

**Ways and Means Committee
United States House of Representatives**

Hearing on Energy Tax Incentives Driving the Green Jobs Economy

Wednesday, April 14, 2010

Statement of the Renewable Fuels Association

Chairman Levin, Ranking Member Camp, and Members of the Committee, the Renewable Fuels Association (RFA) submits this statement for the hearing record in support of H.R. 4940, the Renewable Fuels Reinvestment Act of 2010. This legislation, which provides multi-year extensions of the Volumetric Ethanol Excise Tax Credit (VEETC), the Small Ethanol Producers Tax Credit (SEPTC), the Cellulosic Biofuel Producers Tax Credit (CBPTC) and the Secondary Tariff on Imported Ethanol, is critically important in supporting and promoting our existing biofuels industry and growing our nation's green jobs economy.

As was highlighted by the Obama Administration in the Biofuel Agenda Outline released in February of this year, its goal of a robust biofuels industry will need to be achieved by providing “[support for] the existing biofuel industry, while also accelerating the commercial and sustainable development of the advanced biofuel industry. . . .”¹ As further highlighted in the Outline, this means “continu[ing] support on development of first- and second-generation biofuels with additional strong focus on accelerating third generation . . . biofuels development”² The President's Biofuel Agenda clearly recognizes the benefits that the first generation, grain-based biofuel industry can provide to the country, its citizens and future biofuel development and advances.

The RFA strongly believes that passage of the Renewable Fuels Reinvestment Act of 2010 is necessary to provide our first and second generation ethanol producers with the continued market-based incentives that provide a sustained and robust market for biofuels. We believe the extension of these important incentives are essential to continuing our nation's drive to a clean, independent and secure energy economy.

Introduction

The RFA is the primary national trade association representing the U.S. ethanol industry. The RFA membership includes a broad cross-section of ethanol producers and suppliers, ranging

¹ *Growing America's Fuel: An Innovative Approach to Achieving the President's Biofuel Agenda*, President's Biofuel Interagency Work Group, Feb. 2, 2010.

² *Id.*

from early-stage cellulosic and advanced ethanol producers to larger scale grain ethanol producers, as well as other businesses, individuals and organizations dedicated to the expansion of the U.S. ethanol industry.

Tax incentives have played a critical role in supporting the development of our domestic renewable energy and biofuels markets, making U.S. ethanol and biodiesel the fastest growing renewable energy resources in the world today. We are pleased to provide the Committee with this statement about the ethanol industry and the U.S. energy tax policy that helps support its continued growth and expansion.

In 2009, the U.S. produced a record 10.6 billion gallons of ethanol, displacing the equivalent of 364 million barrels of crude oil valued at \$21.3 billion. Since an increasing share of our oil is imported, this displacement means that these dollars were spent and invested in the U.S. and not sent abroad to foreign suppliers. Ethanol today is the single most important value-added market for farmers, and is revitalizing rural communities across the country.

Finally, as ethanol is produced from agricultural feedstocks taking carbon out of the atmosphere, it is the only real strategy to address climate change in place today, actually lowering greenhouse gas emissions from the transportation sector by 16.5 million metric tons in 2009.³ When consistent analytical boundaries are applied, there is no question that grain-based ethanol reduces greenhouse gas (GHG) emissions significantly compared to gasoline. Government agencies and academia have been studying corn ethanol's lifecycle GHG emissions, or "carbon footprint," for the last 20 years. During that time, a variety of analytical tools have been developed and much empirical data has been collected to assist researchers in estimating the direct GHG benefits of ethanol relative to gasoline. In the last five years alone, dozens of papers quantifying the direct GHG impacts of ethanol have been published in academic journals and regulatory literature. A review of recent estimates clearly shows that there is broad agreement that corn ethanol reduces GHG emissions by 30-50%, on average, compared to gasoline. (See Graph attached hereto as Exhibit A). The newest facilities employing the most efficient technologies have been shown to reduce GHGs by as much as 60% relative to gasoline.

The single most important federal policy driving these impressive results is the tax incentives available to refiners that choose to blend biofuels into gasoline and diesel fuel today.⁴

Background

Ethanol has become an essential component of the U.S. motor fuel market. Today, ethanol is blended into more than 90 percent of the nation's fuel, and is sold virtually from coast to coast and border to border. The industry boasts over 200 plants in 26 states with annual production capacity of 13.1 billion gallons. As a result of the recent recession, however, 12 plants representing 1.2 billion gallons of capacity are currently idled. But, another 11 plants representing 806 million gallons of new capacity are under construction, while another 626

³ Source: *GREET 1.8 Model*.

⁴ The Volumetric Ethanol Excise Tax Credit (VEETC) provides gasoline blenders/refiners with a federal tax refund of 45 cents per gallon of ethanol on each gallon of ethanol blended with gasoline, providing an important incentive to blend ethanol with their gasoline.

million gallons of capacity is being added through plant expansion. When these projects are complete, the industry will have the capacity to produce more than 14 billion gallons of renewable ethanol. Last year, the total ethanol produced in the U.S. increased by 14.7 percent over 2008. This growth in production and operating capacity was fueled by the completion, start-up, and operation of new plants and the ongoing expansion of existing plants, all of which was achieved with the help of VEETC and other existing tax incentives for biofuel.

The U.S. ethanol industry continues to have a positive impact on our nation's economy. U.S. ethanol producers have long been on the cutting edge of the green economy. According to a report prepared for the RFA⁵, spending by the U.S. ethanol industry in 2009:

- Contributed \$53.3 billion to the nation's Gross Domestic Product (GDP);
- Supported nearly 400,000 jobs in all sectors of the economy; and,
- Generated an estimated \$8.4 billion in tax revenue for the federal government and nearly \$7.5 billion of additional tax revenue for state and local governments.

Economic theory suggests that a new national industry should be able to gain a significant market share within the domestic market before tax incentives are phased out or abolished. Thus, RFA supports legislation such as H.R. 4940, the Renewable Fuels Reinvestment Act, which calls for a 5 year extension of VEETC, the Small Ethanol Producer Tax Credit and the Secondary Tariff on Imported Ethanol, and a 3 year extension of the Cellulosic Biofuel Producer Tax Credit. Consistency in Federal policies will send the necessary and appropriate signals to the marketplace. Maintaining and extending the existing tax incentives for ethanol are essential for continued growth of the industry.

Tax Incentives

Volumetric Ethanol Excise Tax Credit

The most significant tax incentive encouraging the expanded use of ethanol is the VEETC. The VEETC provides blenders and marketers of gasoline with a federal tax credit of 45 cents on each gallon of ethanol blended with gasoline. Thereby, VEETC enhances the cost competitiveness of ethanol with gasoline and provides gasoline marketers and blenders an important incentive to blend ethanol with their gasoline.

The VEETC protects ethanol producers from declines in oil and gasoline prices over which they have no control. Since ethanol is sold as an additive to motor gasoline, its price has traditionally been determined more by oil and gasoline than by ethanol supply, though current supplies relative to the artificial limitation on ethanol demand (the E10 blend wall) is undoubtedly weighing on the marketplace. An analysis of ethanol prices over the 1990 to 2009 period indicates that the wholesale market price of ethanol increases 6.3 percent for every 10 percent increase in spot market gasoline prices, but declines only 1.5 percent for every 10 percent

⁵ *Contribution of the Ethanol Industry to the Economy of the United States*, Dr. John Urbanchuk, Director, LECG, LLC. Prepared for the RFA. February 12, 2010.

increase in ethanol production. Consequently ethanol producers are price takers with their revenue determined largely by developments in the oil and gasoline markets.

The VEETC is a tax credit claimed by the refiners and marketers that buy ethanol for blending with gasoline. As such, the credit supports demand by reducing the effective cost of ethanol to the purchaser, allowing him to purchase ethanol at an effective price below that charged by the producer. As a consequence, VEETC helps to reduce prices at the pump for the consumer. Today, because ethanol sells for \$0.70 to \$0.80 less than gasoline before the VEETC is taken into account. If the full value of the VEETC is passed through to the consumer, a gallon of gasoline blended with ethanol is 12 cents cheaper than conventional gasoline. These consumer savings are even greater in higher ethanol blends such as E15, and E85. Allowing VEETC to expire then, would increase consumer gasoline costs and slow the economic recovery.

Finally, it is important to note that VEETC is an exceptionally cost-effective investment in our energy future. According to an RFA report, with the increase in tax revenue, the cost of the VEETC is more than offset. In 2009, the \$8.4 billion in increased federal tax revenue attributable to the ethanol industry is in itself \$3.4 billion more than the estimated cost of the VEETC, assuming the 10.6 billion gallons of ethanol produced were blended. Factoring in the additional \$7.5 billion in tax revenue for state and local governments and the \$21.3 saved in foreign oil payments, each federal tax dollar invested in ethanol incentives returned more than \$7 to government and the economy at large.

Small Ethanol Producer Tax Credit

In addition to the VEETC, current law provides small ethanol producers with a tax credit to help them grow, expand and invest in greater efficiencies and technological advances. This credit, the Small Ethanol Producers Tax Credit (SEPTC), provides ethanol producers with capacity of no more than 60 million gallons can claim a credit against the producer's income tax liability of 10 cents per gallon of ethanol on the first 15 million gallons of ethanol produced in a tax year. The SEPTC, which also expires on December 31, 2010, can provide as much as \$1.5 million in tax benefit to help small, farmer-cooperative ethanol producers survive and flourish in a competitive market.

Cellulosic Biofuel Producer Tax Credit

Also, to facilitate the growth of second generation biofuels that expand the basket of available feedstocks for biofuel production, such as perennial grasses, crop residues, forestry products, and waste, a production tax credit of up to \$1.01 per gallon is available to reduce the income tax liability of producers of cellulosic biofuel. This credit, the Cellulosic Biofuel Producers Tax Credit (CBPTC), provides an important incentive for investment in the start-up, development and growth of the cellulosic biofuel industry. Given the high costs currently associated with production of cellulosic biofuel, and the need for further investment in the commercialization of existing pilot production facilities, the CBPTC is critical to reducing the risk associated with these investments.

Secondary Tariff on Imported Ethanol

Because the VEETC does not discriminate as to the nation or origin of the ethanol blenders' use, it allows foreign ethanol producers the benefit of the incentive. This means that without an offset for the incentive, U.S. taxpayer dollars will be directed to foreign ethanol industries. However, to prevent this from occurring, Congress established a Secondary Tariff on Imported Ethanol. Today, the Secondary Tariff provides a credit offset of 54 cents per gallon when the foreign ethanol is imported into the United States. The balancing act between the VEETC and the secondary tariff has proved effective and must be continued to ensure America is not subsidizing foreign ethanol production.

While some have criticized the secondary tariff, claiming that it is a barrier to trade, this is simply not true. Despite this tariff, direct imports of foreign ethanol from countries like Brazil have continued to persist and grow over time. Prior to 2006, U.S. imports of ethanol, annually, from all countries hovered around 200 million gallons. Then, in 2008, ethanol imports from all countries jumped to 578 million as record high oil prices and high domestic ethanol prices made imports attractive, even with the tariff. Imports landed, paid the offsetting secondary tariff, received the tax incentive, and competed quite effectively. As a consequence of lower ethanol prices and high world sugar prices, imports fell in 2009, totaling only 300 million gallons in 2009.

The fact that the tariff is not a barrier to trade can also be seen through the evidence from importation data under the Caribbean Basin Initiative (CBI). Under the CBI Program, CBI countries may export ethanol to the U.S. duty free provided that the ethanol is produced from a local feedstock or value is added via processing. While the CBI exemption is limited to 7 percent of U.S. consumption, it is important to note that imports have never come close to meeting the 7 percent limit, except in 2008, where it rose to 6.1 percent of consumption.

Job Creation and Economic Growth

The ethanol industry is an integral part of a manufacturing sector that makes a significant contribution to the American economy and adds substantial value to agricultural commodities produced by American farmers. Expenditures by the ethanol industry for feedstocks and other raw materials, other goods and services represent the purchase of output of other industries. The spending for these purchases circulate through the local and national economy generating additional value-added output, jobs in all sectors of the economy, household income, and tax revenue for government at all levels.

Today, the U.S. ethanol industry supports nearly 400,000 jobs in all sectors of the economy. These jobs were created in connection with increased economic activity from ongoing production and distribution, construction of new capacity and research and development. These jobs include direct employment by producers, but also employment from industries that are indirectly or peripherally involved in ethanol production.

As detailed in a recent study,⁶ removal of the VEETC is likely to result in a reduction of as much as 37.7 percent in U.S. ethanol production. As detailed in the study, removing the 45 cents per gallon VEETC would reduce the price to producers by 27.4 percent. While this reduction would increase ethanol demand by nearly 12 percent, the lower price would induce producers to cut supply by nearly 38 percent. Moreover, the failure to extend the VEETC would significantly increase the possibility the currently idled capacity would not be brought back on line, thereby resulting in additional loss for the economy.

Using current production volumes of 10.6 billion gallons for 2009, this would represent a loss of exactly 4 billion gallons or the equivalent of the annual production from more than 60 average sized ethanol plants. This means that the ethanol industry would spend \$6.6 billion less on purchases of raw materials, and goods and services associated with those missing gallons.

According to the study, using value added output, earnings and employment figures provided by the U.S. Bureau of Economic Analysis, the loss to the economy of a 4 billion gallon reduction in ethanol production will have the result of:

- Reducing aggregate GDP by \$16.9 billion (2009 dollars);
- Eliminating 112,000 jobs in all sectors of the economy;
- Reducing household income by \$2.4 billion; and
- Cutting State and local tax revenue by \$2.7 billion and Federal tax revenue by \$2.4 billion

New Technologies

The ethanol industry today is on the cutting edge of technology, pursuing new processes, new energy sources and new feedstocks that will make tomorrow's ethanol industry unrecognizable from today's. Ethanol companies are already utilizing cold starch fermentation, corn fractionation, and corn oil extraction. Companies are pursuing more sustainable energy sources, including biomass gasification and methane digesters. There is not an ethanol company represented by the RFA that does not have a cellulose-to-ethanol research program. These cutting edge technologies are reducing energy consumption and production costs, increasing biorefinery efficiency, improving the protein content of feed co-products, utilizing new feedstocks such as cellulose, and reducing emissions by employing best available control technologies.

The technology exists to process ethanol from cellulose feedstocks; however, the commercialization of cellulose ethanol remains a question of economics. The capital investment necessary to build cellulose facilities remain about five times that of grain-based facilities. Those costs will, of course, come down once the first handful of cellulose facilities are built, the

⁶ *Importance of the VEETC to the U.S. Economy and the Ethanol Industry*, Dr. John Urbanchuk, Technical Director, ENTRIX. Prepared for the RFA. February 10, 2010.

bugs in those “first mover” facilities are worked out, and the technology continues to advance. The enzymes involved in the cellulose ethanol process remain a significant cost, as well. While there has been a tremendous amount of progress over the past few years to bring the cost of those enzymes down, it is still a significant cost relative to processing grain-based ethanol. To continue this technological revolution, however, continued government support will be critically important.

The Renewable Fuels Reinvestment Act of 2010 recognizes the importance of providing continued support for cellulosic and other future biofuel technologies. By providing a 3 year extension of the CBPTC, which does not expire until 2012, this legislation provides for a long term approach to promoting new technologies and new fuels. Given the recent credit crisis and the economic downturn, many existing cellulosic producers have faced difficulties in making the transition from pilot project to commercial scale producer. By extending the CBPTC to 2015, it provides a risk reducer for investors and lenders to help producers make the necessary capital investments and expansion of their facilities. It also gives assurances to the investment community that government support for the industry will be sustained over a long period of time.

The VEETC also helps to reduce the risk associated with investment in new technology, such as cellulosic biofuels. Typically, the financial community will invest in higher risk, non-traditional activities only with the assurance that their revenues will not be threatened by foreign or domestic competition. Continued existence of the VEETC is an effective risk reducing instrument for investors and the financial community who are key to further expansion of the U.S. ethanol industry, particularly the use of cellulosic feedstocks for ethanol production.

Energy Security

One of the core objectives of the federal ethanol program is the need for energy security and energy independence. While our nation benefits environmentally from the production and use of clean, biobased fuels, the promotion of home grown, carbon free alternatives to oil is essential to wean our nation from foreign imported oil and thereby make our country more energy secure. Today, the U.S. consumes approximately 7 billion barrels of crude oil every year, with almost 70 percent of that oil coming from the global market, including from hostile Middle East nations. And, ethanol is currently the only clean fuel alternative that is reducing demand on petroleum based imports.

While the Renewable Fuel Standard (RFS), which mandates that refiners blend ethanol into the fuel stock, incentivizes its use by making it available to consumers, the VEETC ensures that the volumes mandated under the RFS are met with domestically produced ethanol. Under the RFS there is no requirement that RFS’ mandated volumes are satisfied with domestic ethanol supply. This means that, without sufficient domestic supply, the U.S. would have to import ethanol to satisfy RFS volumes, and thereby, continue to trade high trade deficits or large transfers of wealth for energy, by simply substituting one trading partner for another.

As explained above, the VEETC’s market-based, tax incentive structure assures that U.S. ethanol remains cost competitive for sustained periods despite wide and frequent price fluctuations in global petroleum prices. By providing a 45 cent credit on each gallon blended, the tax credit

provides a safety net to ethanol producers and blenders against wide fluctuations in oil prices and thereby assures ethanol producers and investors that their product will remain cost competitive over sustained periods of time. This way, VEETC works with the RFS to provide a demand floor for renewable fuels. The VEETC helps encourage discretionary blending above and beyond RFS levels in times of high crude oil and gasoline prices, which in turn helps hold down the price of gasoline at the pump.

If VEETC is allowed to expire in 2010, the absence of VEETC would greatly reduce U.S. ethanol market prices and deteriorate industry profitability. And, as a result, domestic ethanol production would have to be significantly reduced in the short term. Moreover, without the VEETC's market based benefits, investment in the ethanol industry would be curtailed in response to an increase in perceived investment risks, thereby impacting the long term profitability of the industry.

By encouraging and incentivizing production of ethanol in the United States, the VEETC ensures that the RFS volume requirements will be filled overwhelmingly with homegrown supply. Absent a market based incentive, it is highly likely that imports would be used to satisfy the RFS' growing biofuel volume expectations.

Conclusion

Mr. Chairman, existing U.S. tax policies have made a difference, and can continue to drive investment in domestic renewable fuels such as ethanol. The VEETC, in particular, has played an integral role in supporting investment and development in ethanol production facilities and the significant growth of the industry. The continued existence of U.S. renewable energy tax policy will be critical to the rapid deployment and commercialization of new technologies for biofuels. The RFA looks forward to working with the Committee during the 111th Congress to ensure the U.S. ethanol industry continues to grow.

Thank you.

Exhibit A

There is Broad Agreement that Corn Ethanol Reduces GHGs 30-50% Compared to Gasoline

