WebMemo
Published by The Heritage Foundation

No. 1401
March 20, 2007

Two Cheers for the President's Brazilian Ethanol Initiative

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During his March 2007 tour of Latin America, President Bush pursued bilateral and regional strategies to enhance energy security by expanding sugar cane ethanol production and trade. Brazil and the United States agreed to develop common biofuel standards and to cooperate on research and technology transfer. The President also emphasized facilitating private investment to expand production and consumption of ethanol as the clean alternative fuel in the United States, Central and South America, and the Caribbean. This may go a long way toward stemming Venezuelan President Hugo Chavez's anti-American oil alliance on the continent. Good energy policy makes good geopolitics.

But President Bush stopped short. He refused to waive a punitive and discriminatory 54 cent tariff on the importation of ethanol into the United States. This tariff violates the principles of free trade and works against the Administration's goal of energy security for the United States. Thus, only two cheers for the U.S.–Brazil ethanol initiative.

Market Geopolitics. Promoting economically viable alternative energy sources to alleviate energy dependence is an idea whose time has come. The 9/11 attacks, systemic instability in the Middle East, and high oil prices all drive the point home. The Energy Policy Act of 2005 set out a consumption mandate of 7.5 billion gallons of renewable fuel by 2012. Rapidly increasing demand for ethanol surpassed the target of 4 billion gallons consumed in 2006. Demand also outpaced supply in 2006, necessitating imports totaling 653 million gallons, mostly from Brazil and the Caribbean.

New Goals. In his 2007 State of the Union Address, President Bush ambitiously called for a 20 percent reduction in U.S. gasoline consumption by 2017. He also called on the U.S. energy industry to consume 35 billion gallons of alternative fuels (largely ethanol) by that same year. This implies a seven-fold increase in ethanol production, which is all but impossible due to limited land availability in the U.S. and demand for corn as an animal feedstock. Thus, Brazil, the world's largest exporter of ethanol, is crucial to making up the deficit.

Less than two months after his State of the Union address, the President visited Latin America, championing an increase in biofuels cooperation between the U.S. and Brazil. In this, he was likely encouraged by his brother Jeb Bush, former governor of Florida and now co-chairman of the Intra-American Ethanol Commission. The two other co-chairmen are Luis Alberto Moreno, President of the Inter-American Development Bank (IDB), and Roberto Rodrigues, former Minister of Agriculture of Brazil.

The memorandum of understanding signed in Sao Paolo may well be the first building block of a biofuels alliance that could provide an alternative to the anti-American oil-and-gas, quasi-socialist alliance that is emerging between Venezuela, Argen-

This paper, in its entirety, can be found at:
www.heritage.org/research/energyandenvironment/wm1401.cfm

Produced by the Douglas and Sarah Allison
Center for Foreign Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

tina, Bolivia, and Ecuador. Venezuela is spreading its influence throughout the region by supporting the nationalization of energy assets and providing subsidized energy to poor countries. Chavez is also promoting the PetroCaribe initiative, which facilitates the sale of discounted oil to Caribbean nations. In order to embarrass the U.S. government, Chavez also sells subsidized heating oil to the states of Massachusetts and Maine.

By emphasizing the importance of involving Central American and Caribbean countries in the ethanol equation, the United States has an opportunity to boost new industries in these nations. Jamaica, which was the first nation to sign a bilateral agreement with Venezuela under the PetroCaribe pact, is also Brazil's leading choice as an intermediate destination for the refinement of ethanol destined for the United States.

Beyond that, increased ethanol production and trade in the Western hemisphere and beyond will send a strong signal to oil producing countries and their cartel, OPEC: Stop driving prices up by regulating production, or else your customers will buy more ethanol to satisfy their fuel needs.

Protectionism. Frustrating progress, however, are the protectionist domestic politics and trade policies of the United States. Ethanol from corn enjoys a 51 cent per gallon federal tax credit, while imported sugar cane ethanol is punished with an import duty of 54 cents per gallon and an *ad valorem* tariff of 2.5 percent. But Caribbean Basin Initiative (CBI) member states may export ethanol produced from at least 50 percent agricultural feedstock to the U.S. free of duty. If the local feedstock content is lower, limitations apply on the quantity of duty-free ethanol imports—the greater of 60 million gallons or 7 percent of the U.S. domestic ethanol market.

Brazilian sugar cane ethanol costs 25 percent less to make than its U.S. corn counterpart. Despite the tariffs, the U.S. remained the primary destination for Brazilian ethanol in 2006. This was recognized by Senator Richard Lugar (R–IN), who welcomed the new U.S.–Brazilian cooperation as a move to improve the U.S. image in Latin America and increase energy security: "All possibilities for growth in bio-fuels production must be explored to decrease our 'oil addiction.'"

Competition for ethanol is emerging quickly in the global market. As Japan prepares to mandate three percent ethanol content for its gasoline, the Japan Bank for International Cooperation announced a deal to provide Brazil's Petrobras with $8 billion to increase its production of ethanol. As a result, Japan is projected to absorb close to 90 percent of Brazil's exports.

Expanding the Ethanol Alliance. While in San Paolo, the President refused to remove the trade-distorting sugar cane ethanol tariff. Nevertheless, the National Farmers Union and Renewable Fuels Association criticized him for these first signs of ethanol cooperation. Senators Chuck Grassley (R–IA) and John Thune (R–SD) criticized the agreement with Brazil, calling for subsidized and ephemeral energy "independence" instead of realistic energy security based on cooperation with a large, stable democracy in Latin America.

Protectionism on the domestic front should not become a stumbling block on the road to energy security and regional stability—the issues President Bush was attempting to address with the new ethanol alliance with Brazil. Therefore, the Bush Administration should:

- **Eliminate the tariffs and quotas on sugar-cane ethanol before 2009.** The White House should lead the way, in cooperation with the Department of Energy, the Department of the Treasury, and the Department of Agriculture. This is crucial to convince Brazil and other countries contemplating expanding ethanol production that the United States can provide a reliable market for their ethanol exports. Market-distorting U.S. policies will only hinder the development of ethanol as a global, competitive commodity. With today's technologies, domestic producers of corn-based ethanol will be unable to meet the goals envisaged by the President in his 2007 State of the Union speech. Ethanol importation will be necessary.
- **Develop codes and standards for ethanol.** This should be accomplished by the U.S. and Brazilian ethanol manufacturers, with the American and Brazilian Departments of Energy leading implementation on the government side. Standardization of ethanol by the world's two largest producing countries will help ethanol become a

globally traded commodity, just like oil. This would further entice companies around the world to produce ethanol.

- **Expand cooperation on technology transfer between U.S. and Brazilian companies.** The U.S. possesses significant technological know-how and the financial resources that will be crucial to the expansion of ethanol production worldwide. With U.S. cooperation, other Latin American countries, including Peru and Colombia, African countries, India, and Thailand could boost their ethanol production significantly.
- **Involve Central American and the Caribbean countries in the International Biofuels Forum** to send a clear signal to these nations that there is a potential for them to play an important role in the global ethanol market.

Conclusion. President Bush deserves praise for taking an important first step to develop cooperation with Brazil on ethanol. This will benefit U.S. energy security and America's stature in the Western hemisphere, as well as send a message to the truculent leader of Venezuela. Still, there is room for improving the ethanol situation by waiving the tariffs on sugar cane ethanol from Brazil.

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