



Government & Ethanol:

Cutting Taxes vs. Corporate Welfare

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Abstract

The State of North Dakota has chosen ethanol and biodiesel as a cure all for creating economic growth and ending rural stagnation. Large-agribusiness and professional politicians at the national level have successfully convinced people that the subsidization of ethanol and biodiesel is good for rural economies, national security, and global warming. Those noble goals often blind ethanol and biodiesel supporters to the adverse side affects that government's interference will inevitably create.

History has shown that consumers are a much better judge of an industry's viability than the government. It is important that an industry as important as energy be entrusted to the rigorous critique of the marketplace, as opposed to the politically-minded "generosity" of a government. By choosing some industries over others, future businesses and corporations looking for a new home may skip North Dakota to avoid ever being in the crosshairs of a Legislature willing to side with their competition.

According to the non-partisan Tax Foundation, North Dakota's business climate ranks in the lower half of the country, while neighboring states, such as South Dakota and Montana rank near the top. One the most important factors in determining a pro-growth system of taxation is uniformity. Ethanol subsidies only lead to more subsidies, creating harmful distortions in the market. Industries are propped up on weak stilts sending off a message of stability when in fact it is not stable. Eliminating several harmful taxes will unleash an economic boom that will spur economic growth that is well diversified and competitive. Businesses that are *truly* profitable will create jobs in North Dakota and help grow the North Dakota economy to the benefit of the taxpayer, not at their expense.

The Announcement

At a February 15 news conference, Gov. John Hoeven said, “Here in North Dakota, we want to double our production of energy for this nation by 2025.” Energy is the new frontier for the North Dakota economy and the North Dakota politician. Energy was one of the bigger issues surrounding the 2006 legislative elections and continues to stay on the national stage.

Most Americans believe that the United States should change how it produces energy. Last June, a Public Opinion Strategies poll concluded that 91% of Americans believe that the United States is facing an energy crisis. The same poll showed that 78% of Americans believe that ethanol production should be expanded.¹

North Dakotans have anointed ethanol and biodiesel as the savior for the North Dakota economy, the silver bullet that will kill the importation of foreign oil, and the cure all for rural stagnation. In the fall of 2006, a University of North Dakota Bureau of Government Affairs poll concluded that 79% of North Dakotans favor a ten percent ethanol mandate, and 82% favor a two percent biodiesel mandate in diesel fuels.²

Without getting bogged down in details, it sounds very nice to say that North Dakotans should support an industry that supposedly benefits the whole economy of the state. The raw materials for production are readily available and North Dakota has vast acres of great farmland.

¹ WFRV.com, “New Poll Shows Public Really Wants Ethanol,” June 13, 2006, available from http://wfrv.com/ag/local_blogentry_164172757.html; Internet.

² Dale Wetzel, “Polls show backing for renewable energy initiatives,” *Bismarck Tribune*, September 14, 2006, available from <http://www.bismarcktribune.com/articles/2006/09/14/news/state/120791.txt>; Internet.

Current and Future Production of Ethanol

There are currently four ethanol plants operating in North Dakota. An ethanol plant owned by Alchem Limited in Grafton has been producing ethanol for over twenty years. According to its web site, the Alchem plant is one of the nation's longest standing ethanol plants. Currently, it is producing 10.5 million gallons per year.³

The second longest operating ethanol plant in North Dakota is located in Walhalla and is owned by one of the largest food processing companies in the world, Archer Daniels Midland. It has been operating since 1985, with a temporary shutdown in 1999. The ethanol plant is currently producing about 25 million gallons of ethanol per year.⁴

One of the newest operating North Dakota ethanol plants is in Richardton. Owned by Red Trail Energy, the plant has been producing ethanol since December 2006. It is expected to produce around 50 million gallons per year.⁵

The newest ethanol plant in North Dakota is operating near Underwood and is owned by Blue Flint Ethanol. It started ethanol production in late February 2007. When production reaches full capacity, the plant will produce 50 million gallons per year.⁶

Several more ethanol plants are expected to go online in the next few years. Figure 1.1 outlines future ethanol plans.

³ Alchem Limited, LLLP, "About Alchem Ethanol," accessed on March 1, 2007, available from <http://www.alchemethanol.com/>; Internet.

⁴ GoE!, "Ethanol in North Dakota," Ethanol History, accessed on March 1, 2007, available from <http://www.goefuel.com/ethanol/nd.html>; Internet.

⁵ Red Trail Energy, "FAQ," accessed on March 1, 2007, available from <http://www.redtrailenergyllc.com/index.php/faq/>; Internet.

⁶ *Bismarck Tribune*, "Blue Flint starts up ethanol plant," February 22, 2007, available from <http://www.bismarcktribune.com/articles/2007/02/22/news/local/129224.txt>; Internet.

Figure 1.1

Name	Location	GPY	Company
US Bio Hankinson	Hankinson	100 Million	US Bio Energy
Spirit Ethanol	Near Jamestown	100 Million	Spirit Ethanol LLC
Yellowstone Ethanol	Near Williston	50 Million	Yellowstone Ethanol
Tharaldson Ethanol	Casselton	100 Million	Tharaldson Enterprises

With plants running at peak production, almost 500 million gallons of ethanol will be produced in North Dakota, annually.

Future Biodiesel Production

There are no large-scale biodiesel plants operating in North Dakota, but there are five plants on the way. Figure 1.2 outlines the future plants.

Figure 1.2

Name	Location	GPY	Company
Archer Daniels Midland	Velva	85 Million	Archer Daniels Midland
Magic City Biodiesel	Near Minot	30 Million	Dakota Skies
Northern Prairie EnviroFuels	Munich	30 Million	Northern Prairie EnviroFuels
Northwood Mills	Northwood	3 Million	Northwood Mills
All American Biodiesel	York	2 Million	All American Biodiesel

When all of the planned biodiesel plants are running at peak production, North Dakota will be producing 150 million gallons of biodiesel per year.

The History of State Incentives for Ethanol Production

North Dakota currently provides incentives for ethanol production. Between 1989 and 1995 production incentives totaled over \$9.5 million in payments to the two existing ethanol plants (Alchem and ADM). Figure 1.3 outlines the state payments to the Alchem and ADM ethanol plants.

(Figure 1.3 – Legislative Council)

Fiscal Year	Alchem	ADM	Total
1989	\$1,103,026	\$540,555	\$1,643,581
1990	196,663	506,972	703,635
1991	875,000	950,000	1,825,000
1992	865,466	939,577	1,805,043
1993	950,000	875,000	1,825,000
1994	875,000	950,000	1,825,000
1995	875,000	950,000	1,825,000
1996	1,000,000	500,000	1,500,000
1997	1,000,000		1,000,000
1998	870,686		870,686
1999	875,000		875,000
2000	750,000		750,000
2001	750,000		750,000
2002	750,000	500,000	1,250,000
2003	750,000	500,000	1,250,000

2004	600,000	300,000	900,000
2005	600,000	300,000	900,000
2005-07	900,000	450,000	1,350,000
Total	\$14,585,841	\$8,262,104	\$22,847,945

According to the North Dakota Legislative Council, in 1995 the Legislature limited the length of time an ethanol plant could receive payments. An ethanol plant operating before July 1, 1995, could not receive a production incentive payment “for more than five years of operations after June 30, 1995.” A plant that began operations after June 30, 1995, “could not receive incentive payments from the state for more than 10 years of operation.” After December 31, 2007, the state could not provide production incentives to any ethanol plant.

Each ethanol plant in operation before 1995 that produced less than 15 million gallons of ethanol per year (Alchem) was eligible to receive state funding of up to \$1 million dollars each year. An ethanol plant in operation before 1995 that produced more than 15 million gallons of ethanol per year (ADM) was eligible to receive state funding of up to \$500,000 during the same biennium.

In 1999, the Legislature passed HB1019, which “extended the number of years ethanol plants may receive production incentives,” after the set date of June 30, 1995, “from 5 to 12 years,” for the two plants that had been in operation. Any plants built after June 30, 1995 could receive payments for 12 years. The bill also stipulated that no plant could receive payments after December 31, 2009. The Legislature reduced the number of

dollars the Alchem plant in Grafton could receive and eliminated payments to the ADM plant in Walhalla.

In 2001, SB2019 extended the number of years ethanol plants could “receive production incentives... from 12 to 14 years for plants operating before July 1, 1995, and from 12 to 14 years for plants beginning operation after June 30, 1995.” The Legislature extended the number of dollars the Alechem plant could receive each year (\$700,000), and payments to the ADM plant were restored to \$500,000.

In 2001, the Legislature removed the requirement “that the ethanol produced in North Dakota must be sold in North Dakota in order to be eligible for an incentive.”

In the 1980s, the Legislature created an Agricultural Products Utilization Commission. The Legislature gave the commission the power to administer the dissemination of grant money to ethanol plants. To calculate the amount of money a plant is eligible to receive, the commission multiplies the number of ethanol gallons produced and marketed by each individual plant by forty cents.

In 2003, the Legislature passed SB222 which restructured the ethanol incentive program. The method of calculations for payments became counter-cyclical. In other words, the payments are based on the price of ethanol and the price of corn.⁷

Two factors are used simultaneously to determine the counter-cyclical payments, if any. The two components are the price of corn and the price of ethanol. If the price per bushel of corn is over \$1.80, each facility is eligible to receive one tenth of one cent times their overall production times the number of cents the price is over \$1.80 per

⁷ North Dakota Legislative Council, “Ethanol Productions Incentives Since 1999,” Prepared by the North Dakota Legislative Council staff for Senator (Bob) Stenehjem.

bushel. If the price per bushel of corn is less than \$1.80, one tenth of one cent times their overall production times the number of cents the price is below \$1.80 per bushel will be subtracted from the facility's quarterly eligible amount.

The other part takes into account the price at which ethanol is sold. If the average quarterly rack price per gallon of ethanol is above \$1.30, the commission subtracts from the amount payable two tenths of one cent times the number of gallons produced that quarter. If the rack price per gallon is below \$1.30, the commission adds two tenths of one cent times the number of gallons produced.

The bill also removed provisions in the law limiting the number of years a plant may receive payments. The Alchem plant was eligible to receive up to \$600,000 and the ADM plant was eligible for \$300,000.

Another incentive passed in 2005 gives ethanol plants increased funding to increase its production "by the lesser of ten million gallons or fifty percent of its production capacity." The law also limits the amount of money a plant is eligible for to an overall amount of \$10 million over the life of the plant.⁸

State Incentives for Biodiesel Production

There are two incentives given to biodiesel producers in North Dakota. One is a corporate income tax credit of ten percent per year for five years on equipment purchased for all facilities that produce or blend at least two percent biodiesel fuel by volume. The credits were eligible for purchases starting in 2003, and each plant is limited to a cumulative credit of \$250,000.

⁸ North Dakota Century Code, "Agriculturally Derived Fuel Tax Fund," Chapter 4.14.1, accessed on March 5, 2007, available from <http://www.legis.nd.gov/cencode/t04c141.pdf>; Internet.

A biodiesel loan program was created to help buy down loan interest on loans given for the purpose of plant improvements. The Partnership in Assisting Community Expansion (PACE) program requires that for facilities to be eligible, they must produce a five percent biodiesel blend.⁹

Incentives to Sell Ethanol and Biodiesel

The government is also encouraging gas stations to sell ethanol and biodiesels. Businesses get a ten percent tax credit for five years on equipment that enables them to sell biodiesel. Businesses wishing to sell biodiesel can take advantage of the corporate tax credit up to \$50,000. Any equipment purchased to enable the selling of biodiesel is exempt from the state sales tax. Also, any licensed fuel supplier who sells a five percent blend of biodiesel is eligible to receive an income tax credit of five cents per gallon.

Incentives are also in place to aid the selling of ethanol. The motor vehicle fuels tax rate on E-85 was reduced from \$.23 per gallon to \$.01 per gallon until sales reached 1.2 million gallons. That incentive has currently expired.¹⁰

More Corporate Welfare Planned for 2007

Governor Hoeven's plan to subsidize ethanol and biodiesel is seen in Senate Bill 2180. The bill calls for the PACE program to be changed to the Biofuels Partnership in Assisting Community Expansion fund. All money appropriated into the fund must be used to buy down interest on loans that ethanol and biodiesel plants take out with banks. Ethanol and biodiesel plants can receive up to \$500,000 in interest rate buy downs.

⁹ Alternative Fuels Data Center, "North Dakota Incentives and Laws," US Department of Energy, accessed on March 7, 2007, available from http://www.eere.energy.gov/afdc/progs/view_all.cgi?afdc/ND/0; Internet.

¹⁰ Ibid.

Another bill, SB 2288, would create a Biomass Energy Center which would, among other things, “identify and evaluate incentives for producers, such as providing for payment for producers to grow a dedicated bio-energy crop or support equipment, harvesting, and transportation costs.” House Bill 1020 provides \$700,000 of funding for the center.

Senate Bill 2288 also gives the Industrial Commission the power to make grants and loans to those deemed worthy of receiving them to promote the increased production of alternative energy. The commission would be able to provide incentives for increased ethanol production, and establish interest buy-down programs.

Senate Bill 2288 creates an Energy Independence Development Fund which then gets its funding through the Industrial Commission. Each qualifying facility is eligible for up to \$1.6 million per year.¹¹

Benefits of Increased Ethanol and Biodiesel Production

The plans put forward by the Governor and Legislators, past and present, are put in place to jump start an industry that will benefit North Dakota. Ethanol and biodiesel plants employ people, who then move into and invest in rural communities, increase profits for farmers, help the environment, and ultimately will help provide an element of security to our energy supply.

According to the American Ethanol Coalition, economic growth (specifically rural economic growth), job creation, increased farm income, and fuel security are the

¹¹ Sixtieth Legislative Assembly of North Dakota, “Engrossed Senate Bill No. 2288,” accessed on March 5, 2007, available from <http://www.legis.nd.gov/assembly/60-2007/bill-text/HBOK0200.pdf>; Internet.

biggest benefits of producing more ethanol. They also contend that the use of ethanol combats global warming.¹²

While these goals are certainly noble and possibly achievable, they often have side affects that harm other industries and segments of the economy. Is it worth taxpayer money to prop up an industry that will *possibly* create jobs, increase farm income, create fuel security, or help reverse global warming? If those goals are achievable, will they be realized most efficiently and to the highest degree?

The Full Scope of State Government Involvement

When added all together, the amount of taxpayer money that is being and will be used to subsidize the ethanol and biodiesel industries in North Dakota is staggering. To date, the two current operating ethanol plants in North Dakota¹³ have received a total of \$22,847,945 in state payments since 1989, according to the Legislative Council.¹⁴

Governor Hoeven has already increased the amount each facility is eligible for to \$1.6 million per year. Because the Alchem ethanol plant in Grafton and the ADM ethanol plant in Walhalla have already received payments for ten years, they are no longer eligible to receive payments unless they undergo an expansion or the law changes. The new plants will be eligible for payments based on the price per bushel of corn and the rack price per gallon of ethanol.

At the time of this publication, the price per bushel of corn is \$3.67, in North Dakota and the rack price of ethanol is \$2.20. Assuming that these prices will be the

¹² American Ethanol Coalition, accessed on March 21, 2007, available from <http://www.ethanol.org>.

¹³ No payments have been made to the Red River Energy ethanol plant in Richardton, as it has only been online for a couple months.

¹⁴ North Dakota Legislative Council, "Ethanol Productions Incentives Since 1999."

average prices for a bushel of corn and a gallon of ethanol, respectively, here is how the math breaks down for North Dakota ethanol plants:¹⁵ Each ethanol plant producing 100 MGPY (US BioHankinson, Spirit Ethanol, and Tharaldson) of ethanol qualifies to receive \$700,000. The Blue Flint Ethanol plant in Underwood would qualify for \$455,000, and the Yellowstone Ethanol plant near Williston and the Red Trail Energy plant near Richardton would qualify for \$350,000.

The Biodiesel PACE program also buys down part of the interest on loans that plants take out. Under the proposed law, each eligible facility would be able to receive up to \$500,000.

Assuming that the prices of corn and ethanol stay at or around the same levels, the state of North Dakota will be giving direct payments to ethanol plants of \$15 million dollars in just over the next six years. That number also does not include any tax breaks, which will probably amount to millions of more dollars. The Biodiesel PACE program will also cost the state millions of more taxpayer dollars.

Will the price of ethanol relative to the price of corn stay the same? According to the experts, it could get worse. Eric Brown, an analyst at Bank of America, believes that high corn prices and the vast supply of ethanol will only make the gap larger between the

¹⁵ Here is the math calculation: 100 million gallons times one tenth of one percent equals \$100,000. One-hundred thousand dollars times the number of cents over \$1.80 a bushel of corn costs is \$18.7 million. 100 million gallons times two tenths of one percent equals \$200,000. Two-hundred thousand times the number of cents over \$1.30 per gallon or ethanol is \$18 million. Subtracting \$18 million from \$18.7 million is \$700,000. To calculate the rest, insert the facility's gallons per year where 100 million is.

high price of corn and the lower price of ethanol.¹⁶ The price of corn is \$3.67 right now, but is well over \$4.00 per bushel in the futures market.

The ethanol industry is getting hit on both ends. The more bushels of grains it needs, the higher the price of those grains get. The more gallons of ethanol they produce, the lower the price of ethanol becomes. Brown predicts that the operating margin on a gallon of ethanol will drop to twenty eight cents per gallon in 2009 from fifty six cents per gallon in 2007.¹⁷

The University of Missouri's Food and Agricultural Policy Research Institute predicts that the operating margins of ethanol will drop to nineteen cents per gallon, which would not even cover its capital costs.¹⁸ Ethanol plants would then probably look to the government for more help and if history is any indication, the Legislature will continue to amend the laws to make sure the plants get it.

The price of ethanol is expected to remain low and the price of corn is expected to keep rising, adding additional stress to ethanol plants that cannot currently make a profit on the open market. When the subsidy gravy train ends after \$10 million or ten years, the ethanol plants will be forced operate in the open market, or look to the Legislature to remove the limitations. Under current or proposed law, the only way for the plants to receive additional subsidies would be to expand their operations, which would only lead

¹⁶ Andre Farrell, "Ethanol Output Hits Record Levels," *Forbes.com*, March 6, 2007, available from http://www.forbes.com/business/2007/03/06/ethanol-december-production-markets-equity-cx_af_markets27.html; Internet.

¹⁷ Andre Farrell, "Ethanol Output Hits Record Levels," *Forbes.com*.

¹⁸ Philip Brasher, "Report: Ethanol's easy profits to end," *Des Moines Register*, March 6, 2007, available from <http://www.desmoinesregister.com/apps/pbcs.dll/article?AID=/20070306/BUSINESS01/70306052/1001/RSS01>; Internet.

to further losses as increased supply would drive down the cost of ethanol further, increased demand would drive up the cost of grains, and an unprofitable plant would lose even more money. The failure would only lead to more subsidies.

To make up for those losses, investors and grain producers would probably ask for increased subsidies. As more and more taxpayer money is being spent to help operate unprofitable plants, tax increases become the only option for the government to maintain its support for the plants and its general fund cash flow.

Much of the funding for ethanol production incentives comes from registration fees from farm vehicles. This will help offset some of the gains in higher grain prices that farmers receive as a result of higher grain demand. Once the problem spirals further out of control, the Legislature will start drawing directly from the general fund. Income tax and corporate income tax rates could be raised to offset the state spending on ethanol incentives.

To compound the problem even further, most ethanol or biodiesel plants in operation or under construction seek investment in the plants by local farmers. Should these plants fail, the situation for farmers would become worse, as farmers would lose their investment. While plants are currently eligible to receive \$15 million over the next ten years in direct payments, they very well could end up receiving close to \$60 million. The state is trying to stabilize the industry for farmers and producers, but, in effect, is only propping up a straw man industry that will eventually collapse under its own weight.

Meddling in Free Markets

As Americans look for new ways to power their lifestyles, North Dakota appears to be heading down a path where the government picks and chooses who should do business in North Dakota. The Legislature has given ethanol and biodiesel plants money to bring the cost of their loans down, money to operate the plant, and money to help with costs of transporting their finished product. The Legislature has also given businesses that sell E-85 and biodiesels large tax breaks. By giving the plants corporate income tax breaks and by helping them pay their loans, Legislators can campaign back in their districts and claim to be helping usher in a new future for North Dakota, a future that sees North Dakota as the nation's energy producing leader. By choice or by ignorance, those same legislators fail to realize that their meddling in the energy markets only distorts prices, creates a dependence on state money, and drives the cost of other industries up.

The vicious cycle of government interference in the economy only creates more demand for more government interference. The ethanol and biodiesel industries are no exception.

Being a farm state, North Dakotans determine that the best way to fuel the future is to create viable ethanol and biodiesel industries. There are benefits associated with the increased production of ethanol; so, the government decides that it better act.

As agriculture goes, so does the North Dakota economy. The best way to create higher farm incomes is for their crops to be of higher demand. In an attempt to create higher demand for crops, the government decides to help build ethanol and biodiesel plants by offering corporate income tax credits and by direct payments. The state has

given ethanol plants about \$20 million since 1989 and could increase that number by 300% over the next six or seven years.

With twelve large-scale ethanol and biodiesel plants scheduled to be operating within the next five years, demand for corn and soybeans is steadily rising. As demand gets higher, prices get higher. The plants buy up more and more crops and have more and more gallons of finished product. In order for the plants to be semi-profitable, there needs to be a market for ethanol and biodiesel.

Currently, there is not enough demand for ethanol and biodiesel in the open market; that is a truly free market. There is a good reason for this. Fuels such as E-85 are less efficient than traditional fuels like regular unleaded. According to two professors at North Dakota State University, a report published in Consumer Reports showed that it costs more money to drive four-hundred miles using E-85 (\$3.99) than with regular 87 octane (\$2.49).¹⁹ Indeed, E-85 cannot survive in the marketplace to the extent that it would have any effect on the economy without subsidies.

According to Gov. Hoeven's spokesman, the state gave businesses that sold E-85 a twenty-two cent per gallon tax break, there were thirty gas stations that sold E-85. After the tax ran out in the summer of 2006, that number dropped down to twenty-three.²⁰ The profitability of selling E-85 remains in question. They had to spur demand by artificially making it cheaper.

¹⁹ Jack Carter and John Nalewaja, "E-85 a loser for reduced miles/gallon," *Fargo Forum*, March 4, 2007, available from <http://www.in-forum.com/articles/index.cfm?id=158363§ion=Opinion>; Internet.

²⁰ Ron Kotrba, "Two Steps Forward, One Step Back," *Ethanol Producer Magazine*, November 2006, available from http://www.ethanolproducer.com/article.jsp?article_id=2453; Internet.

Because the government has used taxpayer money to fund the building and operating of ethanol and biodiesel plants, they too have to artificially create demand so subsidized ethanol plants can sell their finished product. North Dakota officials have admitted this much. United States Sen. Byron Dorgan (D-ND) recently noted that with all of the ethanol and biodiesel plants being built, something needs to be done to spur demand. He even mentioned that a ten percent ethanol blend in gasoline is not nearly enough, saying that “if it’s only a ten percent blend we are going to produce more than we need and we are going to run into a problem.” North Dakota Agriculture Commissioner Roger Johnson also expressed concern about the market being over supplied with ethanol, noting that the combination of the new ethanol plants going online with ethanol imports would result in oversupply and “deal the infant industry a stunning blow.”²¹ Typically, the way capitalism works is that the demand spurs the supply, not the reverse which is the case with ethanol and biodiesel.

The federal government has currently set an ethanol mandate at 7.5 billion gallons by 2012. There are those in North Dakota who feel that North Dakota should also adopt a mandate. Roger Johnson believes that North Dakota should adopt a mandate. According to the Bismarck Tribune, there is a concept under construction that would create a ten percent ethanol mandate by 2009, “trending upward to a 25%” mandate by 2019.”²²

²¹ Dale Hildebrant, “Ethanol use needs to expand, Dorgan says,” *Farm and Ranch Guide*, accessed on March 10, 2007, available from http://www.redtrailenergyllc.com/index.php/news/ethanol_use_needs_to_expand_dorgan_says/; Internet.

²² Lauren Donovan, “Legislators focus on oil, coal, ethanol, and wind,” *Bismarck Tribune*, December 31, 2006, available from <http://www.bismarcktribune.com/articles/2006/12/31/news/topnews/126272.txt>; Internet.

Senator Joel Heitkamp (D) and Rep. Jon Nelson (R) submitted Senate Concurrent Resolution 4009 which would have amended the North Dakota Constitution to require every businesses selling gasoline to offer a ten percent ethanol blend and every business selling diesel would have to offer a two percent biodiesel blend.²³ The bill was killed in the Legislature.

Consequences of Meddling

A North Dakota ethanol industry producing over 600 million gallons of alternative energy per year sounds like a good idea, but the consequences of the government action taken to spur the industry will likely cause more economic problems than it solves.

Mandating ethanol and biodiesel has negative consequences. When consumers are forced to use something over a better alternative, it usually means the consumer will have to pay for it. In the spring of 2006 the government warned that an ethanol supply shortage would drive up the price of ethanol-based fuels, with many places possibly seeing alternative fuels rise above the cost of traditional regular unleaded gasoline. In states, such as Minnesota, consumers would still be forced to buy the fuel with ethanol, even though it is of inferior quality and more expensive.²⁴ Creating mandates in North Dakota would limit the choices consumers enjoy in the marketplace. The more choices available, the better price the consumer generally receives.

²³ Sixtieth Legislative Assembly, "Engrosses Senate Concurrent Resolution No. 4009," accessed on March 9, 2007, available from <http://www.legis.nd.gov/assembly/60-2007/bill-text/HGER0200.pdf>, Internet.

²⁴ Brett Narloch, "The problem with mandating ethanol," Taking Back North Dakota, April 12, 2006, available from <http://takingbacknd.com/?p=360>; Internet.

Because the government has chosen to support ethanol and biodiesel to the extent they have, various other industries will invariably suffer. The livestock industry is already feeling the negative impact of higher corn prices. At the end of 2006, Minnesota Extension Educator David Bau said that “how long corn prices stay at \$3 will be a determining factor of when livestock producers will return to profitability.” According to Chuck Feikema, president of the Minnesota’s Cattlemen’s Association, the industry is taking hits from two different sides. Not only are ranchers having to pay more to feed their herd, they are also getting less money for their feeders.”²⁵

The National Pork Producers Council has asked Congress to reconsider the amount at which they subsidize the ethanol industry. According to the NPPC, the input cost per pig is up to \$65, from \$35, in the last year. They attribute the rise in costs to the rapidly expanding ethanol industry.²⁶ The North Dakota Pork Producers executive director has said that hog producers in North Dakota are seeing favorable prices right now, but also said that producers are facing 100% input cost hikes in the next year.²⁷ The National Chicken Council has also stated that the input cost of feeding chickens has gone up 40%.²⁸

Those who raise cattle, chickens, and pigs generally make their money by selling their products into the food market. As a result of higher input costs, the costs of things

²⁵ Minnesota Associated Press, “Some hurt by high corn prices,” *Bismarck Tribune*, November 30, 2006, available from <http://www.bismarcktribune.com/articles/2006/11/30/news/state/124766.txt>; Internet.

²⁶ *Ohio Farmer*, “Pork Producers ask Congress to Back Off Ethanol Support,” March 9, 2007, available from <http://ohiofarmer.com/index.aspx?ascxid=fpStory&fpsid=27364&fpstid=1>; Internet.

²⁷ James MacPherson, “Potential rise in pig numbers could be tempered by corn prices,” *Bismarck Tribune*, March 7, 2007, available from <http://www.bismarcktribune.com/articles/2007/03/07/news/state/129910.txt>; Internet.

²⁸ Libby Quaid, “Crop report: Demand for corn will raise meat prices,” *Fargo Forum*, March 9, 2007, available from <http://www.in-forum.com/ap/index.cfm?page=view&id=D8NOM9AO1>; Internet.

such as beef, dairy products, chicken, eggs, and pork will rise substantially. The higher food costs will also contribute to offsetting commodity gains farmers may see. Food prices for the average non-farming consumer will also increase. Not only are poor and middle class families being forced to subsidize ethanol plants and some of their rich investors, but they also have to spend more money on food for their families.

There are 11,700 North Dakotans²⁹ who raise cattle and 420 hog producers,³⁰ while there are only 3,600 corn growers in the state.³¹ The North Dakota Department of Agriculture also states on their web site that the livestock industry has “traditionally ranked second only to wheat farming as the most important sector in North Dakota’s economy.”³² The North Dakota government is actively supporting the competition of North Dakota’s second most important economic sector. How long before the livestock industry starts demanding more government handouts to compete with the ethanol government subsidies? The cycle of government involvement would continue and the government’s tentacles would reach deeper into the economy.

The government and ethanol and biodiesel supporters are quick to point out how many jobs are created by building one ethanol or biodiesel plant. They rarely talk about the number of jobs that are being lost as a side effect. Dave Warner, spokesman for the National Pork Producers Council, said that the corn required to keep a one-hundred

²⁹ The number was confirmed with the North Dakota Stockman’s Association in an email from Wade Moser, of the ND Stockman’s Association.

³⁰ James MacPherson, “Potential rise in pig numbers could be tempered by corn prices,” *Bismarck Tribune*, March 7, 2007.

³¹ The number was confirmed by Earl Stabenow of the USDA/NASS/North Dakota Field Office. The number given is from the USDA census in 2002. Because of the growth of the ethanol industry and the higher corn prices, the number is probably higher.

³² North Dakota Agriculture Department, “Livestock,” accessed on March 10, 2007, available from <http://www.agdepartment.com/Programs/Livestock/Livestock.html>; Internet.

million gallon per year ethanol plant running creates eighty jobs, but costs the pork industry 800 on-farm jobs.³³

The United Nations is the leading world organization warning the Western world about the dangerous affects of global warming. Ethanol has failed to convince the UN that global warming is something that ethanol can cure. Achim Steiner, director of the United Nations Environment Program, said that “Nobody should take any conclusion as given,” when talking about the implication on the environment of a global expansion of ethanol production.³⁴

An artificially expanded ethanol industry will not secure our energy supply. According to the Wall Street Journal, if the US is to reach President Bush’s goal of producing 35 billion gallons of alternative fuels by 2017, at current production levels, the entire corn supply would be devoted to producing fuels. There would be no corn left for human food consumption or for livestock feed.³⁵ Of course, the acres of corn grown will increase as the price of corn stays high. That, however, will hardly fix the problem.

Donald Cooke, writing for Financial Sense, wrote that “*Best case*, it takes almost as much energy to make corn ethanol as we get from the resulting corn ethanol fuel. Deduct waste and energy consumed in the supply chain, along with a sharp decrease in fuel efficiency, and what do you get? At best, if we reach the goals set by Congress, corn

³³ James MacPherson, “Potential rise in pig numbers could be tempered by corn prices,” *Bismarck Tribune*, March 7, 2007.

³⁴ Andrea Welsh, “Ethanol May Not Easy Global Warming, UN Says,” Planet Ark, March 7, 2007, available from <http://www.planetark.com/dailynewsstory.cfm/newsid/40711/story.htm>; Internet.

³⁵ *Wall Street Journal*, “Very, Very Big Corn,” January 27, 2007, available from <http://www.opinionjournal.com/weekend/hottopic/?id=110009587>; Internet.

ethanol will make America less than 1 percent less dependent on oil as a fuel resource.”³⁶

Using every tillable acre of US farmland to plant corn for ethanol would not be the answer.

An industry headed down the wrong direction after getting government handouts that only hurts farmers at the expense of other farmers, does not necessarily aid in helping supposed global warming, and will not solve our dependency on foreign oil is hardly an investment worth making. Those wishing to invest should be able to choose. In other words, taxpayers should not be forced to invest in a loser.

A Better Approach to Increasing North Dakota’s Energy Output and Growing North Dakota’s Economy

Ethanol, biodiesel, and all other alternative energies could play a very pivotal role in the energy future of the United States and in North Dakota without the large government payouts; the governments just have to stay out of the way. As has been shown, the government is playing a large role in the production and use of ethanol and biodiesel. In fact, the government has entered itself into every facet of those industries. This ultimately ties everything back to the government, which always leaves it vulnerable to political pressures instead of markets.

The viability of the ethanol and biodiesel industries is inherently tied to the government. Ethanol and biodiesel supporters will say that it is because the industries are in their infant stages and need guiding to make them sustainable. In fact, that is exactly the message that the North Dakota Legislature has given because they limit (for now)

³⁶ Ronald Cooke, “What is the Real Cost of Corn Ethanol?” Financial Sense, February 2, 2007, available from http://www.financialsense.com/editorials/cooke/2007/0202.html#_edn7; Internet.

yearly payments and the overall amount of money each plant can receive. What those same legislators and ethanol and biodiesel supporters do not realize is that those industries never had a chance to succeed before the government started “guiding” them. It is all about politics.

Economic Nobel Prize winner Milton Friedman once wrote that “what most people really object to when they object to a free market is that it is so hard for them to shape it to their will. The market gives people what the people want instead of what other people think they ought to want.”³⁷ The combination of a public interested in propping up an inefficient industry and a Legislature willing to implement that will, could have tremendous consequences.

The argument for ethanol subsidies centers on the idea that a strong and viable ethanol industry will payback the state many times over in tax revenue. Friedman wrote that guiding an industry through its infant stages is only justified to the consumers if “they will subsequently get back at least that subsidy in some other way, through lower prices... or through some other advantages of having the industry.”³⁸

If those losses will be recouped, then was the subsidy needed in the first place? Could not the plants sustain losses in the short-term to benefit in the long-term without using the taxpayer as its bank account? When the plants recoup, if they in fact are viable, their investment and losses to “payback” the taxpayers, will the taxpayers or consumers actually benefit or will the government just spend it? After all, the company’s money

³⁷ Milton Friedman, “Friedman’s Sampler,” *Wall Street Journal*, November 18, 2006, available from <http://www.opinionjournal.com/extra/?id=110009267>; Internet.

³⁸ Milton Friedman, “The Case for Free Trade,” *Freerepublic.com*, June 15, 2004, available from <http://www.freerepublic.com/focus/f-news/1154295/posts>; Internet.

will go back to the state which will then be used to presumably finance the next cure all industry. The jobs and new money in the local economies will likely come at the expense of other industries. Or, perhaps, because of the government's involvement other more viable and profitable companies wishing to move in will be deterred.

For the consumer or taxpayer to be paid back, the subsidy must eventually end. In this case, the Legislature has shown an inability to limit the number of taxpayer dollars going to each plant. The Alchem plant has received government payments in nineteen consecutive years and the ADM plant has received payments in fourteen of the last nineteen years. New plants will receive payments for ten more years and it is not a stretch to imagine a world in which those plants that have received payments for twenty years will continue to receive payments until ethanol is no longer politically popular.

In many respects, Iowa has been leading the charge in the production of ethanol and biodiesel. Currently, the Iowa Economic Development Board is considering making some cuts in biodiesel incentives (they cut ethanol incentives a year ago). As could be predicted, renewable fuels advocates started complaining. Monte Shaw, the executive director of the Iowa Renewable Fuels Association said that Iowa's "advantage won't be what it once was if we take a step back while other states take a step forward."³⁹ At what point are ethanol and biodiesel no longer considered infants? At what point do infants grow up?

Has anyone asked where the surplus money is coming from? The very money that the state is using to subsidize the ethanol and biodiesel industries is coming from the

³⁹ Donnelle Eller, "More states want piece of biofuels: Some question why Iowa is cutting incentives for projects," *Des Moines Register*, April 8, 2007, available from <http://www.desmoinesregister.com/apps/pbcs.dll/article?AID=2007704080347>; Internet.

taxpayers. The surplus was largely created by increased oil and gas taxes. In 1996, the state's general fund received about \$24 million from oil and gas taxes production and extraction taxes; in 2006, the amount of gas and oil tax revenues hit the cap set of \$71 million. In ten years the general fund's share of oil and gas tax dollars has increased 300%.⁴⁰ The total amount of tax dollars the state has collected from the oil and gas industries has increased from \$106 million to \$422 million in ten years, which is almost a 400% increase. Not only is the state choosing to raise corn feed prices over what ranchers can afford, but the state has also decided that oil and gas money should subsidize oil and gas's direct competitors, ethanol and biodiesel.⁴¹

Why is oil held out to be the bad guy? Is it because of the jobs created by the ethanol industry? The oil patches employed 4,200 North Dakotans in 2005. According to the North Dakota Petroleum Council, "each drilling rig results in approximately 120 direct and indirect jobs," and that the industry altogether employed "approximately 12,900 people in North Dakota in 2005."⁴² The success of the oil and gas industries also comes at a time when their production is taxed at every point of process, from drilling to consumption; whereas, ethanol and biodiesel producers receive subsidies at every point.

The most economical way for North Dakota to become the leading energy producing state in the country is to let each industry succeed or fail on its own merits. It

⁴⁰ North Dakota Tax Commissioner Cory Fong, "State and Local Taxes: An Overview and Comparative Guide 2006," North Dakota Tax Department, accessed on March 13, 2007, available from <http://www.nd.gov/tax/genpubs/2006-redbook.pdf>; Internet.

⁴¹ Data collected in a telephone conversation between the author and Ron Ness, the President of the North Dakota Petroleum Council.

⁴² North Dakota Petroleum Council, "North Dakota Oil & Gas Industry: 2006 Edition," obtained from Ron Ness, President of the North Dakota Petroleum Council.

is the only way, according to Nobel Prize winner Friedman, to give the people exactly what they are looking for.

The argument is also being made that ethanol subsidies are required for the industry to compete with other industries that are being subsidized. Ethanol subsidization should not be brought up to the level of other industries; rather, the other industries should be dropped down to the level of ethanol and biodiesel. No one truly worried about the economic well-being of North Dakota and its people is picking sides in the energy battle. If ethanol and biodiesel are viable, let them succeed. If the livestock and oil industries are supposed to dominate the economy, then let them. By allowing these industries to be subjected to public scrutiny (i.e. what the public will pay for), lawmakers will get a true sense of what the people actually want and what will actually help the economy in the long-term.

Lawmakers are deciding which industries should and should not fail. Achieving Gov. Hoeven's goal of doubling North Dakota's energy production and maximizing the economic effects of that will take a major shift in the overall business climate of North Dakota.

According to the Tax Foundation, North Dakota ranks thirty-third in overall business climate. This is unacceptable. The Tax Foundation uses five broad categories to score each state: Corporate Tax Index, Individual Income Tax Index, Sales Tax Index,

Unemployment Tax Index, and Property Tax Index. Good systems of taxation will “levy low, flat rates on the broadest bases possible, and they *will treat all taxpayers the same*.”⁴³

There are simple solutions to bringing North Dakota, not only into the top half of the country, but into the top ten: eliminate the corporate income tax, personal income tax, broaden the sales tax, lower the property tax burden, cut out different licensing and registration costs, and cut the tax on gasoline.

Eliminating the corporate income tax would immediately bring a diverse number of corporations and more jobs into the state. Businesses would have their overhead greatly reduced. They would not have to hire as many attorneys or tax consultants to drudge through the complicated corporate tax system and their income would not be taxed. That saved money will be freed up to be spent on higher wages, more jobs, and lowering their products and services, which helps everyone. Businesses would also have a sense of stability, as they know what their costs will always be. Politicians will not be able to manipulate the corporate tax rates.

In 2002, then Senator Randy Schobinger (R-Minot) wrote a letter to the Fargo Forum detailing an email exchange he had with Nobel Prize winner Milton Friedman. After sending an email to him, Schobinger received an email back from Friedman which stated that “an individual state which terminates a tax on corporate income will be an attractive place for corporations to make their home. By eliminating a tax on corporate

⁴³ Chris Dubay and Chris Atkins, “State Business Tax Climate Index (Fourth Edition),” Tax Foundation, October 11, 2006, available from <http://www.taxfoundation.org/publications/show/78.html>; Internet.

income the state of North Dakota could attract an inflow of capital from the rest of the country.”⁴⁴

Reducing each North Dakotan’s individual tax burden will free up more money for them to save or to spend in the economy. By eliminating the personal income tax, North Dakotans, like businesses, will have a better sense of stability and a better sense of their buying power. They will also have more money in their pockets. That money will be spent on the goods and services that corporations offer, thus creating much more economic activity. Like the elimination of corporate income taxes, politicians will not be able to get their grubby hands on peoples’ money, and North Dakotans will be able to spend their money more freely in the marketplace.

Broadening the sales tax like South Dakota did, creates fairness in the system because more people will be affected by it, thus interested in Legislative developments. Currently, people who buy certain items are forced to pay sales taxes, while others are not. If politicians are worried about losing government revenue from income and corporate taxes, they could make it up via sales taxes by actually lowering the rate, but including more goods.

Lowering property taxes is not an issue for the Legislature. Lowering the property tax burden is a local matter. Legislators on both sides of the aisle have submitted numerous property tax relief plans, but none of them will truly bring relief. The best way to achieve true property tax relief is to hold local leaders accountable. In other words, local leaders need to hear the message from taxpayers that local budgets

⁴⁴ Senator Randy Schobinger, “Eliminate ND income tax; stimulate economic growth,” *Fargo Forum*, December 30, 2002, available from http://www.inforum.com/specials/savingnd/index2.cfm?page=editorial_inside&id=24878; Internet.

must be fit to the revenue base, not the reverse. All too often, local leaders create budgets that are so far in the red that they look to the state to help. They pass the buck. Local citizens who tell leaders to limit spending will reap the benefits of lower property taxes, thus, more economic activity and more business growth.

The benefits of lower property tax rates are very similar to the benefits realized if the income and corporate tax rates were eliminated; people will have more money in their pockets and businesses will gain a sense of stability which allows them to take more risks.

Sure ways to bring the price of gasoline down or make gasoline more affordable is to lower the state gas tax and lower other taxes. Currently, the state taxes each consumer twenty-three cents per gallon of gas they purchase.⁴⁵ Collecting less money to help businesses is a better system of taxation than by having the government take more money and redistribute it to politically popular industries.

By enacting a system of taxation that resembles South Dakota's, North Dakota will surely see an economic boom that is much diversified and prepared to compete in the domestic and foreign marketplaces. South Dakota has the second best business climate in the country and, according to the Small Business and Entrepreneurship Council, South Dakota ranks number one for small businesses.⁴⁶

An indicator that the Tax Foundation considers to be one of the most important regarding taxation is uniformity. This report has shown that North Dakota has taken

⁴⁵ Office of the State Tax Commissioner of North Dakota, "Fuels," accessed on March 21, 2007, available from <http://www.nd.gov/tax/fuel/>; Internet.

⁴⁶ CNNMoney.com, "Who Loves Small Business Best?" accessed on March 12, 2007, available from http://money.cnn.com/magazines/fsb/fsb_beststates/2006/snapshots/1.html; Internet.

sides in the energy industry. This creates an environment where businesses are competing for government handouts instead of them competing to lower prices for consumers. While, there are provisions in the ethanol and biodiesel bills that would help livestock operations some, the ethanol and biodiesel industries are greatly favored at the expense of North Dakota's second most important economic sector, livestock. This sends a clear message to current businesses and those looking to relocate that politicians are more than willing to favor one industry over the other. Businesspeople understand this and may stay away. Instead of anointing one industry as the future of North Dakota, creating an even playing field will help establish North Dakota as a great and diversified place to do business. Just because a subsidized ethanol plant does not come to a rural community does not mean that another industry cannot. A better business climate will attract many different industries.

Businesses must have a stable environment. The state believes that it can create that stability, when, in fact, it cannot. Legislators are politicians and make many decisions based on politics, not economics. Businesses may not invest their own money into ventures unless they know that the government will leave them alone. One must be skeptical of a business that operates solely to benefit from government bailouts. This will probably end up being one the downfalls of the ethanol industry.

The Legislature has managed to convey the message that the ethanol industry is stable. Large companies such as Blue Flint Ethanol and Red Trail Energy have also convinced farmers that they should invest in the "stable" ethanol and biodiesel industries. States that have the most successful businesses leave the business to the business people.

By cutting taxes and treating businesses fairly, only the most viable industries will succeed. By keeping taxes high and selecting businesses that should be successful, the Legislature has ensured only two things: taxes will keep getting higher and the “selected” business will not be successful.