Importance of the Ethanol Tax Incentive in Driving the Growth of Biofuels

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U.S. Ethanol Program has Three Objectives

- Energy security
- Domestic economic development
- Environmental quality

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Major Program Components

- Tax Incentives
  - Volumetric Ethanol Excise Tax Credit (VEETC)
  - Small Ethanol Producer Tax Credit (SEPTC)
  - Cellulosic Biofuel Producer Tax Credit (CBPTC)
- Offsetting tariff on Imported Ethanol
- Renewable Fuel Standard
- Environmental Incentives
- *Each component works together to help achieve one or more program objective*

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VEETC and Ethanol Blends Save Consumers Money!

Assumptions	Jan 2010
Conv Reg Gasoline, Rack (cpg)	207.1
RBOB, NYH (cpg)	203.3
Ethanol, IA Spot (cpg)	181.6
Ethanol transportation to NYH (cpg)	10.0
VEETC (cpg)	45.0
Net Ethanol Price (cpg)	136.6
Motor Gas Prime Supplier Sales (MGD)	335.2

	Conventional Regular Gas (cts/gal)	E-10 (cts/gal)	E-15 (cts/gal)
Rack	207.1	197.6	194.8
Wholesale Margin	5.2	5.2	5.2
DTW	212.3	202.8	200.0
Retail Margin	7.6	7.6	7.6
Retail Price (less tax)	219.9	210.4	207.6
Average State Tax	29.3	29.3	29.3
Federal Tax	18.4	18.4	18.4
Retail Pump Price	**267.6**	**258.1**	**255.3**
Savings		9.5	12.3
Percent		3.5%	4.6%
Annualized Consumer Savings (Mil $)		**$11,585**	**$15,053**

Source: EIA/USDA

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The Ethanol Program has Critics

- Critics argue that an excise tax credit for ethanol is unnecessary when a mandate requiring refiners to blend ethanol already exists.

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RFS versus VEETC

RFS

- Requires volume of ethanol blended to increase from 10.9 bg in 2009 to 31 bg by 2022
- Ethanol from corn starch capped at 15 bil gal in 2015
- Future growth from cellulose

VEETC

- 45 cpg tax credit claimed by the refiner/blender
- Enhances cost competitiveness of ethanol with gasoline
- Provides economic incentive to blend ethanol with gasoline
- Expires Dec 31, 2010

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Programs are Interdependent and Complementary

- RFS mandates the use of ethanol, *not the production*
- VEETC's market-based structure encourages and incentivizes domestic production and ensures that the RFS volume requirements will be filled primarily with homegrown supply

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Real Challenge Facing Policymakers

- Will the domestic ethanol industry remain economically viable and at what scale?
- Where will the ethanol (and other renewable fuels) mandated by the RFS be made?
- Will the U.S. end up exporting another industry along with the jobs and economic activity it supports?

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Initial Impacts of Eliminating the VEETC

- Sharply lower U.S. ethanol market prices
- Weakened industry profitability
- Significantly reduced domestic ethanol production

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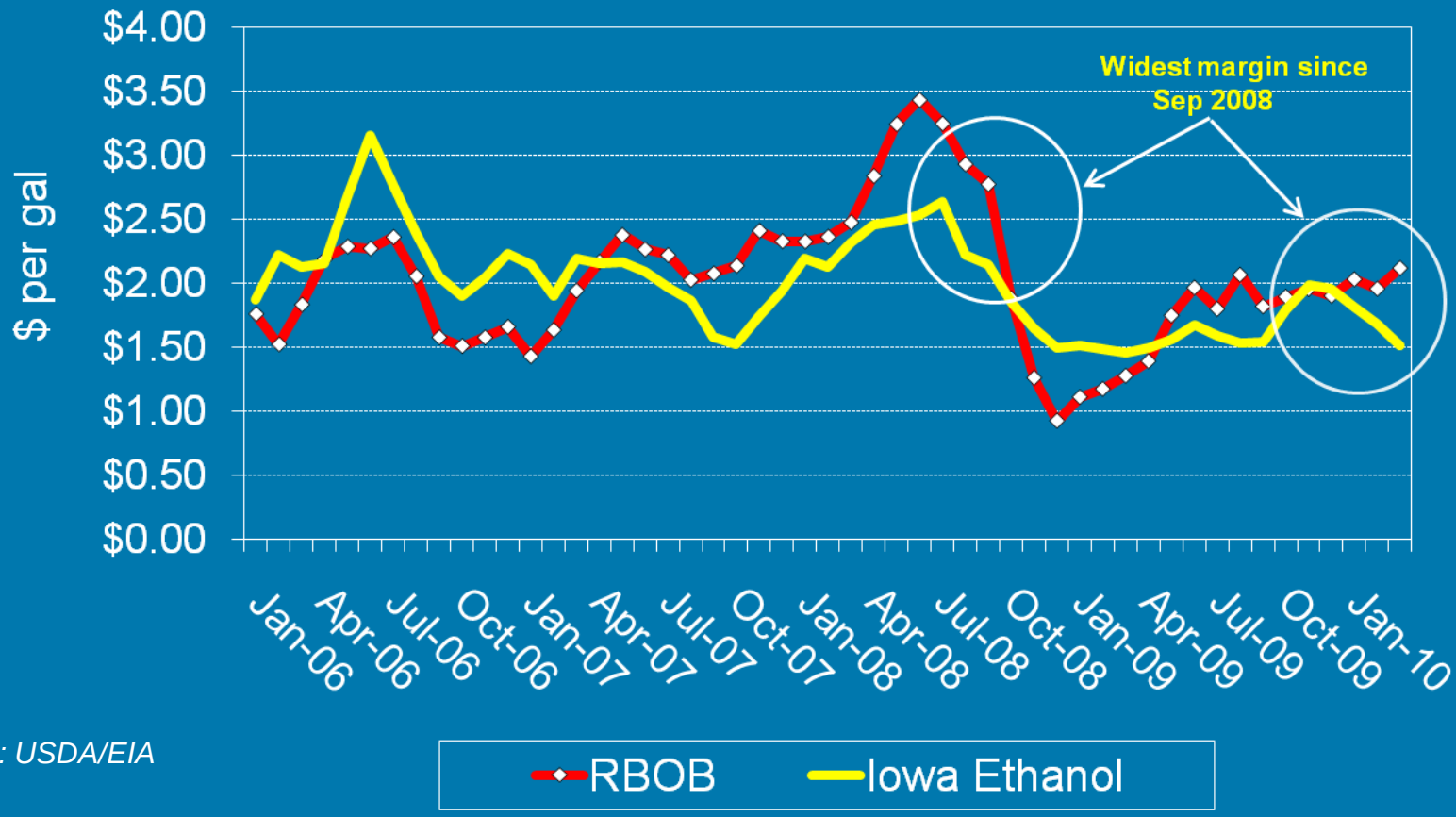
Gasoline-Ethanol Spread has Widened … Profitability is Suffering



Source: USDA/EIA

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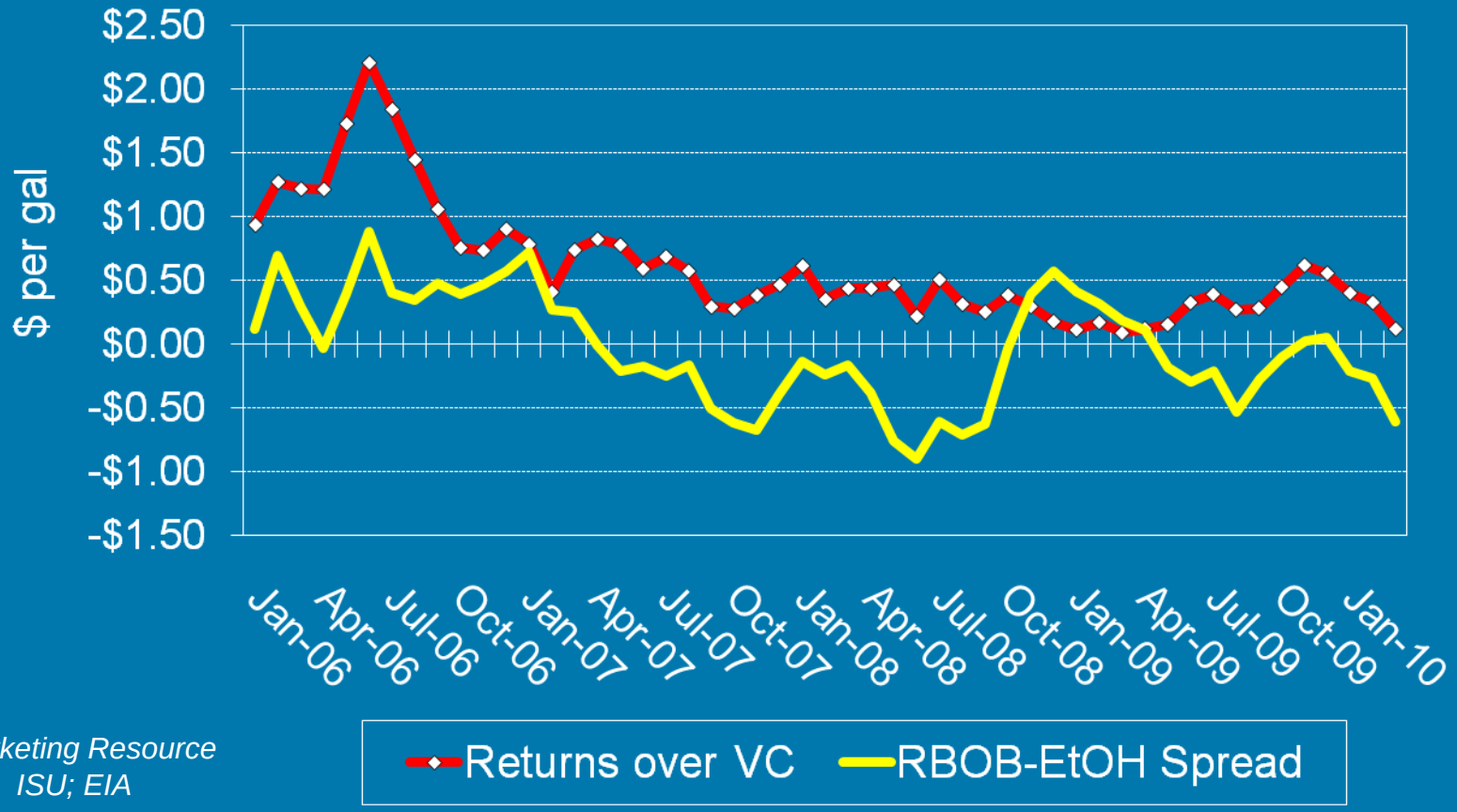
Industry Profitability Tracks the Gasoline-Ethanol Spread



Ag Marketing Resource Center, ISU; EIA

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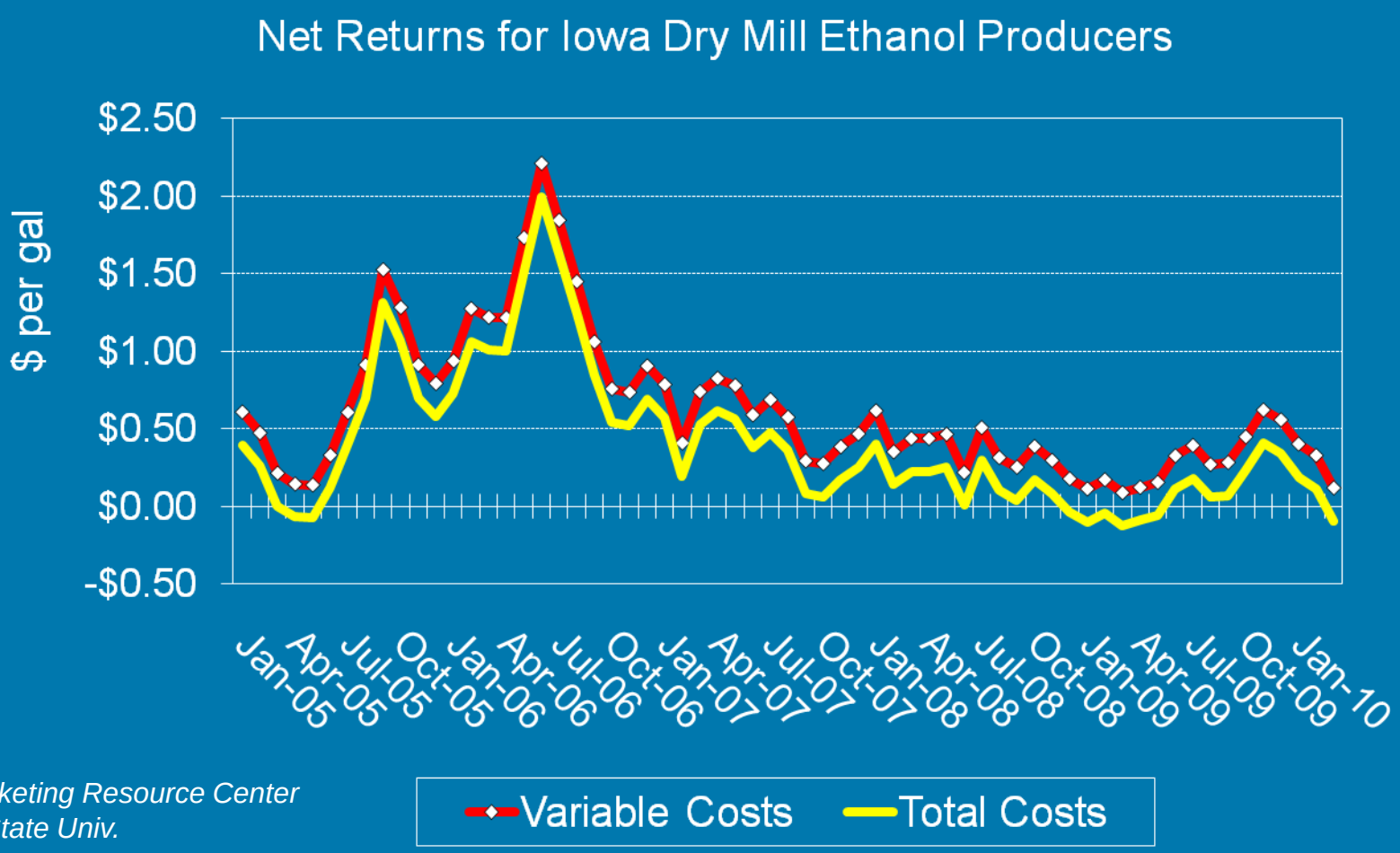
Industry Profitability has been Trending Down



Ag Marketing Resource Center
Iowa State Univ.

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Impact of Removing VEETC on Ethanol Prices: 2009

Base Ethanol Price (FOB NE Plant, cts/gal)	164.0
VEETC (cts/gal)	45.0
Net Ethanol Price (cts.gal)	119.0
Percent Change	-27.4%
Ethanol Demand Elasticity	-0.43
Potential Change in Ethanol Demand	11.8%
Ethanol Supply Elasticity	1.375
Potential Change in Ethanol Production	-37.7%
Price Elasticity of Ethanol Supply	-0.13
Increase in Price from Reduced Production	4.9%
Net Change in Ethanol Price	-22.5%
Ethanol Price after VEETC Removal (cts/gal)	127.0

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Impact of Removing VEETC on Ethanol Profitability: 2009

	2009 Actual	Without Tax Credit	% Change
Corn Price ($/gal)	$3.56	$3.27	-8.0%
Revenue/gal			
Ethanol	$1.63	$1.26	-23.0%
DDG	$0.36	$0.37	3.6%
Total Rev/gal	$1.99	$1.64	-17.8%
Cost/gal			
Corn	$1.27	$1.17	-8.0%
Other Var.	$0.43	$0.43	--
Total Cost/Gal	$1.70	$1.59	-6.0%
Net Return	$0.30	$0.04	-85.3%

Source: Ag Decision Maker, D1-10 Ethanol Profitability. February 2010. Iowa State University.

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Removing VEETC will have Adverse Economic Consequences

- Reducing ethanol production 38% represents the loss of 4 billion gallons of output
  - Size of industry in 2005
  - Equivalent to 60 average sized plants
- Industry would spend $6.6 billion less on purchases of grain and other raw materials, good and services

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Economy-wide Losses from Removing VEETC

- Reduce aggregate GDP by $16.9 billion (2009 dollars)
- Result in the loss of more than 112,000 jobs in all sectors of the economy
- Reduce household income by $4.2 billion (2009 dollars)
- Force consumers to spend as much as $5.5 billion more for gasoline annually
- Cut State and local tax revenue by $2.7 billion and Federal tax revenue by $2.4 billion

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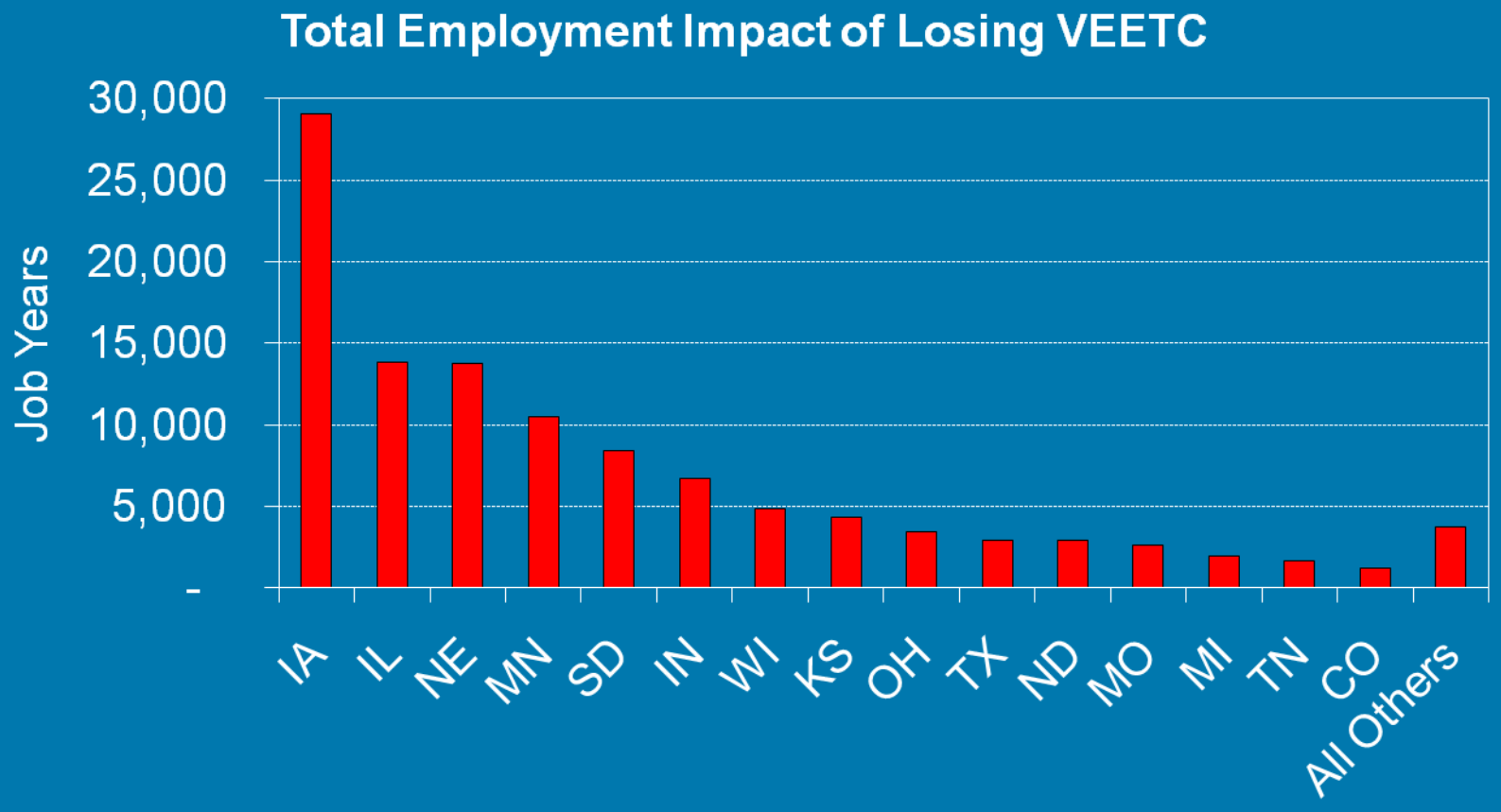
The Biggest Ethanol Producing States will Suffer the Largest Job Losses



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Removing the VEETC will Benefit Foreign Producers

- The U.S. tax credit is accompanied by an import tariff that prevents taxpayer dollars from being paid to foreign producers.
- We expect the import tariff also would be eliminated.
- This would provide a significant incentive for foreign ethanol producers such as Brazil, India, and China to increase exports to the U.S.
- Elimination of both the VEETC and tariff will have an unintended adverse impact on CBI countries

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Removing VEETC will Sacrifice Energy Security

- Removing the VEETC will result in the replacement of domestic ethanol production with imports.
- Instead of reducing dependence on imported energy, the U.S. will be increasing dependence for a different fuel from different supplying countries.

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Development of Cellulosic Ethanol will be Affected

- Removing the VEETC will send an unintended message to the investment community that the U.S. is not serious about supporting the development and growth of the biofuels industry.
- Would raise questions among investors about the potential longevity of the cellulosic tax credit thereby increasing risk for lenders and investors.
- Increased risk is likely to impede the vital flow of capital for investment and development of this component of the biofuels industry

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In Conclusion

- The ethanol tax credit has played a vital role in the expansion of the U.S. ethanol industry.
- Removal of the tax credit would ultimately reduce the market price of ethanol and seriously affect the profitability of producing ethanol in the U.S.
- Removing the tax credit will encourage the exportation of another U.S. industry and result in the loss of the economic benefits provided by the ethanol industry in terms of jobs, income, and tax revenue.

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