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Ethanol is a Budget Buster

Increased Mandate and Subsidies Would Raise Food Prices and Strain Federal Budget

By William Yeatman*

News story after news story highlights the impact of ethanol mandates on food prices in grocery stores across America. The story line is familiar. Ethanol is made from corn, and the new federal ethanol mandate is raising demand for corn and thereby exerting an upwards pressure on the price of corn. Costlier corn, in turn, affects the price of a wide variety of groceries. For some products, like soda[1], corn syrup is a direct input, and higher corn prices are raising production costs. Corn is also a major feedstock for cattle, hogs, and chickens, so higher corn prices are raising production costs for a wide array of products, such as milk[2], eggs[3], cheese[4], beef[5], pork, and poultry.

Higher corn prices are also encouraging many farmers to plant more acres of corn, which means fewer acres of soybeans, other grains, and even cotton[6]. Lower supplies of these commodities are already reverberating throughout the economy, with reports, for example, of higher beer prices. These impacts will intensify if Congress raises the current ethanol mandate of 7.5 billion gallons to 36 billion gallons.

The link between ethanol mandates and higher food prices has been demonstrated amply in the media. What has received scant media attention is the fact that the increased ethanol mandate proposed by President Bush, passed by the Senate, and now before the House, is a budget buster; it would cost American taxpayers almost a quarter trillion dollars or more over the next 15 years. Given that entitlement spending is set to skyrocket as baby boomers retire, the enormous costs of ethanol mandates threaten to become an unmanageable budget liability.

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Table 1 shows the estimated aggregate federal budgetary costs of a 36 billion-gallon ethanol mandate. Much of the liability—nearly $150 billion—comes from a 51 cents-per-gallon refundable tax credit. Other major budget costs include:

- $10.8 billion in future loan losses for loan guarantees for cellulosic ethanol plants;
- An estimated $17.7 billion for a strategic ethanol reserve to deal with the production shortfalls in corn and biomass caused by droughts;
- And $23.9 billion in corn and cellulosic production subsidies.

This corn subsidy is startling. Corn farmers are receiving taxpayer subsidies simply for growing corn when ethanol mandates already assure them substantial profit margins by pushing up the price of corn!

Table 1. Estimated Budget Cost by Spending Category

Spending Category	Cost (Millions of dollars)	
	2008-17	2008-22
Biofuel plant construction subsidies		
Loan guarantees	$8,300	$10,800
Grants, other	$1,000	$1,000
R&D spending on biofuels		
DOE	$4,128	$6,564
USDA	$2,364	$4,234
Strategic Ethanol Reserve	$7,579	$17,698
Extension of 51-cents-per-gallon tax credit	$70,800	$146,800
Extension of $1.00-per-gallon biodiesel tax credit	$6,700	$10,200
USDA subsidies for biomass production, storage, preparation	$870	$4,057
USDA disaster assistance, subsidies for biomass crops	$227	$1,021
USDA corn production subsidies, ethanol-related	$8,840	$14,140
USDA disaster assistance, corn/ethanol-related	$2,946	$4,711
Other federal spending for biofuels	$1,495	$2,945
State and local infrastructure grants	$1,625	$3,350
Total	**$116,874**	**$227,520**

Budget Buster. The federal budget implications of ethanol production quotas are not widely known because ethanol supporters in Congress have proven adept at hiding the total budget costs by adopting a piecemeal strategy. Instead of one omnibus ethanol bill, they have advanced ethanol-related legislation on a number of fronts. The Senate alone has acted on seven separate bills pertaining to ethanol, and the subsidies have been extended or authorized several times every few years. With all this activity, one would have expected that Congress had prepared a comprehensive budget estimate of the costs of federal support for biofuels—but ethanol backers have ensured that no such report exists.

When all the budget costs of ethanol mandates are added up, it comes out to about $200 per American household. Under pay-as-you-go (Paygo) rules, this money has to come from somewhere, and that means either reducing funds from other programs or raising taxes. Increased taxes to support ethanol production create a curious scenario whereby the American public is taxed for the privilege of paying more for its food and gasoline!

What could possibly compel Congress to go down this path? One of the main arguments advanced by ethanol proponents is the notion that domestic ethanol production will reduce America's dependence on foreign oil, and thus make us less vulnerable to the vagaries of Mideast politics. In fact, the proposed ethanol production quota—36 billion gallons—would reduce our reliance on imported oil by a mere 7 percent, while increasing natural gas imports, which are needed to produce the ethanol (Table 2). For each barrel of imported oil that ethanol mandates would displace in 2022, American taxpayers would spend $74! Truly a rotten deal.

Table 2. Federal Budget Cost per Barrel of Petroleum Import Reduction for Biofuels Mandate

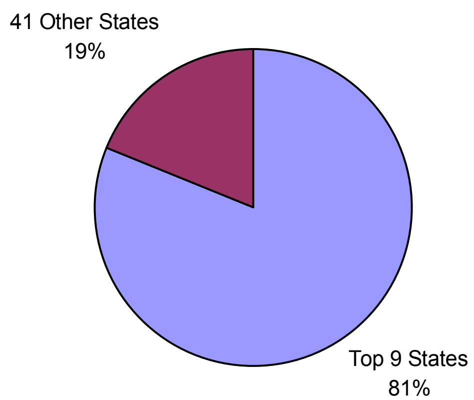
Year	Mandated quantities of ethanol per year (billions of gallons)	Petroleum equivalent (millions of barrels per year)	Percentage of U.S. imports displaced by ethanol	Estimated federal budget cost (millions per year)	**Estimated cost per barrel import reduction (price per barrel)**
2008	8.5	117.5	3.31	$7,973	**$67.83**
2009	10.5	145.2	4.06	$11,527	**$79.39**
2010	12.0	165.9	4.55	$9,909	**$59.71**
2011	12.6	174.2	4.72	$9,967	**$57.20**
2012	13.2	182.5	4.86	$10,100	**$55.33**
2013	13.8	190.8	5.00	$10,802	**$56.61**
2014	14.4	199.1	5.25	$11,036	**$55.42**
2015	15.0	207.4	5.42	$13,815	**$66.60**
2016	18.0	248.9	6.43	$15,309	**$61.50**
2017	21.0	290.4	7.42	$16,736	**$57.63**
2018	24.0	331.9	8.34	$18,277	**$55.07**
2019	27.0	373.4	9.21	$20,346	**$54.49**
2020	30.0	414.8	10.07	$22,251	**$53.64**
2021	33.0	456.3	10.85	$23,346	**$51.16**
2022	36.0	497.8	11.61	$26,426	**$53.08**

Ethanol Not "Green." Another oft-cited argument for ethanol mandates is that they are environmentally friendly, because burning ethanol instead of petroleum reduces greenhouse gas emissions that can cause global warming. This, too, is a flawed assertion. In reality the enactment of the proposed ethanol mandate would decrease America's carbon emissions by a mere 1.6 percent[7]. Surely, $226 billion of taxpayer money should do a better job of reducing greenhouse gas emissions.

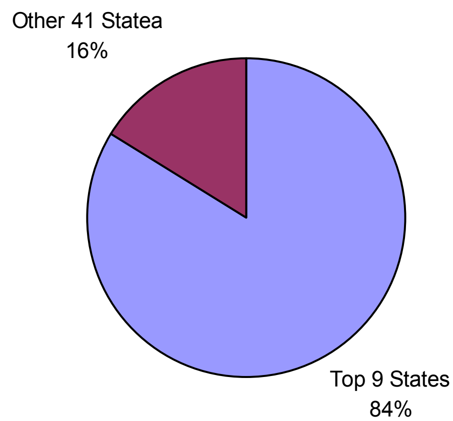
Increased production and use of ethanol could also cause a number of environmental problems. Corn is a nutrient-intensive crop, and its cultivation requires a great deal of fertilizer, which precipitation can wash into rivers, lakes, and bays. *The Washington Post* recently detailed threats to the Chesapeake Bay posed by increased ethanol mandates[8].

Conclusion. Ethanol mandates do not make America energy independent, they are not "green," and they raise the price of food for all Americans. So whom do they benefit? Almost all this federal largesse goes to nine Midwestern states that produce 81 percent and 84 percent of the nation's corn and ethanol, respectively (Graph 1). If Congress increases the ethanol mandate, American taxpayers would pay a quarter of a trillion dollars to guarantee that narrow corn and ethanol interests continue to make huge profits. While this makes for great politics in Iowa, few Americans outside the Corn Belt are thrilled at the prospect of higher taxes and food bills so that corn farmers and ethanol producers can continue to reap—guaranteed—windfall profits.

2006 Corn Production



2007 Ethanol Production Capacity



Before this insanity goes any further, senior members of Congress need to request the Congressional Budget Office to complete comprehensive estimates of the budget cost for the leading biofuel bills pending before Congress and the extent to which petroleum imports would be reduced and natural gas imports increased. Members of Congress, the press, and the American people need to know the enormous costs of ethanol mandates and their energy impacts.

Notes

[1] Michael S Rosenwald, "The Rising Tide of Corn," *Washington Post,* Business Section, June 15, 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/06/14/AR2007061402008.html.
[2] Alejandro Badipa Membo, "Ethanol Kicks Up the Price of Milk," *Detroit Free Press,* June 24, 2007, http://www.freep.com/apps/pbcs.dll/article?AID=/20070624/BUSINESS06/706240589.
[3] Rosenwald.
[4] Whitney Blake, "Ethanol demand helps fuel increasingly expensive food," *Washington Examiner*, July 19, 2007, http://www.examiner.com/a-836028~Ethanol_demand_helps_fuel_increasingly_expensive_food.html.
[5] Scott Paterson, "Costs may make weekend one to remember," *Wall Street Journal*, May 25, 2007.
[6] Victor Davis Hanson, "The impending food fight," *Washington Times,* June 30, 2007, http://www.washingtontimes.com/article/20070630/COMMENTARY/106300001/1012/commentary.
[7] The combustion of ethanol releases about 30 percent less greenhouse gases than the combustion of an equivalent amount of regular unleaded gasoline. The proposed ethanol mandates would stipulate that 20 percent of the nation's fuel supply come from ethanol. Transportation accounts for 26 percent of U.S. greenhouse gas emissions. Do the math (.2 x .26 x .3), and you get a very small emissions reduction.
[8] David A. Fahrenthold , "Green fuel may damage the bay", *Washington Post*, 17 July 2007.