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Why It's Time to Kill the Sugar Tariff

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How corn became king, and why we're starving ourselves because of it.

The US Department of Agriculture says that more than one in seven American households -- about 49 million people -- struggled to get enough food last year, the highest rate since the USDA began tracking hunger in 1995.

And, according to a Congressional Budget Office report earlier this year, the increased use of ethanol is responsible for a rise in food prices of approximately 10% to 15%.

Why?

We're turning corn into fuel -- a highly inefficient one, at that -- instead of food.

The Mackinac Center for Public Policy points out that "mixing food and fuel markets for political reasons has done American consumers no discernable good, while producing measurable harm."

However, perhaps summing up the issue most succinctly is Mark J. Perry, professor of economics and finance at the University of Michigan-Flint:

> Anytime you have Paul Krugman agreeing on ethanol with such a diverse group as the *Wall Street Journal*, *Reason Magazine*, the Cato Institute, *Investor's Business Daily*, *Rolling Stone Magazine*, the *Christian Science Monitor*, *The New York Times*, John Stossel, The Ecological Society of America, the American Enterprise and Brookings Institutions, the Heritage Foundation, George Will, and *Time* magazine, you know that ethanol has to be one of the most misguided public policies in US history.

But Brazil seems to have made it work. Using just 1% of its arable land, Brazil produced 6.57 billion gallons of ethanol last year, roughly half the annual oil production of Iraq. Ethanol accounts for about 50% of Brazil's automotive fuel.

Brazilian aircraft maker **Embraer** (ERJ) and **General Electric** (GE) are working to develop ethanol suitable for powering commercial aircraft, with a test flight possible by early 2012.

Most importantly, Brazil relies on imported oil for only 10% of its energy needs today -- due in large part to its ethanol industry.

So what's Brazil doing right?

The answer is simple. Unlike the United States, Brazil makes its ethanol from sugar, which yields more than eight units of energy for each unit invested, whereas corn-based ethanol yields a paltry 1.5 units of energy for each unit used. Sugar-based ethanol is also cheap to produce, at $0.60 a gallon.

It seems so obvious. An alternative fuel that works already exists. What's stopping us from using it?

A decision made 36 years ago by a man named Rusty Butz, before ethanol was even a blip on anyone's radar.

In 1973, Earl "Rusty" Butz, President Nixon's USDA chief, did away with agricultural price supports introduced by the Roosevelt administration that were intended to prevent farmers from getting hurt financially by limiting supply when bumper crops would have otherwise flooded the market.

They were also meant to keep consumers from being squeezed by releasing warehoused grain when crop yields were low and prices would otherwise naturally spike. Butz ginned up political support for the administration by encouraging farmers to plant "fencerow to fencerow" while the government provided them with subsidies to cover the difference between market prices and production costs.

Of course, growing "fencerow to fencerow" did exactly what one would expect: Prices took a dive as production exceeded demand, which didn't sit too well with **Archer Daniels Midland** (ADM), the nation's largest corn refiner.

Now, there's only so much corn one person can eat. Archer Daniels Midland suddenly needed to figure out how to somehow stimulate sales of all that food.

Then, a Japanese technique called "wet milling" caught the company's eye. Wet milling turned corn kernels into what Archer Daniels Midland hoped would be a low-cost alternative to sugar -- the now-ubiquitous high-fructose corn syrup.

While high-fructose corn syrup was an alternative to sugar, it still wasn't possible to manufacture cheaply enough to make it a *low-cost* alternative.

Enter Dwayne Andreas, who, at the time, was Archer Daniels Midland's CEO.

It just so happened that Florida sugarcane growers were in the middle of a push to get Congress to impose a tariff on foreign sugar, which was exerting downward pressure on market prices. Andreas decided to help fund lobbying efforts by Florida sugarcane growers to convince Congress to impose a quota on non-US sugar, which had been flooding the US market and keeping prices down.

In short, Archer Daniels Midland backed its competition's political agenda and, when Ronald Reagan took office, the sugar tariff was swiftly ushered into place. Naturally, sugar prices escalated (artificially), eclipsing the cost of Archer Daniels Midland's high-fructose corn syrup, and soft-drink makers like **Coca-Cola** (KO) and **Pepsi** (PEP) switched in short order to the cheaper alternative.

Perhaps this is why a statue of Ronald Reagan stands at Archer Daniels Midland headquarters. A token of appreciation from one free marketeer to another for promoting what is, essentially, a patently socialist policy.

Andreas doesn't seem to view our capitalist society through the same lens as most others. In an interview, he said, "There isn't one grain of anything in the world that is sold in a free market. Not one! The only place you see a free market is in the speeches of politicians. People who are not in the Midwest do not understand that this is a socialist country."

From the looks of things, "socialism" has done well for Dwayne Andreas. A report by James Bovard of the Cato Institute notes, "At least 43% of ADM's annual profits are from products heavily subsidized or protected by the American government. Moreover, every $1 of profits earned by ADM's corn sweetener operation costs consumers $10." Minyanville professor and Houston fund manager Ryan Krueger says, "The sugar tariff is the biggest scam since one hour Martinizing. For the first time in human history, more than a billion people this year will be classified as 'chronically hungry.' We'll artificially sweeten prices for US farmers, bankrupting poor farmers in Africa or South America, and then turn around and send them food aid."

Krueger continues, "I'd love all the upside and none of the downside in a game where my competitors are barred from playing against me, yet if I still somehow fail to perform the scoreboard operator nonetheless puts up points for me -- as long as I vote for the right referee when his contract's up."

Okay, so Archer Daniels Midland hijacked the sweetener market. What does this have to do with Brazilian ethanol and our country's insistence on forging ahead with subpar ethanol made from corn, even though tariff-free cane ethanol would cut gas prices by a large multiple?

Aside from the fact that there are a hell of a lot more votes in Iowa that will help a US president get elected than there are in Sao Paolo, the path leads directly back to good old political back-scratching.

You'd be correct to assume that demand for soft drinks drops during the cold winter months. What would Archer Daniels Midland do with idle wet-milling equipment during high-fructose corn syrup's "off-season"?

Turns out, wet-milling machines also make ethanol.

The federal government provides a $0.45 per gallon subsidy for domestically produced ethanol (read: corn-based). Add to that the crippling sugar policy, plus a $0.54 per gallon tariff placed specifically on foreign ethanol (read: sugar-based, from Brazil).

Bang -- Archer Daniels Midland corners the domestic ethanol market. Pretty crafty, huh?

California Governor Arnold Schwarzenegger says, "The federal government is subsidizing corn-based ethanol and we have a tariff of $0.54-a-gallon on the most important ethanol to discourage cheap fuel coming in from Brazil. This is crazy."

Fed Chairman Ben Bernanke says, "As you know, I favor open trade and I think allowing Brazilian ethanol, for example, would reduce costs in the United States."

And C. Ford Runge, an economist specializing in commodities and trade policy at the Center for International Food and Agricultural Policy at the University of Minnesota, says, "… the obvious thing to do is lower that [sugar] tariff and let some Brazilian ethanol come in. But one of the fundamental reasons our biofuels policy is so out of whack with markets and reality is that interest group politics have been so dominant in the construction of the subsidies that support it."

Until corporate welfare takes a backseat to real, proven solutions that would help stateside consumers save a bundle at the pump (and help our less-prosperous allies financially), corn will remain king.