



The Ethanol Rhetoric Ramps Up

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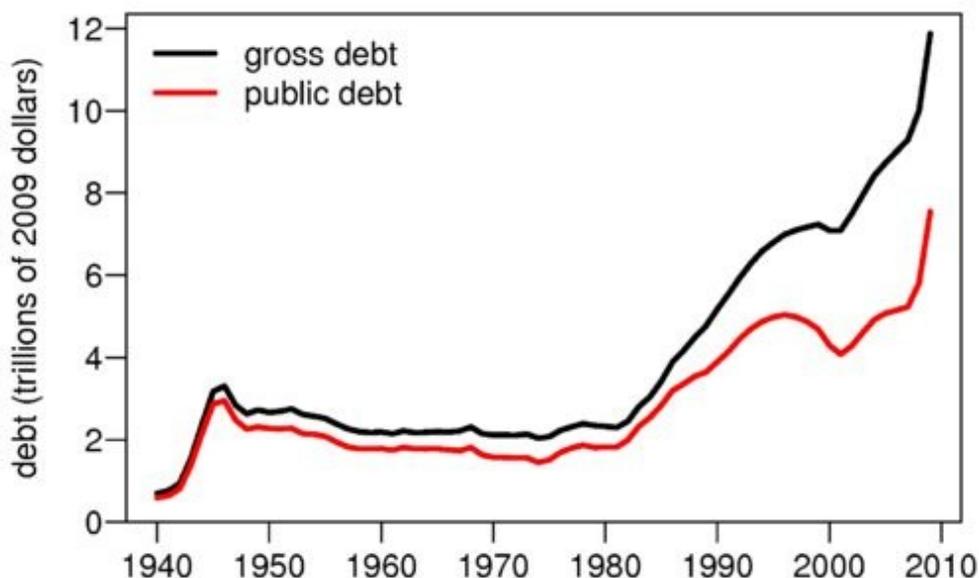
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It has been interesting to watch the flurry of ethanol rhetoric since the recent elections. With the \$0.45 per gallon subsidy (called the [VEETC](#)) and the ethanol tariffs both set to expire at the end of next month, both sides feel that there is a lot at stake, and they have really ramped up the rhetoric. One side will claim that ethanol is the greatest thing since sliced bread, then the other side claims it is an environmental disaster. Around and around the claims go. Misinformation abounds.

Mortgaging the Future

I am not going to argue in this essay that U.S. ethanol policy is good or bad, but I am going to argue that extending the VEETC is fiscally irresponsible. There are a couple of issues that influence my thinking on this: (1) I think governments need to be better stewards of taxpayer dollars; and (2) I hate waste.

Over the past decade, the U.S. has been on a spending binge, spending far more money than we have collected in tax revenues. That means that we are burdening our children with debt. I believe this is incredibly selfish and irresponsible. We are supposed to work to improve the future for our children, not sabotage it. So my view is that when we spend tax dollars, we need to have a very good reason for doing it.



U.S. debt from 1940 to 2009. Red lines indicate the Debt Held by the Public (public debt) and black lines indicate the gross debt.

The Bills Our Children Have to Pay

I also hate waste. Wasted food, energy, money, time – I loathe them all. So any time I see wasteful government spending that mortgages the futures of the next generation, I am determined to fight it.

If, however, I thought that the VEETC was actually doing something to improve the prospects for future generations, I would suggest that it was money well spent. But I don't think that's what it does at all, for reasons I will get into below.

The Redundant Subsidy

To review, here is where things stand. There are two pieces of legislation set to expire at the end of this year. One is the \$0.45 per gallon subsidy (called the [VEETC](#)) that is paid to oil companies to blend ethanol into gasoline. Because the oil companies are also mandated to blend ethanol, the subsidy is mostly redundant. That is, we are paying a subsidy for something that is already being compelled by law. As I have argued before, it is like paying people to obey speed limits. I don't know too many people who would think it is a good idea to borrow money from our children so we can give it back to their parents for obeying traffic laws. (You can find a more detailed discussion on the VEETC [here](#)).

The second piece of legislation is an ethanol tariff that is applied to ethanol entering the U.S. market. Brazilian producers want to see that tariff removed to open up the U.S. market, and U.S. producers want to see it maintained to protect their market. For a more detailed look at the issues around the tariff, see [Implications Of The U.S. Ethanol Tariff](#).

I believe that the ethanol lobby recognizes that they don't really need the VEETC with the mandate in place. After all, we had subsidies for 30 years, but the explosive growth in the industry only happened once the [Renewable Fuel Standard](#) (RFS) was passed into law in 2005. The RFS meant that it was no longer optional for the oil companies to blend ethanol; they were compelled by law to do it.

Following the passage of the RFS, ethanol use exploded, tripling in 5 years following passage of the Energy Policy Act of 2005. In fact, growth was so fast that ethanol producers produced too much ethanol. So they went back and lobbied Congress to increase the amounts that oil companies were mandated to blend. Originally scheduled to blend 7.5 billion gallons of ethanol by 2012, the new schedule increased the blend amount to over 13 billion gallons of conventional (corn) ethanol by 2012 and 15 billion gallons of corn ethanol by 2015.

The Subsidy Protects the Tariff

So if the RFS accomplished what the VEETC was intended to accomplish, why is the ethanol lobby so concerned about seeing the VEETC extended? What I think they fear is that since a cited justification for the ethanol tariff is that it prevents foreign ethanol producers from benefiting from tax credits for U.S. producers, if the tax credit goes away then so does that cited justification of the tariff. Then, corn ethanol has to compete against imports. This is something that corn ethanol producers do not want, so they lobby to keep the VEETC, which then gives them cover to argue to keep the tariff.

Shifting Strategies

It has been interesting to watch the shifting strategies of the ethanol lobby. Initially, [they distanced themselves](#) from the VEETC, saying that it really benefited the oil companies. When it became pretty clear that the oil companies couldn't care less, they started talking about jobs, foreign oil, etc. All of that was irrelevant with respect to the VEETC, because the mandates ensured that any benefits (e.g., displaced imports) would occur with or without the VEETC in place. Later there was some dissension in the ranks, when [Growth Energy suggested](#) (as I had long suggested) that perhaps the subsidy no longer serves the function it was designed for, and perhaps some thought should go into using some of that money for developing infrastructure for E85.

Lately, however, their argument [goes like this](#):

Unlike most subsidies the ethanol blenders tax credit does not go upstream to ADM or stay with the blender. IT GOES TO THE CONSUMER @ the rate of 4.5 cents in savings for every gallon of e10 they buy. It's simple, just follow the money.

One thing I wanted to comment on is that these are clearly talking points that one of the ethanol lobbying groups has sent out. How do I know? [They once sent out talking points](#) related to something I wrote, and they had the same characteristics. People suddenly start to show up parroting the same line of defense. I have now seen the above argument — in almost identical style and making the same claims — popping up in lots of places where people are critical of the ethanol subsidies. The idea is to simulate this big, grassroots movement in favor of continuing the subsidy. But the comments are so similar, it is clear that this was organized.

Subsidizing Consumption

So how about the claim, that the VEETC slightly lowers gasoline prices? Actually, I agree with it. One thing the subsidy does is subsidize the price of gasoline. So it can be argued that some or even all of the savings passes through to consumers. In fact, [ExxonMobil recently said as much to me](#):

ROBERT RAPIER: What is your position on the expiration of the VEETC at the end of the year? Do you object to that expiring? Would you be happy to see that expire? What's your view?

MR. SPELLINGS (XOM spokesman): I think we would be content for it to expire. We do not see ourselves as the beneficiary of that subsidy. **We think in the marketplace today, that subsidy probably flows through to the consumer.** We do not see how it's a subsidy that benefits us or a subsidy that benefits ethanol refiners or farmers that produce the corn, although some folks continue to think that this is a subsidy that benefits either ethanol producers or corn producers.

So let's agree that the subsidy, at a taxpayer cost next year of \$6 billion, will flow through to

consumers. Now I ask you, why on earth is it a good thing to hit all taxpayers with a \$6 billion bill (again, borrowing money from our children) only to subsidize fuel consumption for motorists? Why is it fair for a person who doesn't drive to subsidize the fuel of those who do? Or for those who are very fuel efficient to subsidize those who are not?

I believe with every fiber of my being that WE SHOULD NOT SUBSIDIZE CONSUMPTION OF A DEPLETING RESOURCE. If the subsidy lowers the price of gasoline, it encourages consumption. That is the exact opposite of what we should be doing, and therefore the worst possible reason for extending the subsidy. We are not only mortgaging the next generation's future, but the money we are using to do so will cause us to consume resources that will put them at an additional disadvantage.

The Cost of Discretionary Blending

So what about the argument that the subsidy encourages gasoline producers to blend more than they are legally required to blend? This is the essence of the argument that chief ethanol lobbyist [Bob Dinneen used recently](#) when he talked about extending the subsidies without having a debate:

Bob Dinneen: In the absence of the tax incentive discretionary blending evaporates. With more than 2 billion RINs through the RFS program that are out on the marketplace, they would quickly be bought up by refiners. So there's no question that in the absence of the tax incentive demand for ethanol will fall.

So let's take that one on. What this means is that ethanol producers have overproduced ethanol to the tune of 2 billion gallons. (Remember, the last time they overproduced, ethanol producers lobbied for and received a new RFS schedule that benefited them). It means in 2011, for instance, that gasoline producers could buy and blend 2 billion gallons less ethanol (actually it is more like 1.4 billion gallons since the mandate increases in 2011) than the mandate requires. So if removal of the subsidy caused ethanol to be more expensive per unit of energy than gasoline — almost a certainty since it is more expensive than gasoline today — then demand for ethanol would indeed fall.

So what? Is it the fault of the taxpayer that ethanol producers produced more than the legal requirement? Should we be in the business of encouraging overproduction, or protecting industries who overproduce from the consequences of doing so? Further, what is the price that we are being asked to pay? In 2011, it would amount to around \$6 billion to protect 2 billion gallons of ethanol. Really? Someone can seriously suggest that we should pay a subsidy equivalent to \$3 per gallon of ethanol (on top of the cost of the ethanol!) just to make sure ethanol demand doesn't fall? Preposterous.

Too Late for Debate?

Incidentally, what about Dinneen's argument that it is simply too late in the year to debate the issue, and therefore the default position should be to extend the credits?

Bob Dinneen: You can't have that in the week or two that you're going to have in a

lame duck session. So they can extend this tax incentive with, you know, a stroke of the pen, a little bit of Whiteout, just change the date. That's what they need to do this year and let's have a robust discussion about future biofuels tax policy and make sure we're thinking about it in terms of what's the best policy to promote cellulosic ethanol?

The problem with that is that Dinneen wasn't interested in debating that issue earlier this year either. He could have been proactive and said "Let's have that discussion." Instead, he has simply repeated the mantra all year that the tax credits should be extended. When Growth Energy tried to have that debate way back in July, Dinneen wasn't interested. [His response](#) to their proposal was:

"Now is not the time to add uncertainty and complexity to the energy tax debate," said Bob Dinneen of the Renewable Fuels Association. "Losing the tax incentive will shutter plants and cost tens of thousands of jobs."

So it should be clear that Dinneen isn't interested in having a debate. His strategy is to stall, delay, and then claim it is too late for debate. Top it off with a bit of fear-mongering on the horrible consequences of not extending the tax credits, and you have the stale, backward-looking strategy that he has used for years. I say enough. If it is too late to have a debate, then don't ask taxpayers for \$6 billion. We are broke.

In the next post, we will examine the possibility that part of the VEETC is going toward subsidizing exports.



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