from the Minneapolis Star Tribune:

Budget cuts may cause Minnesota ethanol industry to fizzle

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BUFFALO LAKE -- In this farm community, where corn is king, good jobs can be hard to come by. That's why workers at Minnesota Energy -- one of the state's smallest ethanol plants -- worry that budget cuts might lead to layoffs or even sink their struggling company.

"Being a single mom with a mortgage, where would I go?" asks Jeni Kenney, 30, who handles administrative duties at the plant 75 miles west of the Twin Cities. "We're out in rural Minnesota where the job market isn't as open as in the Twin Cities," Kenney said. "There aren't a lot of jobs that I could move into."

It's not only Kenney and the other 25 workers at Minnesota Energy who worry about slashed incentive payments to ethanol plants, which process corn into a fuel additive. Also concerned are the 326 farmers who have invested in the ethanol cooperative, as well as agricultural lenders, the local grain elevator, the power company, the cafes and the rural schools. They all could be affected if Minnesota Energy cuts its workforce sharply, curtails production or closes.

Gov. Tim Pawlenty proposes slashing ethanol subsidies in half -- by $35 million -- for the next two-year state budget cycle beginning in July, dropping payments from 19 cents per gallon produced to a dime. Last month, Pawlenty cut $20.1 million from the $27 million of ethanol subsidies in the current fiscal year budget, which ends June 30. Before that, the most any ethanol producer could receive from the state had been up to $3 million a year for 15 million gallons produced, for up to 10 years. Under the Pawlenty plan, the most they could receive would be $1.5 million.

The cuts are part of Pawlenty's strategy to address a $4.23 billion state deficit. Ethanol producers say the cuts are disproportionately severe. The state's 14 ethanol plants employ more than 400 and have about 5,000 investors, most of whom are farmers, said Jerry Seck, a Minnesota Coalition for Ethanol lobbyist.

The smallest plants -- Minnesota Energy in Buffalo Lake, Gopher State in St. Paul and Central Minnesota Ethanol Co-op in Little Falls, are struggling and might not survive the cuts, agriculture experts say.

The governor has said he supports ventures that add value to commodities, but he couldn't justify cutting programs for the needy while providing subsidies to the mostly profitable ethanol industry. But Joe Johansen, general manager of Minnesota Energy, takes issue, saying in some years the plant has lost more than it has made in profits. In the cooperative's six years of operation, investors received two modest dividend payments worth 20 percent of what original investors paid.

"While most of the other plants are doing well, the value of our shares are deplorably low," said Warren Klammer, president of Minnesota Energy's board. The cuts could be devastating in Buffalo Lake, where the ethanol plant and the grain elevator -- Buffalo Lake Farmers Co-op -- are leading employers, Klammer said.

Sensitive issues

Help might be on the way. At Pawlenty's behest, officials at the Minnesota Agriculture Department are trying to devise options to help the smaller, struggling plants. Jim Boerboom, assistant agriculture commissioner, said a solution will require tackling politically sensitive issues, including: Where would the money come from, and how could officials decide which plants get the payments?

The ethanol industry is divided over the issue, with some questioning whether money would be diverted from older, more financially sound plants to help the smaller, ailing plants. Seck said all plants should receive at least 16 cents a gallon as an incentive, and this would eliminate the need for "hardship" payments. "There is a very delicate balance between offering a hardship based on need and making sure we don't put public funds into an entity that may not survive long term," Boerboom said.

After years of trouble, Minnesota Energy had been poised to begin turning a decent profit this year, Johansen said. The cooperative had borrowed $4.9 million for a $5.64 million expansion last year from 12 million to 17.4 million gallons, records show. While most of the state's ethanol plants are expanding capacity up to 40 million gallons a year to enjoy economies of scale, Minnesota Energy is landlocked from further expansion, Johansen said.

Lenders worry

To finance construction and expansion, Buffalo Lake and most of Minnesota's 13 other ethanol plants included state payments as part of their capability to repay loans. Profits for the ethanol industry depend on volatile prices for corn and ethanol, and the state's scheduled payments had provided a cushion.

"In the spring of 2002, when we had depressed ethanol prices and corn prices started to go up, the incentive payments certainly became a lot more important to the cash flow and ability to service a debt," said Tom Houser, vice president of agricultural lender CoBank. Based in Denver, CoBank is the lender for 15 ethanol plants across the nation, including six in Minnesota.

Now, with war on the horizon, gasoline prices are shooting up and ethanol prices are beginning to climb. But profits could be offset by soaring costs for natural gas, which is used heavily in ethanol production.

More is needed

Major agricultural lenders say cash-flow analyses show that the Minnesota plants need subsidies of at least 15 cents a gallon -- higher than the 10 cents Pawlenty wants -- to stay afloat and repay debt. "This isn't an issue of financing and funding," said Paul DeBriyn, president and CEO of AgStar Financial Services. "It's an issue of cash flow. It's the ability to generate the revenue to cover the financing source." AgStar has outstanding loans or commitments of nearly $30 million to six Minnesota ethanol plants, DeBriyn said.

Concern over the cuts may be chilling to some investors and other lenders who worry that Pawlenty's proposed tax-free zones to foster rural economic development could someday be slashed, too. "If the state wants to put up these enterprise zones and promise tax breaks for 12 years, how are the investors going to react if they see what the state did to the ethanol plants?" Klammer said Monday. "Personally, I wouldn't invest 5 cents into one of these enterprise zones, not after seeing the state renege on its commitment to the ethanol industry."

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