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Further Implications of the Ethanol Tariff Issue

Posted by Robert Rapier on May 20, 2010 - 10:33am
Topic: Policy/Politics
Tags: energy policy, ethanol, ethanol subsidies, imports, protectionism, tariffs [list all tags]

In Understanding the Ethanol Tariff Issue I discussed the argument that the ethanol tariff is needed in order to prevent U.S. tax dollars from subsidizing imported ethanol. Here I discuss two other issues:

1. The argument that the tariff is warranted because Brazil subsidizes their domestic ethanol.
2. The argument that the tariff is ineffective in any case as there is a "Caribbean loophole."

In order to better understand the intricacies of the issues in involved, I have discussed various aspects with several organizations, including the Global Subsidies Initiative.

The ethanol lobbying organization Growth Energy issued the following press release in response to Brazil's decision to (temporarily) drop their ethanol tariffs:

Growth Energy Responds to Brazilian Ethanol Import Tariff Cut

> "We would not support reducing the U.S. import tariff, despite whatever Brazil is temporarily doing, because Brazilian ethanol already enjoys generous subsidies from the Brazilian government and to provide them access to additional subsidies from the U.S. government makes no sense," said Growth Energy CEO Tom Buis.

Interesting admission from them that the VEETC (the US Volumetric Ethanol Excise Tax Credit, currently at $.45/gallon) is a subsidy. Haven't they stated again and again that it isn't a subsidy, but a tax credit? Isn't that a core mantra of Growth Energy – never say "subsidy?" Further, given their argument that a tariff is justified if Brazil subsidizes their ethanol, I wonder if they would agree with that reasoning if countries apply a tariff to ethanol imports coming from the U.S.?

But this is an important issue: The possibility - as Growth Energy suggested - that Brazilian ethanol receives generous subsidies from their government. If that is the case, then I agree that this may be a legitimate reason to have a tariff on imported ethanol. So I asked Joel Valesco, Chief Representative in North America for the Brazilian Sugarcane Industry Association (UNICA) about specific subsidies Brazil provides for their ethanol production. Here is a portion of his response:

> I'd love to see Growth Energy substantiate that claim. Bottom line is that there are no generous subsidies today – they are a thing of the past that ended back in the 1980s. And if you want to study the incentives back in the 80s, you will find that they pale in comparison with U.S. biofuels support (e.g., by 2000, before ethanol was used in any scale of five years before the RFS, the Government Accountability Office (GAO) said that these subsidies had topped $11 billion.)
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> The only things that a purist would consider "subsidies" are credit lines that the Brazilian Development Bank (BNDES) provides to finance new projects and lower sales tax rates in some states. The financing is provided on a competitive basis – domestic or foreign investor – and the interest rates are close to 10% per year, far higher than any rates offered in the U.S. In other words, if high interests are subsidies, hell, we're guilty. Also, some Brazilian states (3 of 27) charge a lower VAT (Value Added Tax) on hydrous ethanol sold to Flex-Fuel cars compared to VAT imposed on gasoline at the pump. That's a savings to consumers in that state and does not apply to ethanol exports.

I certainly think this is a topic worthy of discussion. If Growth Energy is going to claim, "Brazilian ethanol already enjoys generous subsidies from the Brazilian government," then perhaps it might be helpful if they would put together a list. It may very well be that they are correct, but the remedy for that situation would not be a tariff.

An import tariff is applied broadly. If a country does not subsidize their ethanol in any form they could still be subject to the same penalty as a country that does. So the proper remedy in this situation would be a countervailing duty. There are specific rules in place under World Trade Organization rules that are there specifically to offset the impact of subsidies.

The second issue is that I have frequently heard is that Brazil bypasses the tariff anyway by routing their ethanol through the Caribbean basin, dehydrating it, and then sending it to the U.S. I once again asked Joel Velasco about this:

> Countries in the Caribbean receive preferential trade access by the United States, generally referred to as the Caribbean Basin Initiative (CBI). In a nutshell, CBI countries don't pay the tariff on ethanol that they process (i.e. dehydrate) up to a limit of 7% of U.S. ethanol consumption. For details, see page 19 of this Powerpoint by Doug Newman at the U.S. International Trade Commission (ITC).
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> As an example, Jamaica imports HYDROUS (with 5% water content) ethanol from Brazil and removes that water in Jamaica to turn it into ANHYDROUS ethanol (nearly 0% water). Then the ANHYDROUS ethanol can enter the U.S. as if it were Jamaican product under the trade preferences.
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> The problem with that is that Jamaica (not picking on them, just an example), like the rest of the Caribbean, is a net energy importer. So, to run their dehydration facility (click here for a Google Maps of one, Jamaica Broilers) they must import fuel from somewhere. Jamaica gets most of its oil from Venezuela and Mexico. That means more emissions (EPA modeled that in their Renewable Fuel Standard), but also more costs.
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> So, instead of paying 54 cents per gallon to import Brazilian ethanol, we are incentivized to pay 30 cents per gallon (that's the average cost according to most ethanol traders) to

> turn Brazilian (hydrous) ethanol into Jamaican (anhydrous) ethanol. Nuts, huh? But Sen. Grassley (R-IA) seems to think it's a good program. For background, remember when we dehydrate ethanol in Brazil, we don't use oil, but instead the cogeneration of the bagasse (byproduct) into steam and electricity -- more energy efficient, less emissions. On cogeneration benefits, read my comments to EPA's RFS and California's Air Resources Board (CARB).

Again, I am not trying to answer the question here of exactly what we are trying to accomplish with our tariff policy. This is not a discussion of who receives subsidies or whether they are warranted. It is simply an attempt to cut through the charges and countercharges on this tariff issue by various interest groups, and shed some light on the implications of the policy.