ALFA

AUSTRALIAN LOT FEEDERS' ASSOCIATION

Briefing Note
Ethanol

KEY POINTS

- Government assistance and protection towards the ethanol industry has resulted in inflationary pressure on grain, molasses and food prices (particularly during low grain production years) as it distorts the operation of international and domestic markets. This has led to an unlevel playing field in the market for these products, increasing costs of production for cattle lot feeders thereby placing them at a competitive disadvantage to beef producers in other countries.

- Despite hundreds of millions of dollars worth of state and federal Government assistance and protection towards the ethanol sector, it is clear that such policies have not only been ineffective but have resulted in costs which have grossly outweighed the benefits. This is readily demonstrated by the fact that 1) there are only 3 ethanol manufacturers in the country, 2) ethanol comprises only 1 per cent of the total road transport fuel mix, 3) there is decreasing not increasing demand for the product, and 4) the taxpayer cost for such policies have been large whilst the benefits have been small and declining over time.

- Various independent Government reports have concluded that the arguments in favour of Government assistance and protection towards ethanol production; namely fuel security, regional development and environment are at best highly dubious and associated policies a waste of taxpayers' dollars.

- History has proven that 'infant industry' type assistance (such as that provided for the Australian ethanol sector) result in Government dependence, complacency, inefficiency and moral hazard issues.

BACKGROUND

What is the issue?

Ethanol is a volatile flammable liquid that is predominantly used as a motor fuel. Of Australia's three ethanol plants, around 52% of ethanol is produced from grain with the remainder sourced from processed grain by-products or molasses. The Australian Lot Feeders' Association (ALFA) is concerned that Federal and State Government assistance and protection for the domestic ethanol industry distorts grain and molasses markets, increases food prices and places lot feeders at a competitive disadvantage when competing against ethanol manufacturers for these products.

Why is it an issue?

Despite the fact that the technology to extract ethanol is not new (it was used in Ford's Model T cars), it has not advanced beyond the fermentation of food crops such as grain and sugar cane. This has created food price concerns around the world as an increasing proportion of grain is diverted to fuel not food.

Feed grains represent the single largest cost in a kilo of beef, pork, dairy and chicken. In a normal season, 80% of Australia's east coast grain production is consumed by these intensive livestock industries with the feedlot sector the largest user with 3.7 million tonnes. During drought periods this percentage increases greatly as exports diminish. Accordingly, Government assistance and protection towards the ethanol industry, has the ability to impose significant price pressures on intensive livestock industries and hence beef, chicken, pork and dairy prices.

These plants have received significant 'infant industry' type assistance and protection in the form of capital grants, streamlined development approvals, fuel excise payment subsidies, tariffs on imported ethanol and mandates that guarantee demand for the product. For example, the Ethanol Production Grants program alone has provided an $895 million subsidy to the sector over the 2002-15 period. Such measures not only result in Government dependence, complacency, inefficiency and moral hazard issues among such manufacturers but place inflationary pressure on grain and food prices (as it allows them to pay prices beyond normal market equilibrium levels). The effect of these domestic Government policies aggravates those from foreign governments such as the US where over 40% of its corn crop goes to fuel not food production. With the US corn crop supplying 60% of world grain exports, their ethanol policies therefore have a large bearing on international grain prices including those in Australia (given that we are a net grain exporter). Notably, ALFA is not opposed to ethanol nor increased competition for grain or molasses but we are staunchly opposed to Government intervention which artificially increases prices for these inputs.

The arguments put forward to justify the fuel excise relief subsidy for the ethanol industry; namely fuel security, regional development and environment have been proven to be flawed with the negligible benefits provided more than offset by the costs of Government intervention to society;

1. The fuel security argument is flawed because Australia's ethanol is predominantly sourced from food crops (wheat, sugar cane and sorghum) and crop yields (and hence ethanol production) varies in line with our erratic climate. Moreover, ethanol comprises only 1% of the total road transport fuel market in Australia and the National Energy Security Assessment has concluded that we don't have a fuel security issue (our fuel security position is rated 'high' to 2016 and 'moderate' to 2035[1]). Moreover, grain derived biofuels can only hope to replace a negligible portion of Australia's transport fuel demands without impacting food supplies. Mandates of ethanol content in fuel aggravate this situation because they create an inflexible demand for grain which is disconnected to supply. This is the same for the world's largest ethanol producer, the US, where 100% of its corn crop if diverted to ethanol would only meet 7% of its fuel needs.

2. The regional development argument is flawed because the jobs created by a Government assisted ethanol industry are few, extremely costly to taxpayers and more than offset by job losses in other more viable rural industries that compete with it for grain. There are currently only 3 ethanol plants in Australia with the industry receiving more Government assistance and protection per litre of ethanol produced than the US. A February 2014 Bureau of Resources and Energy Economics report determined that the costs of the Ethanol Production Grants program were large whilst the benefits were limited and declining over time. Specifically the report stated that the tax payer cost per job created by the program was between $540,000-680,000. The high cost of job creation means that it would be cheaper to pay each worker average weekly earnings to do nothing than to subsidise them to produce ethanol. Given that a feedlot using the same amount of grain as an ethanol plant alone contributes more than 2 times the number of jobs, a Government assisted ethanol industry may actually result in a net loss in employment due to unfair competition and rising costs.

3. The environmental argument is flawed because the life cycle emission benefits compared to regular unleaded (RUP) are negligible (the CSIRO states only 1-4%) and extremely costly to taxpayers. The Productivity Commission has concluded that the $144 mill provided to the biofuels industry in 2010 contributed to only a 0.6% reduction in emissions or $496 for each tonne of CO_2-e reduced. Moreover, given ethanol also has poorer fuel economy to RUP, more ethanol and hence emissions are in fact released from its use.

Government assistance towards Australia's ethanol industry provides significant financial benefits to only 3 ethanol producers in Australia yet negatively impacts millions of food and fuel purchasing consumers, livestock producers and tax payers. Moreover, ethanol is incompatible for 30% of cars, 70% of motorbikes, 100% of boats and almost all 2 stroke engines such as mowers, wipper snippers, hedge trimmers etc. These engine owners have been forced to pay more for expensive premium unleaded as regular unleaded becomes increasingly unavailable (sales of regular unleaded have declined by 73% in NSW since February 2007). The owners of E10 compatible vehicles are similarly affected, with drivers forced to pay more for fuel as ethanol has inferior fuel economy compared to regular unleaded petrol. The Australasian and Convenience Petroleum Marketers Association states that a 3.5cpl discount of E10 compared to regular unleaded petrol is required to offset its poorer fuel economy. However, and despite nearly $1 billion in Government subsidies since 1980, the ACCC has reported that the ethanol sector has never provided such a discount with the discount in fact reducing over time.

What we are seeking
ALFA seeks the removal of distortionary Government assistance and protection for ethanol production so that the market alone determines the price for grain and molasses.

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[1] BREE (2014), *An assessment of key costs and benefits associated with the Ethanol Production Grants program, a report for the Department of industry*, http://www.bree.gov.au/publications/other-publications