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Splash and Dash

The perils of subsidy.

By David Freddoso

Somewhere in Germany, a trucker is thanking you. A biofuel executive is cursing you. You probably don't know it, but you paid \$1 for each gallon of the Brazilian biodiesel fuel blend the trucker is using. The fuel-maker is upset because your generous contribution is driving down the price at which he can sell his product.

For their elation and disgust, for your impoverishment, and probably for some harm to the environment as well, you can blame the United States Congress. This all results from yet another misguided attempt to manipulate economic behavior through the tax code.

The problem began when Sen. Chuck Grassley (R., Iowa), the friend of farmers, inserted the so-called "Blenders' Credit" into the Jobs Act of 2004. The idea was to increase biofuels production and consumption in the U.S., as biofuels were thought to be environmentally friendly and a viable alternative to fossil fuels. The credit provides \$1 for each gallon of biodiesel that is mixed with regular diesel in the United States. The provision has not dramatically increased domestic consumption, but it has increased production and exports to Europe's thriving and subsidized diesel markets.

Under World Trade Organization rules, the U.S. government cannot extend the credit only to American companies or to fuels produced in America. Thus, foreign companies are eligible whenever they bring their biodiesel stateside for mixing. But the limited American market for the fuel has given birth to an unintended consequence known as "Splash and Dash."

Rep. John Shadegg (R., Ariz.) demonstrated the concept's simplicity last week by referring to [an article](#) that received little attention when it was published last year. It works like this:

A foreign tanker carrying 9 million gallons of biodiesel from Brazil or Malaysia sails to an American port. While it waits, 9,000 gallons of American diesel is added — that's right, a .1 percent blend — so as to earn the blender a \$9 million tax credit. The tanker heads to Europe, where diesel cars are far more common and biodiesel is further subsidized.

In some cases, tankers have reportedly made round trips from Europe to the U.S. simply to collect the subsidy. Thus we “import” and “export” the same fuel from and to the same country.

“Just think of it,” said Shadegg. “If I produce biodiesel anywhere in the world where the cost of shipping it to the United States before shipping it to the end consumer is less than a dollar a gallon, then I'm going to take advantage of this subsidy.”

It is difficult to track the exact cost of Splash and Dash to the U.S. Treasury, but the tax credit's absurd distortion of the market is impossible to miss. According to numbers from U.S. International Trade Commission and the Census Bureau, the United States exported 5.4 million more gallons of biodiesel in January than it produced domestically. This was the first month this has ever happened, and the gap will grow by leaps and bounds in each month of this year, according to industry estimates. In the month of December, America will export twice as much biodiesel as the 27 million gallons we are expected to produce. Based on the 2008 projections, we will re-export *at least* 51 percent of the 412 million biodiesel gallons we import this year — but possibly much closer to 100 percent. The total subsidy for all exported biodiesel for 2007 and 2008 combined could approach \$900 million.

By subsidy standards, this is a rather small sum — ethanol blends will reap more than ten times as much from the same provision. But the incentive to export diesel to Europe, combined with the obviously abusive nature of Splash and Dash, has sparked anger on both sides of the Atlantic.

Last week, Shadegg proposed a bill (H.R. 5713) to end “Splash and Dash” by limiting the blenders' tax credit to biodiesel that is actually consumed in the United States. But domestic producers are already upset by this idea: Although they resent foreign firms' use of “Splash and Dash” to take away their competitive advantage, they still want their

subsidy for the biodiesel they export to Europe. Grassley, the original author of the tax credit, wants to make Splash and Dash less profitable but continue those subsidies for American exporters that have so angered the Europeans. His plan in the Senate would force blenders to pay the excise tax at 24 cents per gallon when they mix the fuels.

Shadegg, who would prefer to abolish the subsidy altogether and return the savings to taxpayers, said that at least the subsidy for exports must be completely abolished in order to end Splash and Dash without violating WTO rules. Any attempt to limit the blenders' credit to American fuels would cause Europe to retaliate with tariffs. Even now, with European blenders still eligible to scam American taxpayers with Splash and Dash, the European biodiesel industry has already announced that it will demand anti-dumping tariffs and levies to countervail U.S. subsidies, according to [a recent report](#) from the *Financial Times*. Yet even if it wastes taxpayer money and causes trade tension, might the blenders' credit at least help the environment?

"Absolutely not," says Doug Koplow of the Cambridge, Mass.-based group Earth Track. He pointed to the fact that biofuel plantations often require the destruction of rainforests, causing greater net carbon emissions and destroying animal habitats. "You can say we're growing crops for biofuels from pre-existing farmland, but then the offsetting food production begins to cut into natural habitat," he added. "There's a lot of concern that biofuels production is causing environmental damage." Moreover, the world's environmentalist community has [all but lost faith](#) in the idea that biofuels themselves help to begin with.

Shadegg said he doesn't expect Democratic leaders to let his bill move as a stand-alone, but that Splash and Dash may still become a casualty of their pay-go budget rules. "They're desperate to find offsets for the spending in their mortgage bailout bill," he said. "They could take language of this type and use the savings — even if it's just \$300 million on the year — to spend it in some other way."

The blenders' credit, like all other subsidies, is a cautionary tale about what happens when government attempts to turn an unprofitable enterprise into a profitable one.

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