

We'll run out of beer before we run out of oil

Posted by Jerome a Paris on February 27, 2007 - 11:31pm in <u>The Oil Drum: Europe</u> Topic: <u>Demand/Consumption</u> Tags: <u>beer</u>, <u>biofuel</u> [list all tags]

Today's story is about beer, and about the unexpected consequences that the combined energy and global warming crises have on its price, but it also more generally about the unpredictable links we find between apparently unrelated issues as we push the limits on the exploitation of the earth's resources.

The immediate story is this:

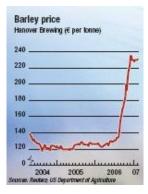
Blow for beer as biofuels clean out barley

The rapid expansion of biofuel production may be welcome news for environmentalists but for the world's beer drinkers it could be a different story.

Strong demand for biofuel feedstocks such as corn, soyabeans and rapeseed is encouraging farmers to plant these crops instead of grains like barley, driving up prices.

Jean-François van Boxmeer, chief executive of Heineken the Dutch brewer, warned last week that the expansion of the biofuel sector was beginning to cause a "structural shift" in European and US agricultural markets.

One consequence, he said, could be a long-term shift upwards in the price of beer. Barley and hops account for about 7-8 per cent of brewing costs.



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"In the US, land that was cultivated for growing barley has been given over to corn because of the ethanol demand," said Levin Flake, a grains trade analyst at the US department of agriculture.

The biofuels boom, motivated by a combination of subsidies and regulation, is already creating

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 plenty of problems while doing very little to solve the underlying issue, our gas-guzzling habits...
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Ethanol is now required as a fuel additive in the USA as a substitute to MBTE, an additive that was found to be noxious; it is also seen as a home-grown substitute for gas produced from oil, and a renewable one at that, thus helping to solve two problems in one go: dependency on Middle Eastern oil, and carbon emissions.

The problems with that approach are numerous. The first one, endlessly discussed, is that biofuels provide a pretty weak substitute for oil, as their production (at least for so-called 'first generation' biofuels such as those made from corn) still requires a lot of oil in the context of our current energy-intensive agriculture. The second, which is slowly emerging, is the ripple effects that the rapid switch to biofuels is creating in other sectors, starting with the impact on corn prices (as demand for the crop skyrockets), and continuing with similar consequences on other crops that are now being displaced by corn as farmers try to take advantage of higher prices.

What we are seeing is what appears to be increasingly desperate efforts by our industrial model to switch from one input to another as shortages appear - and propagate, and we keep on discovering new bottlenecks.

Resource scarcity is spreading, and the looming shortages implied in these skyrocketing prices suggest with increasing force that we are really going to need to start thinking about the demand side of the equation, instead of always looking for new solutions on the offer side. All our resources are at stake, and it's simply not going to be easy to reduce demand for one by finding substitutes - we're going to have to learn to do with less of *everything*, soon.

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In this context, KKR's announcement that it was purchasing TXU for a record \$44 bn (in the largest private equity deal ever) comes with an interesting twist, and a highly relevant one here:

How Green Green-Lighted the TXU Deal

It's a turn of events in a bitter feud between environmentalists and the highly profitable Texas utility giant that no one could have predicted.

Until two weeks ago, representatives from the Environmental Defense and the Natural Resources Defense Council (NRDC) thought they were in for a long, drawn out battle with TXU over its unprecedented \$10 billion plan to build 11 coal-fired plants in Texas. The plants would have more than doubled the amount of carbon dioxide the company sends into the atmosphere. Indeed, TXU's plans had turned into a national referendum on coal-generated electricity. City mayors, business and religious leaders, and the state of Oklahoma joined forces with the environmentalists to fight the project.

But instead of fighting, the environmental groups helped to broker a deal with the private equity groups, sharply reducing the number of coal-fired plants to be built in Texas. Given the fierce resistance to TXU's plans, the private equity firms had decided that they would only go ahead with their takeover bid if they had buy-in from environmentalists and could work to turn TXU into a leader on environmental issues. That led to William Reilly, a longtime conservationist-turned-private equity investor at Texas Pacific Group, to reach out to environmental groups and get them involved in working out a deal under the type of deadline more common to boardrooms than environmental meetings.

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But Reilly and his other private equity partners didn't want to go ahead without an agreement from the environmental groups to pull back their opposition and support the buyout. "Smart money knows that global warming is real and that a sophisticated approach to this is good business," says David Hawkins, one of the negotiators for the environmental groups.

What this means is another linkage in that tale - that of Wall Street big money with "greenery". One of the reasons for the skyrocketing corn and other related crop prices is the sheer amount that has poured into the sector in record time, lead by private funds and private equity firms who are seeing great opportunities to make money in fast growing sectors with a good image. They are investing massively in all sorts of new technologies, from wind to solar to various carbon sequestration or compensation mechanisms, and are helping develop the industry at record speed.

While this is obviously a good thing, and it is helping the renewable energy sector grow and be taken seriously (and it is helping the traditional energy sector shed its most polluting practices, as in the case of TXU above), it is also ensuring that other bottlenecks are being reached increasingly fast.

Fundamentally, the muscle of the financial firms in that sector is still focusing on improving the offer side of the equation. It's great, but it's not enough. We need to find smart ways to reduce our consumption of energy, or we'll end up running out of beer before we run out of fuel in our desperate quest for endlessly available energy.

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