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Ethanol Producer Grant Program (DATCP -- Trade and Consumer Protection)

[LFB 2001-03 Budget Summary: Page 100, #3]

CURRENT LAW

1999 Act 55 created an ethanol producer grant program for annual payments of 20¢ per gallon to qualifying producers for up to 15 million gallons ($3 million per producer maximum) of ethanol produced in a 12-month period in Wisconsin. The program is scheduled to sunset on June 30, 2006. No funding was provided under Act 55. If appropriated funds are insufficient to pay all ethanol producer claims, payments are prorated.

GOVERNOR

Provide $3 million GPR in 2002-03 for grants to ethanol producers. Further, transfer the program from the Department's marketing division to its trade and consumer protection division.

DISCUSSION POINTS

Background

1. Although ethanol can be produced from various starch sources, over 90% of U.S. ethanol is made from corn. It is estimated that in 2000, 1.6 billion gallons of ethanol were produced using 600 million bushels of corn. Wisconsin ranks seventh among states in the production of corn for grain, harvesting 408 million bushels in 1999. Approximately 5.8 million bushels of corn are used to produce 15 million gallons of ethanol (one bushel of corn is equivalent to approximately 2.6 gallons of ethanol).

2. Some have estimated the price of corn increases by 10¢ to 30¢ per bushel for growers near ethanol plants. The Congressional Research Service indicates that when corn supplies are plentiful, the use of every 100 million bushels of corn for ethanol raises the national price of corn by 4¢ per bushel. When corn supplies are limited, the price impact is higher. In addition to its impact on prices, an ethanol plant also may give local farmers a more stable market for their grain.

3. While no ethanol production facility in Wisconsin currently produces enough ethanol to qualify for an ethanol producer grant, the state used approximately 93.8 million gallons of ethanol in 2000 (up from 75.4 million gallons in 1999). State law requires state employees to use gasohol (an ethanol mix of up to 10%) or alternative fuel for the operation of all state-owned or state-leased motor vehicles whenever feasible. In addition, the federal Clean Air Act requires the use of reformulated gasoline or oxygenated fuels in Kenosha, Milwaukee, Ozaukee, Racine, Washington and Waukesha Counties due to significant ozone levels in Southeastern Wisconsin. Most of the federal requirement is met through the use of reformulated gasoline, which is mixed with up to 10% ethanol.

4. The Department of Administration (DOA) estimates that in 1999, 67.4 million gallons of ethanol were used in reformulated gasoline and eight million gallons of ethanol were blended for sale in the state as gasohol. In 2000, it is estimated that 70.7 million gallons were used in reformulated gasoline and 23.1 million gallons were blended for gasohol. Industry officials suggest the increase in gasohol consumption reflects the higher gasoline prices in 2000. As gasoline prices rose, ethanol blends became more competitively priced, particularly when used to make higher octane fuels.

Other Ethanol Production Incentives

5. A federal tax reduction of 5.3¢, which gradually will be reduced to 5.1¢, per gallon of gasoline mixed with up to 10% ethanol is in place through 2007. This incentive translates to a federal subsidy of approximately 53¢ per gallon of ethanol produced. Some states provide additional ethanol production incentives. Minnesota provides up to $37 million annually for a producer incentive of 20¢ per gallon for the first ten years of ethanol production for up to $3 million annually per plant. In addition, in the mid-1990's, Minnesota provided blenders a 5¢ tax credit per gallon of ethanol mixed with gasoline. Further, an ethanol production facility loan program provides low interest loans of up to $500,000 for plant construction. Minnesota currently has the capacity to produce 290 million gallons of ethanol at 14 ethanol plants and actually produced 190 million gallons of ethanol in 1999. State law also requires that all gasoline sold or offered for sale in Minnesota contain at least 2.7% oxygen by weight, which generally is met by adding ethanol. As a result, it is estimated that 200 million gallons of ethanol are used annually in Minnesota.

6. A few other states also offer ethanol production incentives, including North Dakota for up to 12 years at 40¢ per gallon, Nebraska for up to five years at 20¢ per gallon (this expired on December 31, 2000 and was replaced by an incentive of 7.5¢ per gallon for up to three years for new production), Missouri for up to five years at 20¢ per gallon for the first 12.5 million gallons and 5¢ per gallon for the next 12.5 million gallons and South Dakota at 20¢ per gallon with a limit of $1

million per facility per year and no more than $10 million total to any one producer. In addition, South Dakota provides blenders a 2¢ tax credit per gallon of ethanol blends (Missouri offered the same credit until July 1, 1996). Iowa offers a subsidized loan program specifically for building ethanol production facilities and provides blenders a 1¢ tax credit per gallon of ethanol blends, but provides no producer payment. Nor do Illinois or Indiana offer producer subsidies, but each of these states has large ethanol production facilities. In fact, despite not offering producer payments, Illinois and Iowa are the leading producers of ethanol in the nation. Table 1 portrays ethanol production capacity and consumption in area states (while the table shows national capacity of 1.9 billion gallons, actual production was estimated at 1.6 billion gallons). Wisconsin consumption numbers are from the Wisconsin Department of Revenue and DOA's Division of Energy and consumption numbers for other states are from federal highway administration estimates derived from gasohol tax collections.

TABLE 1

Area Ethanol Production and Consumption
(In Gallons)

	2000 Production Capacity	1999 Consumed in Gasohol
Illinois	457,800,000	215,565,000
Iowa	394,300,000	70,900,000
Minnesota	289,600,000	206,542,000
Nebraska	287,333,333	22,127,000
North Dakota	169,900,000	4,630,000
Indiana	85,000,000	95,281,000
Kansas	73,433,333	5,252,000
Missouri	30,000,000	15,257,000
South Dakota	29,000,000	19,124,000
Wisconsin	4,000,000	75,400,000
Ohio	0	207,956,000
Michigan	0	35,898,000
Area Total	1,820,366,666	973,932,000
National Total	1,945,900,000	1,339,239,000

7. Ethanol plants may be eligible to participate in Wisconsin economic development programs through the Department of Commerce. The Wisconsin Development Fund offers grants and loans to businesses for items such as technology development and major economic development. Further, Commerce provides grants and loans through a Rural Economic Development Program, which includes funding for business startups in rural areas. It could be

argued that the state is already providing incentives for businesses to locate in the state. Further, if the ethanol industry is offered additional incentives, other industries may seek production subsidies for their products.

Wisconsin Ethanol Grant Program

8. The Department would like to move the ethanol producer grant program from its marketing to its trade and consumer protection division, due to the fuel-related expertise of staff in that division. Staff in the trade and consumer protection division already collect data on fuel use and deal with fuel issues relating to the weights and measure program and minimum mark-up provisions. Further, the division currently has auditors that could be utilized for the ethanol producer grant program.

9. To date, six plants that would qualify for state production subsidies have expressed interest in locating in the state. Table 2 lists locations and projected production of currently proposed ethanol facilities. It is estimated to generally take at least two years to build an ethanol plant, including finding a site, permitting, design, financing and construction. Further, the actual construction time is at least 14 months, and often a plant does not reach full production until several months after a facility is complete. Under DATCP's final draft rule on the ethanol grant program, producers would need to have at least 10 million gallons of ethanol produced by March 1, 2003, in order to be eligible for a grant, so that payments may be made before the close of the fiscal year. Thus, even if each of the six currently interested ethanol facilities did construct plants in Wisconsin, it is unlikely that more than one would have 10 million gallons of ethanol produced by March 1, 2003.

TABLE 2

Interested Ethanol Producers

County	Municipality	Planning Stage	Proposed Capacity (in gallons)
Green	Monroe	Financing	40 million
La Crosse	La Crosse	Financing	30 million
Dodge	Elba	Designing and Permitting	40 million
Barron	Stanley	Finding a Site and Permitting	18 million
Winnebago	Oshkosh	Finding a Site and Designing	20 million
Dunn	Menomonie	Finding a Site and Designing	20 million

10. Nonetheless, some maintain that a $3 million subsidy is inadequate. With current prorating provisions and the $3 million GPR proposed by the Governor, it may be difficult for these ethanol plants to receive financing, as actual payments would be less than 20¢ per gallon if multiple facilities meet the minimum production of 10 million gallons of ethanol to qualify for grants. In

some cases, it is reported that due to the prorating provision of the statutes, lending institutions are not including state payments as projected plant revenue for financing plans.

11. Current law sunsets the program on June 30, 2006, and allows the Wisconsin Department of Transportation (DOT) to end the program earlier if federal transportation funding has decreased due to increased ethanol sales in the state. While these provisions minimize the state's potential future liability from providing an ethanol subsidy, they may also decrease the investment confidence of ethanol producers and their lenders.

12. It has been suggested that the annual producer grant appropriation be replaced by a GPR sum sufficient appropriation in order to make more funding available to potential producers. While this option would guarantee that monies were available to provide all producers with a full 20¢ per gallon subsidy, it also would increase the state cost of the program by unforeseen amounts in future biennia. In order to better budget the state commitment in a sum sufficient appropriation, the Committee could choose to convert the program's annual appropriation to a sum sufficient appropriation capped at an amount deemed acceptable.

13. Further, in order to ensure financing for a specific number of plants (or level of production) the proration provision could be replaced. If DATCP awarded grants based on when a producer first met the 10 million gallon production threshold, it would give the first plants to meet the production threshold more security as they would know how much of a payment to expect from the state. It could also hasten the construction of plants in the state.

14. Others would point out that since six groups are pursuing plant options before any available subsidy amount has been set by the Legislature, the prorating provision under current law might not be a significant impediment to potential producers. Still, as none of the proposed plants have been given financing approval or actually begun construction, it may be too early to determine the impact of current prorating provisions on attracting ethanol plants to the state.

15. If a proposed producer does receive funding, it could be argued that a producer subsidy is not needed since the lending institution believes the facility would be profitable without any subsidy. However, a production subsidy does encourage initial capital investment in a facility that might not otherwise be profitable. A $3 million annual production subsidy could recoup a $10 million investment in ethanol equipment purchases after less than four years of producing ethanol. Such a return on a capital investment creates a more favorable status for a potential producer applying for funding from a lender and minimizes the risk to begin construction.

16. According to a study funded by the Wisconsin Corn Growers/Corn Promotion Board, the cost to production of constructing the six ethanol plants proposed ranges from $20 to $55 million each. Further, once each plant is operating at capacity, the study estimates combined corporate and individual income tax revenues, including multiplier effects, from each plant to range from $2 million to $5.5 million, depending on the plant's capacity. While these factors could be seen as benefits offsetting subsidy costs, some could argue that other industries may provide the same or greater benefits to the state without receiving substantial state subsidies. Further, with our current

relatively low unemployment rate, the affect of new ethanol plants on state income tax revenues is unclear, as people may still be employed elsewhere.

17. Due to recent groundwater contamination concerns relating to the use of methyl tertiary butyl ether (MTBE), a petroleum-based product, as an oxygenate in gasoline, the national market for ethanol could rapidly expand. Ethanol can be used as a substitute for MTBE, and federal Clean Air Act regulations require the use of oxygenated fuels in certain areas (including southeast Wisconsin). However, it is also possible that federal vehicular emission standards could be relaxed, which could reduce the demand for ethanol. Further, the profitability of ethanol production facilities would be adversely affected if federal subsidies were not reauthorized in 2007.

ALTERNATIVES TO BASE

1. Approve the Governor's recommendation to:

a. Provide $3 million GPR in 2002-03 for grants to ethanol producers.

Alternative 1a	**GPR**
2001-03 FUNDING (Change to Base)	$3,000,000
[Change to Bill	*$0]*

b. Transfer the program from the Department's marketing division to its trade and consumer protection division.

2. Convert the GPR appropriation for payments to ethanol producers from an annual to a sum sufficient appropriation and cap annual expenditure authority at one of the following amounts: (It is not anticipated that more than one facility would qualify for payments in the 2001-03 biennium.)

a. $6,000,000

b. $9,000,000

c. $12,000,000

d. $15,000,000

Alternative 2	**GPR**
2001-03 FUNDING (Change to Base)	$3,000,000
[Change to Bill	*$0]*

3. Specify that DATCP grant eligibility be on a first-come, first-served basis based on

reaching the 10 million gallon production threshold (rather than prorating payments to all producers under current law).

4. Maintain current law.

Alternative 3	**GPR**
2001-03 FUNDING (Change to Base)	$0
[Change to Bill	***-** $3,000,000]*

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