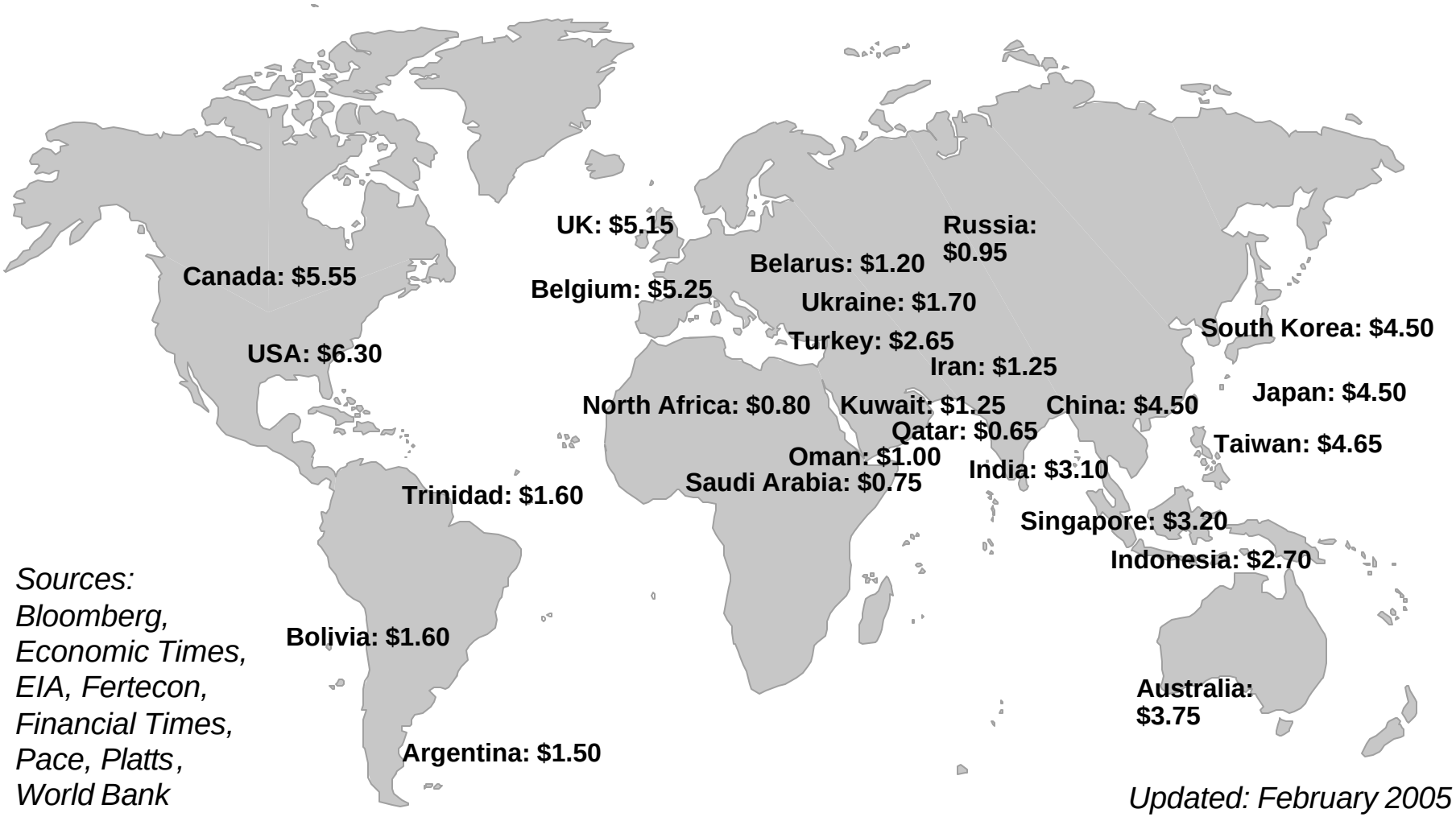
One good use of this debris – or biomass – is production of energy. There are currently "mobile energy units" that can produce biomass-based electricity in relatively small quantities to meet rural electric needs. We understand this technology is currently being explored in the western U.S. and offers some potential for utilization of the biomass debris. As stated earlier, the forest products industry has substantial experience with producing energy from biomass. The "gasification" technology has the potential to create a synthesis gas that could be used to make hydrogen or other biomass fuels. This new technology development, however, will not solve the short-term problem of helping the Forest Service cost-effectively address all of the forests that need treatment for hazardous fuels reduction. In these circumstances new products and uses for the biomass need to be developed.

Although there is not a perfect alignment, there are some areas of the country where the existing forest products infrastructure could be an important component in ensuring the cost-effective utilization of some of the biomass being removed from federal lands. (See attached map.) We recommend that the Forest Service look at these locations initially for hazardous fuels treatment projects because the likelihood of successful cost-effective treatment may be the greatest where there is already an infrastructure in place to use to biomass.

We would urge this committee to help us work with the Forest Service in order to expand the understanding and appreciation of the interrelationships between the industry and Forest Service programs and projects designed to meet land management objectives through fiber sales (commercial and stewardship contracts.) There is a growing understanding that Forest Service employees involved in these programs need more information about the business and financial environments of the companies that wish to continue to purchase federal fiber. Federal managers will make better decisions if they understand the industry infrastructure and business environment of potential private sector partners when planning projects that are necessary to accomplish federal land management goals and objectives – like forest health.

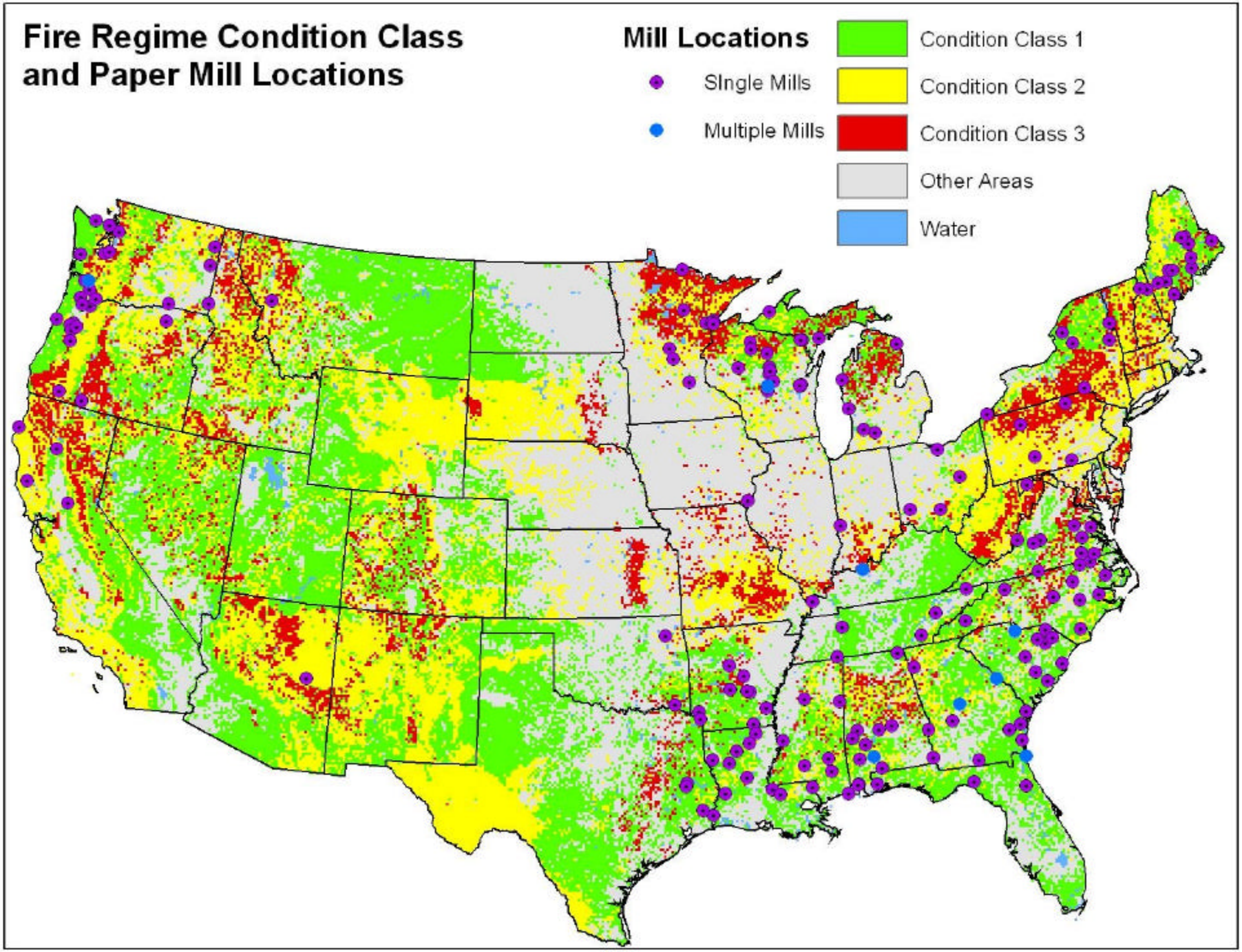
The U.S. forest products industry faces multiple challenges which together reduce its ability to compete in global markets. Some of these challenges, such as concern about the ongoing availability of wood and healthy forest surrounding us are unique to our industry. But many are problems, like escalating energy costs, that we share with other U.S. manufacturers. Our industry is committed to doing its part to meet these challenges, but successfully addressing them will require changes in federal laws that increase our nation's energy supply and ongoing partnerships between industry, investors and federal agencies. By working together, we can create a climate in which the forest products industry can flourish and ensure that future generations will have the abundant forests, diverse wildlife, secure jobs and useful products that we enjoy today. We appreciate the Committee's interest in understanding energy costs as they affect our manufacturing. We hope this information has been useful and informative as the committee will clearly have legislative opportunities in the coming months to address many of these important issues. We look forward to working with you and would be happy to answer your questions.

Natural Gas Costs around the World ($US per million BTUs)



Sources: Bloomberg, Economic Times, EIA, Fertecon, Financial Times, Pace, Platts, World Bank

Updated: February 2005


Fire Regime Condition Class and Paper Mill Locations
Mill Locations
SIngle Mills
Multiple Mills
Condition Class 1
Condition Class 2
Condition Class 3
Other Areas
Water