



**Transatlantic Biofuels Policies:
What's in it for Developing Countries?
March 16, 2007**

**Conference Summary
Drafted by Kara Laney and Charlotte Hebebrand**

On March 16, the International Food & Agricultural Trade Policy Council (IPC) and the German Marshall Fund of the United States (GMF) hosted a luncheon discussion examining US and EU biofuel policies and the emerging role of international trade in biofuels and feedstocks on both sides of the Atlantic. The panel featured Carol Goodloe, a senior economist in USDA's Office of the Chief Economist; Andreas Kramer, Director of the German environmental NGO Ecologic; Klaus Schumacher, Head Economist of Toepfer International; Sergio Trindade, a bioenergy trade specialist; and Barbara Bramble, a senior program advisor at the National Wildlife Federation; and was moderated by IPC Chief Executive Charlotte Hebebrand. The meeting was opened by Dr. Randall Soderquist, Director of GMF's Economic Policy Program, Trade and Poverty Forum.

This event was the third in a series GMF is sponsoring on transatlantic approaches to biofuels. A capacity crowd was in attendance, with significant participation from USDA, international finance organizations, the private sector, embassy officials, and environmental non-government organizations.

Dr. Goodloe opened the event with an overview of US trade policy for biofuels. Regarding imports, there are two tariff lines for non-beverage use: undenatured ethanol has a 2.5 percent ad valorem tariff, denatured is subject to a 1.9 percent duty. An additional tariff of 54 cents per gallon applies to ethanol designated for fuel use. NAFTA partners and members of the Caribbean Basin Initiative (CBI) are not charged this additional duty. Furthermore, CBI countries can import unlimited amounts of ethanol made from local feedstocks duty-free and have a tariff rate quota (TRQ) for up to 7 percent of US ethanol consumption for ethanol made from non-local feedstocks. As none of the CBI countries make ethanol from their own feedstocks, this first exception is irrelevant. Brazil does take advantage of the TRQ, but imports are not close to the 7 percent maximum level. In fact, imports of ethanol were negligible until 2004. Since that time, with the phase out of the fuel additive MTBE, biofuel imports increased substantially, from around 150 million gallons in 2004 to over 600 million gallons in 2006. Two-thirds of the imports in 2006 came from Brazil (even at the high tariff rate); the other third was also primarily from Brazil, but came into the US under the CBI.

Regarding the fuel ethanol tariff, Dr. Goodloe highlighted that the Food and Agricultural Policy Research Institute (FAPRI) has run a model on the impact on ethanol prices if the 54-cent duty were eliminated. Under these circumstances, FAPRI estimates the world price of ethanol would increase 23 percent and the US price would fall 14 percent. US production would decrease by 8

percent while imports would increase by 193 percent, albeit from a very low starting level. Ethanol would no longer be imported through the CBI, and Brazil's production would increase 9 percent, accompanied by a 62 percent rise in its net exports.

USDA projects that any increases in corn yield will go primarily to fuel use; therefore, US exports of corn will experience some negative effect from the growth of ethanol production, but will mostly remain relatively flat.

Dr. Goodloe briefly mentioned that the US tariff for biodiesel is 4.6 percent. Its key export markets are the EU and Canada, while it imports from Malaysia, Ecuador, and Indonesia.

Andreas Kraemer is the director of Ecologic, a European think tank devoted to applied environmental research and policy analysis. He focused his comments on the EU's biofuels policies. This month, the heads of the EU member states agreed to set a binding target of 10 percent for the share of biofuels in EU transportation fuel consumption by 2020. Kraemer noted that this directive is dependent upon second generation biofuels becoming financially viable; the EU thinks that its 10 percent target cannot be met sustainably by first generation technology, even with imports.

Kraemer stated that the European biofuels debate is dominated by environmental issues. Using agricultural crops as feedstocks for biofuels is part of a larger conversation on rural development initiatives in the member states. Regarding the constant tension between national policies and supranational policies, he noted that agriculture policy is moving towards the national level while energy policy is moving toward the EU level.

The debate on biofuels is focused on three issues, according to Kraemer: 1) energy balance; 2) economic balance; and 3) environmental balance. Based on the technology available, rapeseed is the best crop in the EU as far as energy balance. He thinks the current subsidies to biofuel production will probably be subject to WTO disciplines eventually. Moreover, the European climate is not as suitable for feedstock production as that of tropical countries.

In his opinion, the tropical countries that will export biofuels will be the ones that can afford to invest in the industry. He anticipates more calls for social and environmental criteria.

Klaus Schumacher presented the European agribusiness point of view. Toepfer International is a global trading company for agricultural products based in Germany. He observed that world population growth and demand for bioenergy will cause farmers to expand their production of grains, oilseeds, and vegetable oils. As interest in bioenergy grows, Schumacher anticipates that most countries will source their bioenergy domestically; that countries that can afford to subsidize bioenergy production will export fewer crops; and that trade in bioenergy will increase. Under such circumstances, how will the need for food and oils and the demand for transportation energy both be met? More acres will have to be brought into production. Market prices will also rise, in order to create the incentive for more crop production.

Out of such a scenario emerges the strong likelihood that market volatility will increase. If more countries implement biofuel blending requirements, the demand for biofuel feedstock will

become inelastic, as the need for transportation fuel, an inelastic consumer good, is not anticipated to decrease. Therefore, the food and feed markets will have to absorb any changes in market supply, including if there is a crop failure. Because of these market uncertainties, developing countries could face higher prices for imported food.

Schumacher stressed that, with the exception of Brazil, most biofuels production today is driven by politics rather than market-driven. If this situation continues, biofuels will fail to become market-competitive and will instead be perpetually reliant on political support.

Sergio Trindade of SE²T International, Ltd., pointed out that, if biofuels are ever to amount to more than a curiosity, they must be traded internationally, just like any other energy commodity. Right now there are four ethanol futures and options contracts in operation, and no biodiesel ones that he knows of. The ethanol markets are not functioning well because of a lack of liquidity, a dearth of contracts, and too little speculation. However, as demand for both these fuels grows, he anticipates that the futures markets will emerge as well.

Trindade also noted that no biofuels program has ever developed without the assistance of subsidies and mandates. While this approach provides investor confidence, support measures must ultimately be phased out to encourage technological advancements through competition and the sooner this occurs, the sooner more efficient biofuels will reach the marketplace.

In his estimation, trade flows of biofuels will center around the two largest markets for transportation fuel, the EU and the US. Since the US is a gasoline-dominated economy, ethanol trade will flow from Brazil and other Western Hemisphere countries to the US. Biodiesel from Southeast Asia will meet European demand. Trindade spoke of the need to keep in mind the true meaning of “fuel security,” which does not equal self-sufficiency but rather a country’s ability to procure energy resources and mitigate disruptions.

Like Schumacher, Trindade noted the potential perils of food and fuel competition. Avoiding this conflict by developing cellulosic ethanol is another reason to encourage innovation.

Barbara Bramble began by stressing that the National Wildlife Federation’s goal is to see second generation biofuels developed in a sustainable manner that will help reduce greenhouse gas emissions. While biofuels are promoted as a means of addressing energy security, stabilizing commodity prices, promoting rural development, and reducing greenhouse gas emissions, it is unreasonable to think that they can achieve all these goals alone or at the same time. Therefore, biofuels must be produced under social and environmental safeguards, and expectations for their ability to address these concerns must be moderated.

Biofuels as they are produced today cause concern because of the amount of fossil energy that has to be used into order to produce them. Ethanol refineries are tremendous users of water; large amounts of water are also necessary for cultivation of feedstock. NWF is concerned about deforestation and potentially huge production shifts in agriculture, which would result in biofuels meeting less than 5 percent of the transportation fuel demanded in the United States.

Bramble drew the audience's attention to the "Sustainability Criteria for Biofuels" 2006 Bonn conference organized by the UN Foundation and the German NGO Forum. Studies highlighted at this meeting noted that if land that stores significant amounts of carbon is plowed for feedstock cultivation, the greenhouse gas impacts would be negative, even if the feedstocks are perennial crops. The Bonn conference concluded that sustainability safeguards for biofuels are essential to protect people and the environment. A certification system is needed to translate sustainability safeguards into performance measures.

A voluntary private sector initiative, the Roundtable on Sustainable Biofuels, was recently launched. This multi-stakeholder process is based in Switzerland, and it is working to create an evaluation process for use by all parties interested in biofuels. Bramble noted that several other countries as well as the state of California are working on their own sustainability criteria.

Hebebrand kicked off the discussion by referring to the mixed signals developing countries deliberating whether to establish a biofuels industry might pick up from these presentations. Ambitious mandates and insatiable appetites for energy in the EU and US, combined with the comparative advantages that some developing countries may have for biofuel feedstock cultivation (i.e. available land, good climate, cheap labor), appeared to point towards a good export opportunity. Developing countries are not in a position to subsidize their industries as much, however, and would need to rely much more on private investment, which may not be forthcoming if the significant trade barriers that are in place are not removed. Moreover, environmental sustainability criteria – whether of a voluntary or mandatory nature – will make biofuels production and certification even more expensive. And on top of that, increased biofuels production will lead to higher food import bills in net food-importing developing countries.

Several speakers expressed concern about deforestation in Indonesia. Jane Earley from the World Wildlife Fund said that it was wrong to think of developing countries as squanderers of their resources; many of them are proactively engaged in creating more sustainable agriculture. These efforts are crucial given agricultural intensification, climate change, and now the increased production of biofuels. Klaus Schumacher argued that rather than focusing on Indonesia, people should look also to Africa, where lots of land is available and palm oil used to be produced quite widely. He commented that although biofuels could help rural development in developing countries, one should not underestimate the difficulties in setting up such industries.

Ralph Ichter from Euroconsultants said that the discussion had not included reference to WTO aspects, in particular to the fact that biodiesel and ethanol are classified as an industrial and agricultural good respectively. He also expressed the hope that the US and the EU might find agreement on biofuels in the context of the WTO negotiations on Environmental Goods & Services. The moderator referred to the IPC paper on Biofuels and WTO disciplines and indicated that the other major WTO issue to explore is whether tax exemptions and mandates could potentially be classified as amber box support to corn, in which case the Canadian case on US corn subsidies would represent an even more serious challenge.

Carol Goodloe indicated that she did not think the EU and US would reach any type of agreement on biofuels as part of the Doha Round, referring to the "19th century negotiations barely able to address 20th century problems."