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Two Cheers for Ethanol Subsidies Expiring—But Costly Mandate Remains

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Two federal policies expired at the close of the year: the federal tax credit for blending ethanol into gasoline and a 54 cent-per-gallon tariff on imported ethanol. A diverse group of fiscal watchdogs, environmentalists, and free-trade proponents all hailed this as a major victory. While the tax credit and tariff expirations are a good start, the real burden on consumers is that producers will continue to blend ethanol into gasoline—because they are federally required to do so.

Ethanol Mandate Still in Effect. Although designed as a temporary tax credit to reduce America's dependence on foreign oil, the tax credit for blending ethanol into gasoline has merely wasted taxpayer dollars for decades (an estimated $45 billion in total and $6 billion in 2011 alone) while hardly making a dent in meeting America's energy needs. The protectionist tariff, meanwhile, has prevented developing countries from exporting cheaper, more efficiently produced ethanol to the United States.

In 2011, Congress did not extend these and other "temporary" tax policies. However, the ethanol mandate is still in place. The Energy Policy Act of 2005 contained the first-ever requirement that renewable fuels be mixed into the gasoline supply. The 2007 Energy Independence and Security Act increased the mandate substantially to 36 billion gallons by 2022. Allowing the tax credit and tariff to expire is good for taxpayers and consumers, but to truly drive innovation in the transportation fuel sector, Congress should repeal the renewable-fuel standard and all other subsidies for transportation fuels.

Mandate Artificially and Incorrectly Creates a Market. The fact that the renewable-fuel standard remains intact is largely why the biofuels industry has not been extremely vocal in pushing for the tax credit and tariff extension.[1] Matthew A. Hartwig, a spokesman for the ethanol trade group Renewable Fuels Association, told *The New York Times*, "We may be the only industry in U.S. history that voluntarily let a subsidy expire. The marketplace has evolved. The tax incentive is less necessary now than it was just two years ago. Ethanol is 10 percent of the nation's gasoline supply."[2] The mandate continues to provide a guaranteed market for their product.

That is, if the producers can actually make the ethanol—which has not been the case with cellulosic ethanol made primarily from non-food sources such as wood chips, switchgrass, or corn stover. The

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2007 Energy Independence and Security Act (EISA) mandated that 250 million gallons come from cellulosic ethanol in 2011,[3] increasing to 500 million gallons for this year. Thus far, *zero* gallons have been produced, because no companies have been able to produce commercially viable cellulosic ethanol. As a result, refiners had to pay more than $6 million in waiver credits or surcharges to comply with the Environmental Protection Agency's (EPA) minimum volume requirements.[4] Undoubtedly, refiners then pass these costs on to the consumers.

The EPA ratcheted down its goal for cellulosic biofuel production in 2012 to 8.65 million gallons—less than 2 percent of the original goal. The fact that cellulosic ethanol production is nowhere near providing industrial-scale quantities of fuel demonstrates the government's inability to determine what is commercially viable and beneficial for consumers.

Ethanol's Unintended Environmental Consequences. Politicians cause numerous unintended consequences when they interfere with the free market. In this case, ethanol production actually produced more carbon dioxide, despite its supporters' praising ethanol as a way to reduce such emissions.

Many environmental organizations have raised concerns about the increased inputs of energy, pesticides, and fertilizer needed to grow more corn for ethanol production. A recent report from Rice University notes that after accounting for land use conversion, the use of fertilizers, insecticides, and pesticides, as well as the fossil fuels used for production and distribution, biofuel production becomes quite carbon-intensive.[5] To grow corn, farmers must plow more land, and more land plowed means not only less area for trees but also the release of carbon dioxide stored in trees, plants, and soil.[6]

Removing Subsidies Will Drive Competition. Subsidies take away the incentive to innovate and lower costs. They promote business models geared more toward gaining favor with politicians than delivering a product that is competitive and valued in the market. The result is that subsidized industries quickly become dependent on government. At that point, long-term competitiveness becomes secondary to near-term survival, which is generally conditioned on more handouts. It sets a precedent for other industries to clamor for handouts as well, further distorting the market.

If biofuels or other transportation fuels are to succeed as a competitive fuel source, legislation should not be necessary to mandate their production or consumption. Rather than catering to special interest groups' demands for handouts and protection, removing subsidies would save taxpayers billions and encourage competition to provide low-cost fuel, ultimately benefiting consumers.

The cellulosic ethanol debacle is exhibit A in the case against government directing taxpayer money

1. There is also the possibility that both policies could be reinstated in a tax extenders package. In the event that some of these economically unsound tax credits do expire, it would constitute a tax increase, and Congress should reduce other taxes by the amount of revenue that eliminating those unsound policies would raise. For more detail, see Curtis Dubay, "The 2010 Tax Deal: A Chance for Congress to Lay the Groundwork for Tax Reform," Heritage Foundation *Backgrounder* No. 2569, June 13, 2011, at *http://www.heritage.org/research/reports/2011/06/the-2010-tax-deal-a-chance-for-congress-to-lay-the-groundwork-for-tax-reform*.
2. Robert Pear, "After Three Decades, Tax Credit for Ethanol Expires," *The New York Times*, January 1, 2012, at *http://www.nytimes.com/2012/01/02/business/energy-environment/after-three-decades-federal-tax-credit-for-ethanol-expires.html* (January 13, 2012).
3. Reduced to 6.6 million gallons.
4. Jenny Mandel, "Refiners protest EPA's 'ridiculous' cellulosic targets," Greenwire, June 22, 2011.
5. James A. Baker III, "Fundamentals of a Sustainable U.S. Biofuels Policy," Institute for Public Policy, Rice University, January 2010, at *http://www.bakerinstitute.org/publications/EF-pub-BioFuelsWhitePaper-010510.pdf* (January 13, 2012).
6. Joseph Fargione, Jason Hill, David Tilman, Stephen Polasky, and Peter Hawthorne, "Land Clearing and the Biofuel Carbon Debt," *Science*, Vol. 319, No. 5867, February 2008, pp. 1235–1238.

toward or creating mandates for any transportation fuel, whether it is wood chips, corn, natural gas, propane, electricity, or oil. There is an exceptionally large demand, not just in the United States but all over the world, for transportation fuels. The technologies that can produce them in a cost-effective and efficient manner will not only be very lucrative but they will also benefit consumers and the economy. Price signals and an economic system that promotes risk-taking and entrepreneurial activity will do much more for consumers than the government picking winners and losers.

Time to Repeal the Mandate. Allowing the ethanol production tax credit and 54 cent-per-gallon tariff to expire are long overdue steps to removing market distortions from the energy sector. This will save taxpayers money and allow for more competition, but there is more to be done. Congress should repeal the ethanol mandate and eliminate targeted tax credits for all transportation fuels and technologies. This will continue to drive America's energy policy in the right direction.

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