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Golden image of corn-based ethanol shows some erosion

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Enlarge By Andy King for USA TODAY

The Al-Corn Clean Fuel ethanol plant in Claremont, Minn. Explosive growth of the ethanol sector has contributed to increasing volatility in grain markets.

By Sue Kirchhoff, USA TODAY

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CLAREMONT, Minn. — From his office window at the Al-Corn Clean Fuel ethanol plant, manager Randy Doyal watches a steady stream of trucks roll in, weighed down with grain. A decade ago, many of the delivery trucks were beat-up, all-purpose workhorses. Today, a growing number are gleaming semis, reflecting the improved fortunes of this farmer-owned facility as well as the nearby countryside.

"All the folks that invested in the first place took a gamble. It's been big for them," says Doyal. The firms' huge fermenters, grain elevators and cooling towers loom over the flat cornfields, physically underscoring the economic reality that ethanol is the most important thing around.

Market changes and a growing chorus of concerns about ethanol make Doyal and other ethanol supporters question how long the good times will last. Corn prices, though down lately, remain high at $5.98 a bushel, making it harder for ethanol producers to profit. Livestock producers blame the ethanol industry for driving up feed prices and fueling food inflation for consumers.

Industry supporters say opponents are overstating the impact of ethanol on food prices and ignoring other factors in driving up food costs — high oil prices and bad weather in exporting nations, for example. But they acknowledge that corn-based ethanol is not seen as the long-term solution to greater energy independence, but rather a transition to more efficient biofuels that may not benefit those farmers fueling current ethanol plants.

They also acknowledge that the explosive growth of the ethanol sector has contributed to increasing volatility in grain markets and in farming generally. The industry took off at the same time the world began consuming more grain than it was producing and oil prices surged. The result: tight supplies, high prices and unpredictable markets as food prices now are linked to energy demand.

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"This is a roller coaster," Gene Hugoson, commissioner of the Minnesota Department of Agriculture, says of the farm sector. "I'm not so sure we're going to have permanent winners."

For corn growers and other farmers, the strain of high energy costs and tight supplies of everything from fertilizer to seed — caused partly by the ethanol boom itself — has started to show. Farmers are being told to come up with cash, now, for next year's supplies. Grain elevators are strapped for financing. The Minneapolis Federal Reserve Bank cautions of a possible farmland price bubble.

If that weren't enough, the industry faces a rising backlash from some scientists, elected officials and livestock producers who say that burning more than a quarter of the U.S. corn crop for fuel has contributed to growing hunger abroad and undercut conservation efforts.

More than two decades ago, Minnesota began subsidizing corn-based ethanol production to bolster rural communities, meet tougher federal clean air standards and reduce reliance on imported oil. By those measures, its program mostly has been a success. State and U.S. subsidies have contributed to record farm income and account for 10% of the state's fuel use. Eighteen of the USA's 167 ethanol plants are in operation here, with four more under construction, making Minnesota the nation's fourth-largest producer.

Government mandates

Ethanol production exploded in this decade after MTBE**,** a petroleum-based competitor to ethanol, was banned for being a water pollutant. Congress passed legislation mandating minimum ethanol usage in motor fuel to replace it. Perhaps the biggest governmental boost for corn-based ethanol came in December when federal energy legislation required U.S. firms to blend into the nation's gasoline supply 36 billion gallons of biofuels by 2022. The statute, building on landmark 2005 federal legislation that required blending of ethanol or other biofuels with gas, mandates use of 9 billion gallons this year, and sets escalating requirements.

The law survived a key challenge this month when the Environmental Protection Agency denied a request by Texas Gov. Rick Perry, a Republican, to cut in half this year's ethanol mandate. EPA rejected Perry's argument that increased demand for corn for use in fuel has more than doubled feed costs for the livestock industry in his state.

Ultimately, Perry and other critics argue, the increased demand for corn as fuel drives up consumers' costs for meat and other groceries. Consumer food prices have risen at an 8% annual rate in the past three months, more than triple the average increase of the past decade.

Last year, ethanol used a quarter of the corn crop — the largest in history — and it will soak up about a third of this year's production. Initially, ethanol was envisaged as a way to increase corn prices and farm income and whittle down mountains of surplus production.

But the federal usage mandates have coincided with rapid growth in China and India, which has helped push prices for oil to historic levels. Agricultural productivity slowed as nations reduced research. The falling value of the dollar also meant other nations could buy U.S. grains at a relative bargain, so they didn't cut back on U.S. purchases as much as expected when corn prices rose. The result is the tightest world grain supply in decades, sharply higher prices and a growing chorus of criticism of the ethanol industry for upsetting the supply-demand balance.

Bob Christensen, CEO of Christensen Farms in Sleepy Eye, Minn., one of the nation's biggest pork producers, says the 2007 federal biofuel mandates have been a disaster. While pork producers have seen the price they receive rise by 20% in the past year, corn prices have jumped more than 60% and soybean meal prices are up nearly 70%. The industry has been buoyed by a huge surge in exports. But Christensen warns that only about half of farmers' higher costs have been passed on to the U.S. consumer and predicts much higher prices in coming months.

"The American consumer is going to be totally shocked," says Christensen. "It's a little striking that no one ever thought of the fact in Washington, D.C., that food might be more important than fuel."

Economists' estimates vary widely on ethanol's impact on corn prices and, ultimately, on consumers' food bills.

The Farm Foundation, an Illinois-based non-profit, in July released a report by Purdue University economists concluding that ethanol subsidies have directly contributed about $1 to the cost of a bushel of corn.

The study estimates high oil prices have contributed $3 a bushel, including increased demand for ethanol production. Ethanol sells for about $2.40 a gallon wholesale and gasoline for about $3.05 a gallon. As long as ethanol is cheaper than gasoline, it remains an attractive blend for motor fuel.

The Renewable Fuels Association, the trade group for ethanol producers, says the Farm Foundation study proves ethanol policies have had a minimal impact on corn prices and grocery bills.

But Wallace Tyner, one of the Purdue economists who produced the study, calls the situation more complex. If ethanol subsidies hadn't been in place, the industry probably wouldn't have taken off until oil prices hit $60 a barrel, which happened in 2005, so ethanol production now wouldn't be so large, and corn demand wouldn't be so high.

Tyner cautions that any rollback in federal biofuel mandates won't prompt a quick reduction in food prices or a major shift in farming patterns. Ethanol firms already produce more fuel than required by law and will keep doing so as long as the spread between per-gallon prices of ethanol and gasoline produces a profit.

Even if Congress were to eliminate the current 51-cents-a-gallon federal ethanol subsidy, which will decline to 45-cents-a-gallon next year, Tyner estimates it would take as long as two years for the impact to show up on the supermarket shelf.

Economist Bruce Babcock of Iowa State University has estimated that corn prices would decline just 13% this year even if ethanol supports and import tariffs were eliminated, unless oil prices fell substantially. Weather conditions could have a bigger impact, he says.

Though the ethanol industry could claim a victory with the EPA support of usage mandates, big challenges remain. Legislation has been introduced in Congress to reduce ethanol subsidies. Federal Reserve Chairman Ben Bernanke last month added his voice to those who support eliminating a tariff on imported ethanol, and foreign governments have threatened trade complaints.

Ethanol plants have seen diminished profit margins, and some new facilities were put on hold, as corn prices surged. The situation became especially acute in June, as devastating Midwest floods threatened the crop, propelling prices to a record of more than $8 a bushel.

Delayed operations

Ethanol giant VeraSun Energy in June announced it would delay opening two ethanol plants in Minnesota and Iowa, though its latest earnings report last week exceeded market predictions. Also in June, Heartland Ethanol disbanded, canceling plans to build seven alternative-fuel plants.

Even as some companies delay operations, others are pressing on. New plants have recently opened or are scheduled to open in Iowa and Montana, among other states. The most recent biofuels plants, including a demonstration facility in Butte, Mont., are designed to use a variety of energy sources, not just corn.

Larry Liepold of Okabena, Minn., grows corn and is a shareholder in an ethanol plant that opened last year within a mile of his farm. He also raises hogs. He sees a need for ethanol production but also worries that the overheated farm sector could take a big beating from high prices it has helped create.

Liepold's fertilizer supplier is telling him he must lock in next year's supply now, at nearly double the current price in dollars per acre, and pay upfront. Land rents are rising. To get financing, Liepold has to presell next year's crop, taking a big bet on prices.

"Input prices are through the roof. I don't have any idea what seed's going to be next year," says Liepold. "We're moving more product than I've ever moved, but my margins are not greater because input costs have gone up."

Adding to the uncertainty is the fact that corn-based ethanol is not seen as a long-term solution to energy problems but as a foundation for follow-on technologies that will produce fuel from such sources as switchgrass, animal waste or wood chips. Those are envisioned as producing far more energy, while consuming less water, fertilizer, oil and natural gas during production.

Minnesota officials envision a second-generation energy policy that includes cellulosic fuels and other renewable fuels. Al-Corn's Doyal and others are trying to ensure current plants have a major role in the next generation.

Doyal acknowledges that ethanol is a factor in feed-cost increases for livestock farmers. But, he says, the industry has been unfairly "singled out as a bad actor." A multiyear drought in Australia, for example, has been a huge factor in higher food costs.

"I'd like corn to be cheaper. Holy cow, that's my biggest cost," Doyal says.

But, in Sleepy Eye, pork producer Christensen has limited sympathy for investors who jumped on the ethanol bandwagon — and big worries that the farm economy is riding a boom-bust cycle. "If you're making a decision based on a federal subsidy, that's really a risk that you have to bear," says Christensen. "It will be painful, certainly, but it was fun on the way up, too."

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But we don't need to grow corn or any other crop to make ethanol: