

Ethanol Industry Booms Amid New Controversy

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The Washington Post (1974-Current file); Dec 8, 1985; ProQuest Historical Newspapers The Washington Post (1877 - 1992)

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FTC Investigates Charges Against Big Producer

By Michael Isikoff
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DECATUR, Ill.—It swept through the Midwest in the late 1970s—a politically irresistible idea that promised a home-grown solution to the energy crisis. Why buy Arab oil? farmers asked. The country's vast stockpiles of surplus grain could be distilled into a new domestic fuel called gasohol.

Congress and state lawmakers responded, and today the harvest of gasohol—gasoline mixed with one-tenth ethanol made from corn—is nowhere more abundant than here at the home office of Archer Daniels Midland Co., the country's leading agricultural processing company. Every morning, caravans of grain trucks rumble through the company's gates and dump off mountains of corn that are converted to an alcohol brew destined for the gas tanks of U.S. motorists.

"The farmers are absolutely agog over this program," said Dwayne Andreas, who has pioneered the industry as chairman of the company known throughout the Midwest as ADM. "There's an evangelical fervor that has driven this thing."

That fervor has also proved a boon for ADM and Andreas. In the seven years since Congress began to shower the industry with more than \$1 billion in federal subsidies and tax breaks, ADM has grabbed the lion's share of this largesse. Today, it is the Exxon of ethanol—accounting for about 60 percent of the country's production with \$425 million in alcohol fuels sales this year.

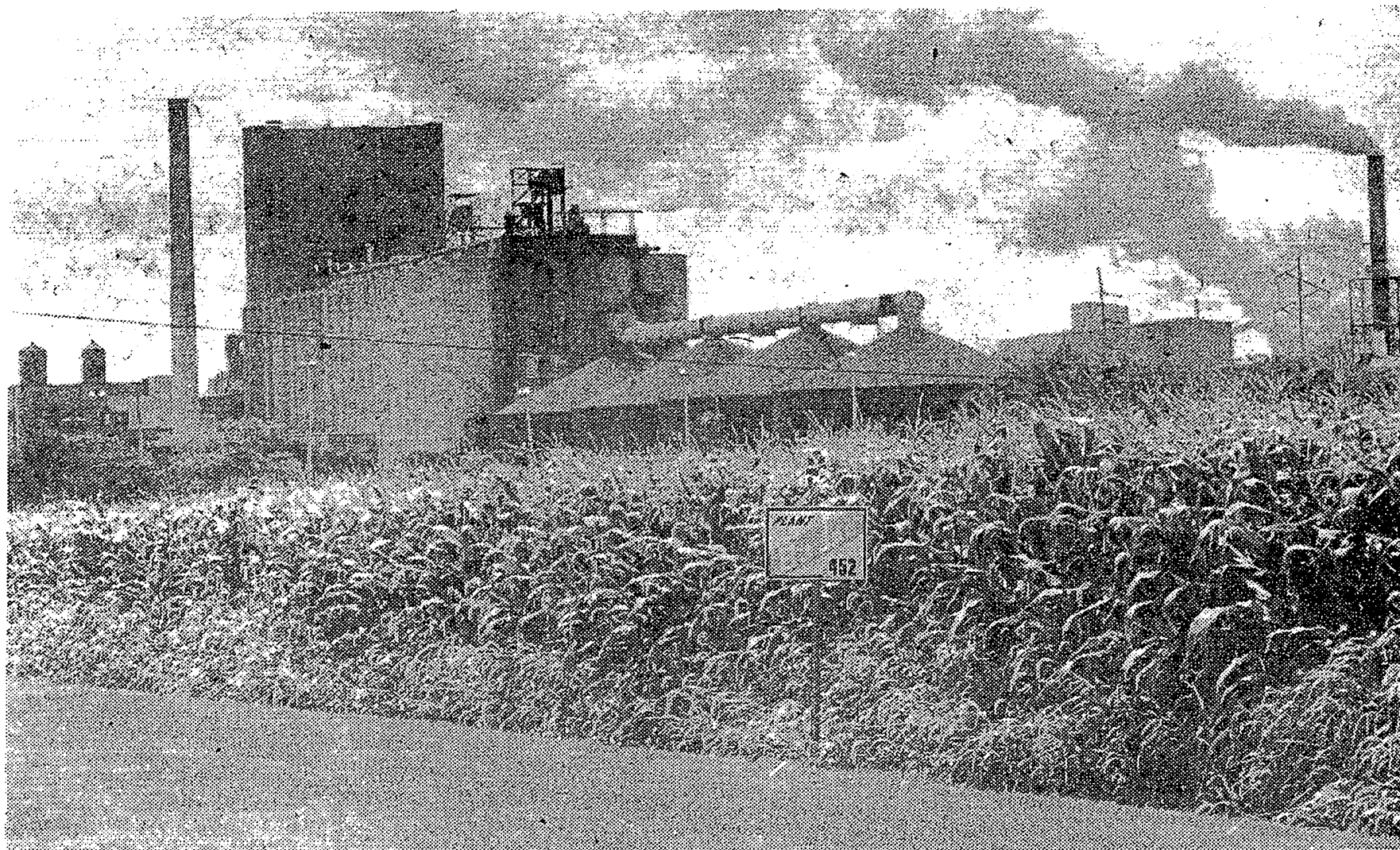
The ability of ADM to capture the heavily subsidized gasohol market is testimony to the business and political skills

of Andreas. His campaign contributions and careful cultivation of farm state lawmakers—most notably, Senate Majority Leader Sen. Robert J. Dole (R-Kan.)—has helped sustain the flame of gasohol long after the energy scare of the 1970s faded.

It has also embroiled ADM in repeated controversy. The Federal Trade Commission is investigating charges that ADM engaged in predatory pricing and other unfair trade practices to maintain its dominance of the industry. The company also has provoked an international trade dispute by trying to choke off foreign competition. Earlier this year, it joined other domestic alcohol producers—such as the A. E. Staley Co., the Pekin Energy Co. and the New Energy Co. of Indiana—in filing a complaint with the International Trade Commission accusing Brazil of dumping alcohol here for less than it costs to produce. The anti-dumping complaint was "engineered" by ADM "as a means of furthering its monopolistic position over the fuel ethanol market in the United States," lawyers for Brazil responded.

"This is probably the most expert tapping of the federal treasury than anyone can imagine," contends Jack Blum, Washington counsel to the Independent Gasoline Marketers Council, who first raised the anticompetitive charges with the FTC. "It's crazy. Here you have one company that figures out how to mine the government in order to go into business and then spends a ton of money to keep everybody else out . . . Their market control is so complete they're absolutely able to take whatever they want out of the marketplace."

ADM officials dismiss such charges as



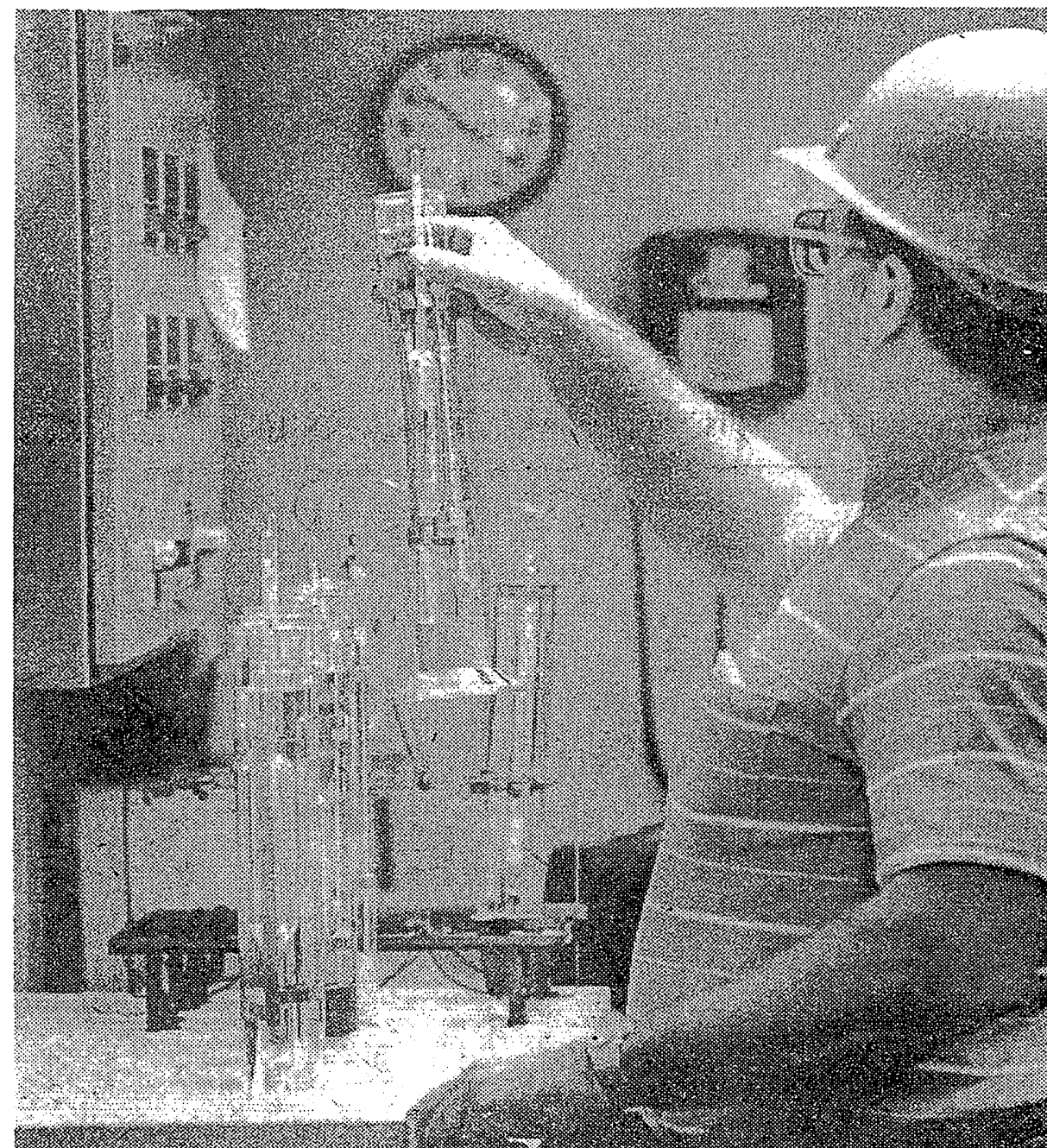
Archer Daniels Midland Co.'s alcohol and corn sweetener plant in Decatur, Ill. In the foreground is—what else?—a field of corn.

groundless and insist it is farmers—not the company—who are reaping most of the benefits from federal subsidies and protection for their industry.

According to the industry's own figures, federal and state tax breaks for gasohol cost the federal government \$420 million a year and drain off another \$280 million a year from state highway trust funds, which are financed by gasoline taxes.

But pro-gasohol groups such as the National Corn Growers Association cite studies showing that, by providing a market for an estimated 222 million bushels of corn this year, the ethanol industry has

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Ed Smith of Warrensburg, Ill., checks the proof of alcohol samples inside the plant.

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boosted the price of corn by nearly 10 cents per bushel. That has pumped an extra \$849 million into the depressed farm economy, according to a recent Purdue University study commissioned by the Indiana branch of the Corn Growers.

"There's a confluence of interests here," says Michael Hall, executive vice president of the National Corn Growers Association. "Its ADM's commercial interest and our public policy interest."

"The people who make most of the money out of ethanol is the U.S. government," insists Andreas. "It's the U.S. government that wants it and the farmer that wants it. For them, it's significant. For us, it's just a throughput."

The rapid growth of the ethanol business is an illustration of how federal subsidies can foster the emergence of a major industry. Before 1978, annual production of ethyl alcohol for fuel was estimated at no more than 10 million gallons. After Congress exempted gasohol from part of the federal fuel tax, and several midwestern states provided relief from state taxes, ADM and scores of smaller companies rushed into the business, and production soared.

Today, with a federal tax exemption of six cents a gallon and 32 states offering tax breaks averaging another four cents a gallon, ethanol production has grown to 550 million gallons. Gasohol will account for about 7 percent of the gasoline sold in the United States this year. In some midwestern states where the tax breaks and gasohol fever are particularly intense, its market share ranges between 30 and 40 percent.

In a free energy market, most energy economists agree, there would be no demand for fuel alcohol. Even with today's depressed corn prices, ethanol costs between \$1.25 to \$1.40 to produce—40 to 55 cents more than the wholesale price of gasoline.

"If you didn't have the federal and state subsidies, you wouldn't have an [alcohol] industry—period, no discussion," says Fred Potter, president of Information Resources Inc. a Washington-based alcohol fuels research group.

Federal and state highway officials complain that these tax breaks are tearing up road-building programs that have traditionally be financed by taxes on motor vehicle fuels. "You've got a bunch of free-loaders out there who are not paying their fair share," says Francis Fran-

cois, director of the American Association of State Highway and Transportation Officials. "But the problem is there are a handful of very effective lobbyists at ADM who have convinced the Congress that this is a way to help the farmer."

An agricultural processing giant with sales of \$4.7 billion this year and profits of \$163.9 million, ADM has dominated the gasohol industry from its inception, principally because it was the first and biggest company to go into the ethanol business. ADM says that after deducting start-up costs and plant depreciation, it has until now made relatively modest profits totalling less than \$40 million from ethanol over the last six fiscal years.

But that situation may be about to change, transforming ADM's \$300 million investment in ethanol into a potential gusher. The Environmental Protection Agency has decided to phase out the use of lead in gasoline to eliminate pollution by the metal. Since alcohol is considered the most environmentally sound substitute for lead as an octane booster in gasoline, ethanol demand could double by 1990, according to industry officials.

Anticipating an ethanol boom, ADM plans to increase the capacity of its four large ethanol plants from 300 million to 500 million gallons over the next two years.

"It's been a poor business until now . . . but the outlook is much better," said Andreas. "I think we could make between \$20 million and \$50 million [a year] from now on."

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According to its critics, ADM is using its market power to ensure that it captures most of the profits from gasohol's growth. One way the company does this, gasoline marketers have complained to the FTC, is by charging different prices in each state, depending on the level of state subsidies.

At ADM's ethanol terminal in Ceder Rapids, Iowa, the price of the alcohol depends on where the product will be sold. Ray Gaffney, vice president of Highway Oil, a Kansas gasohol distributor, said that if the ethanol is to be sold in Iowa, where the state fuel tax exemption is one cent a gallon, ADM charges \$1.51 cents per gallon. But if he plans to truck it to Nebraska, where the state tax break on gasohol is three cents a gallon, ADM charges \$1.64 cents per gallon for its ethanol.

"I consider this an insult, but they will not sell me the product unless I tell them where I'm taking it," said Gaffney in a recent interview.

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"They're taking advantage of a tax structure so they can take all the profit away from the marketers . . . But the problem is they've got a captive audience. They control the alcohol market almost lock, stock and barrel."

"We're in a no-win deal on that," responded Ed Harjuehausen, ADM's vice president for ethanol marketing, when asked about the firm's state-by-state pricing policy. "I know on the surface it doesn't look good . . . But that doesn't tell you the whole story. In areas where there is a higher tax incentive, the product is worth more."

"It's a question of who's going to get that extra money—is it going to be the jobber or is it going to be us?" asked Harjuehausen. "Who has the right to make that money? Who's got the biggest investment in this business?"

Another of the complaints received by the FTC—which will not discuss its investigation—is that ADM has used retaliatory pricing to "punish" competitors.

Dean Walcutt, president of Certified Oil Co. of Columbus, Ohio, said that when he tried to import two barges of Brazilian ethanol into Illinois last October, ADM immediately began dropping its ethanol prices in that state, weaning away two of his principal customers.

Walcutt said ADM also slashed its ethanol prices in Ohio by more than 10 cents a gallon over a 30-day period—a clear case, he charged, of "retaliation" by ADM. "They beat the hell out of me in Ohio," says Walcutt.

Blum, who is representing Walcutt before the FTC, says the price-

cutting binge was an example of "abuse of monopoly power" to drive out a competitor. Andreas, when asked about the incident, said ADM's price slashing was a justified response to the introduction of Brazilian ethanol into the company's market. "Whenever Brazilian ethanol comes into this country to take our business away, we cut our price," said Andreas.



Another debate revolves around ADM's attempt to limit low-cost foreign imports. Five years ago, gas-ohol producers persuaded Congress and the administration of former president Jimmy Carter to impose a stiff ethanol tariff to keep cheap imported alcohol—most of it made from sugar—from reaping the benefits of federal tax subsidies. In their recent dumping complaint, ADM and the other industry producers contended Brazil's state-owned oil company, Petrobras, is "flooding" the U.S. market with cheap ethanol.

But while complaining about the Brazilian threat—and its adverse consequences for midwestern corn growers—ADM also considered importing Brazilian ethanol on its own last fall.

Marco Marnagoni, chief of the alcohol export section of Petrobras, testified before the ITC in March that, in November 1984, ADM proposed through a broker "that it would become the exclusive distributor in the United States for Petrobras."

According to Marnagoni, a broker purporting to represent ADM proposed a three-year deal to import 150 million gallons of Brazilian ethanol the first year (an amount equal to about 30 percent of U.S. production), 200 million gallons the second year and 300 million gallons the third year. Petrobras rebuffed the overture in December, and, two months later, ADM and other domestic producers filed suit against Brazil at the ITC.