CAFTA's Impact on U.S. Ethanol Market

Many organizations that supported the North American Free Trade Agreement (NAFTA) have assumed that the Central American Free Trade Agreement (CAFTA) is simply an extension of the first agreement beyond Canada and Mexico to the countries of Central America and the Caribbean. The two trade agreements, however, have striking differences that may have significant adverse impacts on U.S. farmers. Some of the CAFTA provisions that have not received enough attention pertain to ethanol imports.

The U.S. ethanol industry has experienced rapid growth in recent years. Much of this growth in the Midwest has been financed and fueled by local investments, primarily from family farmers, who now collectively own over half of the 84 ethanol plants in the U.S. These plants provide risk mitigation and a preferred market for corn farmers, new jobs and income streams for rural communities, and reduced dependence on increasingly expensive foreign fossil fuels. Congress has instituted a 54 cent per gallon tariff on ethanol imports to promote the development of the domestic renewable fuel industry, but CAFTA and other trade agreements threaten to put this emerging American industry—and an opportunity to reduce our energy dependence—at risk.

CAFTA locks in tariff-free access to the U.S. market for foreign ethanol. Provisions in the Caribbean Basin Initiative (CBI) allow 7 percent of total U.S. ethanol production that is produced by foreign feedstock (outside CBI countries) to be imported into the U.S. tariff-free. The foreign feedstock must be processed in a CBI country. In a case that has received a lot of attention, high water content Brazilian ethanol would be dehydrated and turned into fuel in an El Salvador plant, and then exported into the U.S. Moreover, the CBI also allows unlimited amounts of ethanol above the 7 percent cap to enter the U.S. without a tariff, provided it is produced with at least 50 percent Caribbean Basin country feedstock.

The CBI provisions are permanent until another free trade agreement comes into effect. In this case, CAFTA overrides the CBI. CAFTA could have increased or decreased the levels of tariff-free ethanol entering the U.S. This is why agribusiness companies waited until the CAFTA agreement to begin rapid investment in ethanol-related ventures in Central America and Brazil. This analysis of the CAFTA ethanol provisions and market development in Central America and Brazil shows:

- For 2005, 240.4 million gallons of ethanol derived from foreign feedstocks are allowed to enter the U.S. from CAFTA countries tariff free. This is more ethanol than, or roughly equal to, the amount produced by farmer-owned ethanol plants in most of the top ethanol producing states in the U.S., including: Nebraska, Kansas, Wisconsin, Illinois, Indiana, Missouri and South Dakota.

- Global agribusiness companies have announced plans or have finished construction on ethanol processing plants in El Salvador, Jamaica, Trinidad and Tobago, and Panama. These plants are designed to take advantage of the CAFTA ethanol provisions by importing high water content Brazilian ethanol, dehydrating the ethanol to make it fuel grade and useable in the U.S., and exporting it into the U.S. tariff-free.

- Once the facilities are in place, it would not be difficult for CAFTA-based ethanol facilities to use a portion of regional feedstock in their ethanol production, which

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would allow them unlimited exports into the U.S. tariff-free.

- Agribusiness companies are also making significant investments in Brazil to increase ethanol exports. These investments include Cargill's decision to expand its soy port in Santos to include the world's first ethanol-exclusive terminal.

- Backed by strong government supports, Brazil's ethanol production costs are at one-half to two-thirds of those in the U.S. Even when taking into account the 54 cent U.S. tariff, it can still be economical for transnationals to ship to U.S. coastal cities when U.S. ethanol prices are high. Many U.S. coastal cities are facing ethanol mandates for gasoline formulation to help them meet national Clean Air Act requirements.

CAFTA is a model for how ethanol will be considered in future trade agreements. Of particular relevance is the Free Trade Area of the Americas (FTAA), which would expand CAFTA to include all 34 countries in the Western Hemisphere, except Cuba. If Brazil were able to gain CAFTA language on ethanol in an FTAA agreement it could flood the U.S. with foreign-produced ethanol.

The largest beneficiaries of CAFTA's ethanol provisions will be agribusiness corporations in Brazil, a country that already has a well-established ethanol industry. Unlike much of the farmer-owned ethanol production in the U.S., international agribusiness giants control the ethanol development in Central American countries.

An influx of imported ethanol threatens to undermine some of the most important reasons why ethanol is so attractive to rural communities in the U.S. and policymakers interested in energy independence. Those reasons include:

- **U.S. ethanol is largely based on local investment.** Over half of the U.S. ethanol plants are farmer-owned. When businesses are owned locally, money is more likely to stay in the community and less likely to move elsewhere.

- **Improving local energy production.** Ethanol allows the U.S. to reduce its dependency on foreign oil. A stable, local source of cheap, cleaner energy could greatly help rural economic development in a number of ways.

- **Higher corn prices.** Ethanol increases demand, and thus prices, for corn. U.S. market corn prices are at historic lows—well below the cost of production for farmers. Studies have shown that corn prices in markets near ethanol plants will increase between five and eight cents per bushel. By allowing ethanol imports into the U.S., it will likely limit how high the U.S. price for ethanol will go, and in turn, the price of corn.

- **Declining corn export markets necessitate domestic uses.** Despite tremendous efforts to expand export markets through NAFTA and the World Trade Organization, U.S. corn exports have been in slow decline since 1980. Domestic uses of corn, and specifically ethanol production, have been a bright spot in compensating for failed efforts to increase exports.

By enabling ethanol imports into the U.S., CAFTA undercuts decades of work by farmers, rural communities, and millions of dollars in taxpayer investments in federal and state government programs to build the U.S. ethanol industry. Expansion of ethanol imports through CAFTA and other trade agreements puts U.S. trade policy squarely in conflict with domestic economic and energy policy. The winners in such a system are multinational agribusiness firms, who can play Brazil, Central America and the U.S. against each other to gain cheaper prices for raw materials and larger profits. The losers are U.S. farmers, rural communities and taxpayers who have heavily invested in ethanol as a source of economic development and to increase energy independence for the country. ■

This fact sheet is based on IATP's report *CAFTA's Impact on U.S. Ethanol Market*. Read the full report at tradeobservatory.org.