

Ethanol, Please, But Not the Cheap Stuff: Why Americans Pay Too Much for Fuel

By Joseph D'Agostino

Summary: Lobby groups representing corn growers and the U.S. ethanol industry want more subsidies for domestically produced ethanol and stiff tariffs against foreign ethanol, moves that hurt consumers, the environment, and the hungry masses of less-developed countries. U.S. lawmakers give lip service to the ideal of energy independence and urge Americans to become less dependent on foreign oil, but they listen to powerful groups that aim to keep out cheap Brazilian ethanol. Does anyone care?

A new administration, a new Congress, and a new energy policy: What will it bring? Whatever else President Barack Obama and the newly-strengthened Democratic majorities in Congress endorse under the heading of energy policy, it's unlikely to be the cheapest proven alternative to fossil fuel-based transportation. Consumption of ethanol derived from sugarcane has been rapidly growing in several countries, including Latin America's largest nation, Brazil, where it has recently displaced gasoline as the consumer's automobile fuel of choice. But don't expect to run your car on sugarcane ethanol in this country even if the government mandates more ethanol use. Instead, if you have to put ethanol in your car it will be the more expensive and inefficient kind—corn-based.

With a population of 200 million, Brazil is a major agricultural producer with a vast undeveloped interior. The nation decided decades ago to promote ethanol as a fuel. It is made in Brazil using various types of plant matter from corn to sugarcane to switchgrass. Ethanol use in Brazil reached critical mass



The Costa Pinto Production Plant located in Piracicaba, São Paulo state, Brazil. The facility produces fuel ethanol from sugarcane.

only in the past few years, after the government mandated that gasoline stations sell it and that most cars sold in the country be adapted to run on ethanol-rich "flex-fuel." Now, nine out of 10 new cars sold in Brazil can run on gasoline, ethanol, or a mixture of the two. With global oil prices extremely high for so much of last year, ethanol sales in Brazil surpassed those of gasoline for the first time. Brazil is the second-largest producer of ethanol in the world and the largest

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producer of ethanol from sugarcane. It wants to expand its production of sugarcane and ship enormous amounts overseas, including far more than it currently exports to the United States.

The U.S., the No. 1 global producer of ethanol, doesn't want Brazilian sugarcane ethanol even though it's cheaper and more efficient to use than American corn ethanol. American corn-growing conglomerates such as Archers Daniels Midland (ADM) have lobbied to maintain longstanding U.S. policies giving agricultural subsidies and tariff protection to corn ethanol. Now the American ethanol industry has become a power in its own right, and it intends to keep American tax and consumer dollars flowing its way. Last year, Congress passed a \$300 billion farm bill over President Bush's veto that contained a 45-cent tax credit for every gallon of corn ethanol that is blended into gasoline (a drop from 51 cents per gallon in a 2005 law). American taxpayers pay at least \$4.5 billion a year for the ethanol subsidy. The U.S. also discriminates against Brazilian sugarcane ethanol by slapping a 54-cent per gallon tariff on it, thereby pricing it out of the market.

During his campaign for the presidency Barack Obama spoke often about the need for alternative fuels to displace most fossil

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fuel use. But he supported retaining the tariff on Brazilian ethanol and the subsidy for American corn ethanol in last year's farm bill, stances that delighted ADM, the agricultural giant based in his home state of Illinois. (As a U.S. senator, he has allowed ADM to fly him on its corporate jets at least twice.) Obama was campaigning for president and thus absent on May 22 when the Senate voted 82-to-13 to override the Bush veto of the bill. But his strong support for corn ethanol subsidies helped him win downstate Illinois voters when he first ran for the U.S. Senate in 2004 and Iowa caucus voters when he won the first major contest of the 2008 Democratic presidential campaign. As a senator, Obama in 2005 successfully attached an amendment to that year's highway bill that gave up to \$30,000 in income tax credits to gas station owners who installed pumps for E85, a blended fuel containing 85% ethanol.

Senator Obama also promised to keep out foreign sugarcane ethanol.

"As it relates to our country's drive toward energy independence, it does not serve our national and economic security to replace imported oil with Brazilian ethanol," Obama said on the Senate floor while President Bush was negotiating an ethanol agreement with the president of Brazil in 2007. "Brazil has done an excellent job in encouraging its own biofuels industry. America should follow suit," Obama said. A journalist opined that Obama's "concerns probably portray the fears of his voters. The senator comes from Illinois, the second-largest producer of corn and ethanol in the U.S. The American version of the biofuel is obtained from corn, while Brazil uses the more cost-effective and environmentally-friendly sugarcane." (BBC, March 30, 2007)

Senator John McCain, Obama's Republican opponent during the presidential contest, voted to uphold the Bush veto of the farm bill. His opposition to ethanol subsidies was so politically toxic in Iowa that he skipped the state's Republican caucus race.

The Renewable Fuels Association

American lawmakers and policy experts who worry about U.S. dependence on foreign oil say we must find better alternatives. Last year Republicans in the House of Representatives

staged demonstrations calling for more oil and gas production at home. "Drill, baby drill" was their rallying cry as they called for an end to the moratorium on off-shore oil drilling. Texas oil man T. Boone Pickens is pushing his own plan. He wants a national commitment to replace imported oil with domestically-produced natural gas as a transportation fuel and to generate electricity from wind and solar energy—sources that are more than abundant in Texas. Meanwhile, acolytes of former Vice President Al Gore want us to take public transportation, turn down the thermostat and replace our incandescent light bulbs with compact fluorescent ones—and then turn them off.

Supporters of bio-fuels like ethanol also have lots of ideas. They say we already know how to mass-produce it: What we need now are new technologies that will better exploit our resources. For instance, instead of growing corn, what about producing bio-diesel from algae cultivated in tanks? Huh? "To have it matter as a strategic initiative versus OPEC, we would have to create a vast new kind of industry of algae farms," says Dr. Robert Zubrin, author of *Energy Victory: Winning the War on Terror by Breaking Free of Oil* (2007). "Conventional farmers have their act together now."

Zubrin would have the federal government require cars sold in the United States to be flex-fuel, as in Brazil. Under his plan, public policy would let consumers use both domestic and foreign-produced ethanol, making it price-competitive with oil.

Clearly, there are lots of wheels spinning as individuals and groups think about new ways to produce energy—and make a profit by foisting some of the heavy capital costs onto taxpayers or unwitting consumers. One of the most powerful of the new breed of special interests is the Washington, D.C.-based Renewable Fuels Association, the trade association of the domestic ethanol industry. It represents the big industry players like ADM and VeraSun Energy Corporation as well as many small Midwest producers that want to keep out foreign competition. RFA wants to encourage more use of flex-fuel made of 85% ethanol, but not if it's sugarcane ethanol made in Brazil. The association makes the absurd, self-serving claim that removing the tariff amounts to having the

U.S. support Brazilian producers. Said an RFA spokesman, "It's not about free trade, but fair trade."

RFA publications emphasize the benefits of ethanol refining plants to farmers and small towns. "We used to plant half corn and half soybeans," South Dakota farmer Dave Dietrich says in one glossy RFA report. "Now that the plant is operating, we are planting about 92% corn with almost all the harvest going to VeraSun." Dietrich adds, "We're getting 20 cents to 25 cents more for each bushel we produce. And our land values are increasing as well."

Such high praise appeals to politicians. The domestic ethanol industry cultivates the support of both Republican and Democratic politicians, especially in the Midwest but also among urban liberals. The Congressional Biofuels Caucus, which supports the industry, counts 12 senators (from Kentucky Republican Jim Bunning to Iowa Democrat Tom Harkin) and 37 representatives (from Speaker Nancy Pelosi and Michigan Democrat John Conyers to Iowa Republican Steve King) among its members.

At the same time, the ethanol industry appeals to urbanites who are infatuated with environmentalism, afraid of global warming, and eager for breakthroughs in "green" technology. "[A]gricultural wastes today—cornstalks, switchgrass, citrus waste, wood chips—are going to be the ethanol feedstocks of tomorrow," says the RFA report.

Tellingly, the Renewable Fuels Association is a member of the Chicago Climate Exchange, the voluntary cap-and-trade program for pricing trade in greenhouse gases produced by burning fossil fuels. Members of the Exchange look forward to the profitable day when the federal government enacts a mandatory cap-and-trade system. (For more on carbon-restriction profiteering, see *Foundation Watch*, October and August 2008, and *Organization Trends*, June 2008.)

The RFA is happy with President Obama's environmental appointees. "The energy and environmental challenges facing this country are formidable, but not insurmountable. We are confident that the energy and environmental team President-elect Obama

is assembling shares his vision of a diverse energy portfolio that capitalizes upon America's great ingenuity and productivity. Ethanol, today largely derived from grain, is a key component in this nation's energy transition to homegrown renewable liquid fuel sources...." it said. Of course, former Iowa governor Tom Vilsack's selection to be secretary of agriculture is a star pick. Vilsack is a biofuels booster (although he was co-chairman of a Council on Foreign Relations task force that recommended phasing out subsidies for corn ethanol and reducing tariffs on Brazilian sugar ethanol).

In commenting on the nominations of Dr. Stephen Chu, Lisa Jackson, and Carol Browner to be energy secretary, EPA head, and energy "czar," respectively, the RFA released the following statement on Dec. 11: "Judging by the reported nominations of these well-qualified individuals, we believe President-elect Obama fully intends to build upon the successes renewable energy technologies like ethanol are achieving. We look forward to working with the Obama Administration to make the renewable fuels vision the president-elect detailed during the campaign a reality."

Like the rest of the economy, the ethanol industry is now going through hard times. After riding high, ethanol prices cratered along with oil prices as the demand for fuel took a dive. VeraSun Energy, which opened a new ethanol plant in Iowa in 2007, with Senator Obama in attendance, filed for Chapter 11 bankruptcy protection at the end of October. Ironically, it attributes "a dramatic spike in corn costs" to its third quarter losses.

However, the Renewable Fuels Association is so well connected in Washington that it may receive a federal bailout this year. On Dec. 24 the Wall Street Journal reported that the Renewable Fuels Association "is seeking \$1 billion in short-term credit from the government to help plants stay in business and up to \$50 billion in loan guarantees to finance expansion. The lobby would also like Congress to ease the 10% limit on how much ethanol can be added to gasoline for conventional cars and trucks – never mind the potential damage to engines from such an unproven mix." The story notes that some state governments are considering raising

the ethanol mandate to 20%, even though General Motors warned that using such fuel would void the warranties on its cars.

After investing billions to subsidize a money-losing industry, is it likely that Washington lawmakers will let ethanol producers collapse? As the Obama administration crafts its plans for "fiscal stimulus," it's hard to believe that the former senator from Illinois won't be attentive to the needs of corn growers and ethanol refiners.

Washington's Bi-Partisan Ethanol Lobby On the Attack

The 33,000-member National Corn Growers Association and the American Coalition for Ethanol (ACE) are naturally anxious for continued Washington protection. ACE, which presents itself as the grassroots voice of the ethanol industry representing 1,500 producers, suppliers and investors, pushes for legislation requiring Americans to pay for more ethanol. It wants the government to mandate an increase in the percentage of ethanol that must be mixed into gasoline sold in the U.S., a move that would increase travel costs because American ethanol costs more than gasoline. ACE has a list of key federal policies that it keeps tabs on, including the Renewable Fuels Standard (puts more ethanol into gasoline), the Volumetric Ethanol Excise Tax Credit (gives a tax credit for gasoline-ethanol blends), the Small Ethanol Producer Credit, and the secondary offset tariff on ethanol imports (stops foreign ethanol from being competitive with domestic ethanol).

Then there is the National Commission on Energy Policy (NCEP), which uses the cover of bi-partisanship to promote federal government controls over energy planning. Its co-founders include Republican Senator Bob Dole from the corn-rich state of Kansas, and former Senate majority leader Tom Daschle, the South Dakota Democrat is President Obama's pick for secretary of health and human services. NCEP is bankrolled by the William and Flora Hewlett Foundation. (NCEP was profiled in "The National Commission on Energy Policy: 'Bipartisanship': The Cover for a Government Energy Takeover," by Max Borders, *Organization Trends*, September 2007.)

One of the commission's priorities is to give more government subsidies to fuel-growing

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American farmers at American taxpayers' expense. NCEP exploits the global warming fad, arguing that ethanol emits 25% less carbon dioxide than gasoline. (Brazilian industry groups claim sugarcane ethanol production emits only 10% of the greenhouse gases that gasoline does.) Under the Dole-Daschle plan, farmers would receive credits, paid for by American manufacturers, for reducing carbon emissions or planting crops that absorb more carbon dioxide than they emit.

Last June Dole and Daschle made explicit the linkage between taxing consumers for using oil-based gasoline and subsidizing farmers for producing corn ethanol. The mechanism is a cap-and-trade mandate. They wrote in a joint report: "Political leaders, members of the business community, and the general public increasingly expect that restrictions on emissions of greenhouse gases (GHGs) will be needed to address the problem of global warming. As Congress moves forward in the near future to draft and debate climate change legislation, American agriculture can play an important role in shaping the eventual policy outcome—and specifically, in ensuring that any future U.S. cap-and-trade program fairly credits farmers and ranchers for GHG reductions and allows them to participate in a new national market for carbon credits. The stakes are extremely high for America's agricultural producers. Done well, a national GHG emissions control policy can provide a new *multi-billion dollar per year market opportunity for farmers.*" (italics added)

Flying Down to Rio

When I visited Brazil in December, I rode around in a friend's car that takes four kinds of fuel: gasoline, ethanol, a gasoline-ethanol blend, and natural gas. In the big cities, natural gas is easy to find at filling stations, and my friend can choose whatever fuel suits him best in terms of price and performance.

Until recently, ethanol has been a great moneymaker for the Brazilian economy, and most people I spoke with expect it to return to profitability. "We're still doing well," a financier at a hedge fund told me in Rio de Janeiro. "But we are going through some very difficult times because of our dependence on the United States and Europe." Ethanol prices have declined with the global economy and Brazilian producers admit that oil must



Ethanol critic Kenneth P. Green of the American Enterprise Institute

stay above \$40 a barrel for their product to be competitive. About 30% of Brazil's automobile fleet is still gasoline-only.

Brazilians believe they need more access to First World markets to prosper. But when American politicians block Brazil's ethanol exports to the U.S., they create market distortions and create new vested interests. For example, a Brazilian ethanol producer recently signed a major deal with a company in Peru to distill its ethanol there because Peru has a free trade agreement with the United States. Obviously, routing sugarcane across the Andes is not the most cost-effective way to get ethanol to the United States, but it avoids the U.S. tariff (although American corn ethanol still enjoys a government subsidy.) The end result? The American consumer will pay more for Brazilian sugarcane ethanol than he would if it were imported directly from Brazil, while the Brazilian and Peruvian producers and Peru's government gain a vested interest in the inefficient status quo.

Jamaica already has a vested interest in keeping Brazilian ethanol tied in knots. This small island nation is a major sugarcane grower and it wants to export large

amounts of sugarcane ethanol to the United States without competition from Brazil. As Jamaica's Sunday Observer noted (Nov. 2, 2008), "Jamaica ethanol exports to the U.S. market, under the CBI [Caribbean Basin Initiative], benefit from a duty-free access, while Brazilian ethanol attracts a 54-U.S. cent-per-gallon tariff for entry. The island, as a consequence, is attractive to Brazilian energy companies that seek to reroute the fuel as the tariff restriction pushes up the price of ethanol imported directly into the U.S. from the South American country."

Even ADM is hedging its bets. It supports the tariff on imports but has begun to invest in the Brazilian sugarcane industry.

Conclusion

Even if it is seldom mentioned, protecting the U.S. corn ethanol industry and corn growers will be a priority for the Obama administration. During the campaign, Obama energy adviser Heather Zichal said as much. Bloomberg quoted (Nov. 6) Zichal saying that Obama plans to continue Bush's goal requiring that fuel producers use a minimum of 36 billion gallons of biofuels by 2022. The Obama administration will direct as much support to the domestic ethanol industry as the Bush administration provided, including tax credits aimed at increasing consumption, she said.

Zichal echoed Obama in touting renewable fuel as a source of "green jobs" and an alternative to foreign oil. "Obama recognizes how important the renewable and biofuels industry is to creating jobs and meeting our goal of reducing dependence on foreign oil," she said. "He's fully committed to it and sees tremendous value in the renewable fuels standard and continuing down this path."

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The Problem with Corn Ethanol

The unfortunate fact is corn ethanol is an inefficient fuel. A 2002 study from the U.S. Department of Agriculture found that corn ethanol yields only 1.34 units of energy for every unit of energy used to produce it. (See "The Energy Balance of Corn Ethanol: An Update," at <http://www.transportation.anl.gov/pdfs/AF/265.pdf>.) Other experts estimate that the ratio is closer to 1:1. Sugarcane ethanol, by contrast, can yield 8.3 units of energy for every unit used to produce it. (New York Times, April 10, 2006)

Another unhappy fact: Using corn for fuel converts American farmland from food production to ethanol production. About one-third of the U.S. corn crop is used to produce ethanol fuel, and that has led to an increase in corn prices that hurts people in poor countries. Experts at the UN's Food and Agriculture Organization and the World Bank have blamed spiking corn prices as a cause of last year's food crisis.

Everyone from President Obama to the Illinois Corn Growers Association calls corn ethanol a "bridge" to cellulosic ethanol, which, because it is made from switchgrass and agricultural waste, has no impact on food production. But the technology needed for large-scale cost-effective production of cellulosic ethanol does not exist. Dr. Kenneth P. Green, resident scholar at the American Enterprise Institute, says corn ethanol is a bridge to nowhere. "It is not in any way, shape, or form a sustainable fuel. The idea that it is a bridge to cellulosic ethanol is a fantasy."

Despite the eagerness of Brazil, Peru, Jamaica and other nations to provide a cheaper alternative to corn-derived ethanol that doesn't discourage domestic food production, U.S. ethanol consumers are stuck with corn for now. "There is both a tariff on Brazilian ethanol and multiple subsidies for producing American corn-based ethanol," says Green. "The net effect of them is to make Brazilian sugarcane ethanol non-competitive." Asked if sugarcane ethanol is being kept out of the country for political reasons or for sound policy reasons, Green says, "It's 90% the former and 10% the latter."

Green is no fan of ethanol. "Ethanol production is extremely hard on the environment," he says. "Ethanol production creates huge amounts of water pollution, air pollution." "You need too much switchgrass or other sources, it takes too long to ferment it and produce sugar; it's too long a process for cellulosic ethanol to be feasible," he says.

President Obama "talks more about wind and solar than he does about ethanol. But the technology is just not there. Like all renewables, ethanol will be good for certain niche markets," and nothing more, Green says.

Ethanol advocates credit Brazil's switch to sugarcane ethanol with helping to insulate the country from oil shocks. But according to a 2008 National Bureau of Economic Research study, "Oil production was responsible for three-quarters of the energy wealth created by Brazil's energy development over the last twenty-eight years." (See: http://www.aei.org/docLib/20081212_IsSugarSweeteratthePump.pdf.)

Relying on Brazilian sugarcane means America remains dependent on foreign sources of fuel. South America may seem less volatile than the Middle East but, says Green, becoming dependent on imported ethanol means other nations "still can jerk you around."

-JAD

Understanding the Nonprofit World

Capital Research Center's new *Guide to Nonprofit Advocacy* surveys more than 100 key nonprofit public interest and advocacy organizations shaping U.S. politics and society today. Although the law prohibits 501(c)(3) nonprofits from lobbying and political spending, this year nonprofits are working aggressively through 501(c)(4) and 527 affiliates and umbrella groups to pass laws and elect candidates.

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Terrence Scanlon
President

Briefly Noted

President **Barack Obama** has chosen **Gregory Craig** as his White House Counsel. Craig was President **Bill Clinton**'s legal counsel during the impeachment saga and was instrumental in having six-year-old **Elian Gonzalez** sent back to Cuba after his mother died trying to bring him to America. Meanwhile, at press time **Thomas J. Perrelli**'s nomination for the post of associate attorney general in the Obama administration remained pending. You may remember Perrelli, managing partner in the Washington, D.C. office of **Jenner & Block**, from a few years back. Perrelli represented **Michael Schiavo** in the landmark right-to-kill case that paved the way for Mr. Schiavo to terminate the inconvenient life of his wife, Terri. Pro-life groups said they plan to oppose the nomination.

Dissident **ACORN** members calling themselves the "ACORN 8" are demanding that federal authorities investigate the group for criminal wrongdoing, the Pittsburgh Tribune-Review reports. After they learned last year that the founder's brother embezzled nearly \$1 million from ACORN and that the crime was covered up by top managers for a decade, the splinter group released a report last month urging federal authorities to consider conspiracy, fraud, and embezzlement charges, along with criminal civil rights violations against ACORN. The **Catholic Campaign for Human Development** (CCHD), a charitable arm of the **U.S. Conference of Catholic Bishops**, has decided to cut off ACORN permanently "because of serious concerns about financial accountability, organizational performance and political partisanship."

Carol Browner, President Obama's choice to be the White House energy/global warming czar (really, *czarina*), is an actual card-carrying socialist. The **Socialist International**, an umbrella group for the socialist parties of the world, has removed the reference to Browner being a member of the group's "Commission for a Sustainable World Society" on its website. Browner, a former EPA administrator, supports draconian carbon emission controls aimed at halting global warming.

Penny wise, pound foolish? In a breathtaking leap of faith, the **Church of England** has decided to gamble £150 million on global warming alarmist **Al Gore**'s sketchy investment firm, **Generation Investment Management** (GIM). What makes the investment so risky is that GIM stands to make a killing only if the U.S. government cracks down on carbon dioxide emissions. We examined Gore's adventures in climate change finance in the August 2008 and August 2007 editions of *Foundation Watch*.

People for the Ethical Treatment of Animals (PETA) has launched a new campaign to rename fish. On the theory that giving fish a cuter name will save more of them from the dinner plate, the group argues the aquatic creatures should be called "sea kittens."

In a proposed regulation last year the EPA proposed regulating greenhouse gas emissions under the Clean Air Act. One of the suggestions the agency made was to levy a tax on livestock. "The tax for dairy cows could be \$175 per cow, and \$87.50 per head of beef cattle. The tax on hogs would upwards of \$20 per hog," the release said. "Any operation with more than 25 dairy cows, 50 beef cattle or 200 hogs would have to obtain permits." Analysts predict that it would raise the cost to produce a gallon of milk by about 8 cents. It would also drive up the production cost of beef and pork and these costs would be passed on to the consumer. The American Farm Bureau Federation thinks the proposal stinks.

The discriminatory "Akaka Bill," which is certain to resurface in the new Congress, would inflict serious harm on the economy of Hawaii if enacted, according to a new report from the **Grassroot Institute of Hawaii** and the **Beacon Hill Institute**. The measure would grant special race-based privileges to "Native Hawaiians" (they need only one drop of Hawaiian blood flowing in their veins to qualify) by exempting members of that group from paying state income and excise taxes. It would also create a new "tribal" government in the state that could help lay the groundwork for Hawaii's secession from the United States. We examined the bill and related issues in the May 2008 *Foundation Watch*.

Representatives of the nation's pornography industry are demanding a \$5 billion cut of the federal bailout action. "The take here is that everyone and their mother want to be bailed out from the banks to the big three," said **Owen Moogan**, spokesman for Hustler magazine publisher **Larry Flynt**. "The porn industry has been hurt by the downturn like everyone else." This bailout request is obscene.

Country singer **Merle Haggard** is suing the environmentalist group, **Green Train**, claiming it used his name and likeness without his permission to raise money. Haggard alleges the group forged his signature and exaggerated his involvement with the group to seek donations.