



# Ag Decision Maker



**A Business Newsletter for Agriculture**

**Vol. 6, No. 8**

**June 2002**

## The Rise of Ethanol in Rural America

*by Nancy Novack, assistant economist, Center for the Study of Rural America*

**E**thanol could suddenly become the gasoline additive of choice in America. As policymakers debate the future path of U.S. energy policy, they face added concerns for public safety and America's growing dependence on foreign oil. The outcome of these debates could spell the end for MTBE (methyl tertiary butyl ether) as a fuel additive—and have important implications for the future of the ethanol industry in rural America.

Because ethanol is produced mainly from corn, an expanding ethanol industry would give an economic lift to many farmers. New ethanol plants would also create jobs, raise incomes, increase tax revenues and offer new investment opportunities to some rural communities. Whether rural America will tap these economic benefits depends on two factors—the future course of public policy and the nation's willingness to pay for renewable fuels.

to ethanol's future as a new national energy policy moves through Congress with a focus on energy independence.

Amendments to the Clean Air Act in 1990 opened the door for increased ethanol use. The new laws required refiners to formulate gasoline with higher oxygen levels. Oxygen helps gasoline burn cleaner and thus reduces harmful emissions. The so-called oxygenate standards were first imposed in the Winter Oxyfuels Program, and the standards were then extended in the year-round Reformulated Gasoline Program. The Winter Oxyfuels Program was implemented in 1992 and required

*continued on page 2*

**Handbook updates**  
For those of you subscribing to the *Ag Decision Maker Handbook*, the following updates are included.

**2002 Corn and Soybean Loan Rates** — File A1-34 (2 pages)

**Revenue Insurance for Hog Producers** — File B1-50 (3 pages)

Please add these files to your handbook and remove the out-of-date material.

### Why is the nation turning to ethanol?

Ethanol is a fuel made from plants such as corn. It is more expensive to produce than petroleum-based fuel but has the advantages of burning cleaner while boosting octane levels. Its environmental attribute has placed it squarely in the middle of ongoing national policy debates on environmental and energy policies.

By mandating clean burning fuels and providing subsidies to ethanol producers, policymakers are reshaping the ethanol industry. Public policy will remain the key

---

### Inside . . .

- Are Consumers Buying More Private Label (or Store Brand) Products? ..... Page 4
- Building your brand with brand line extensions ..... Page 5

The Rise of Ethanol in Rural America, continued from page 1

gasoline to contain 2.7 percent oxygen by weight during the winter months in cities with high carbon monoxide pollution. The Reformulated Gasoline Program began in 1995 and required specially blended gasoline containing 2 percent oxygen in cities that significantly exceeded federal ozone standards.

Because regular gasoline does not contain oxygen, additives must be used to meet federal standards. The energy industry turned to two oxygen-rich additives, MTBE and ethanol. These additives also serve as octane enhancers which boosts the grade of conventional gasoline, thus commanding a higher price.

Petroleum-based MTBE became the energy industry's first choice, even though ethanol contains twice as much oxygen per gallon. MTBE is easily blended with gasoline and can be transported via pipelines, creating fewer problems for refiners. Ethanol has not been shipped via pipelines because the pipelines contain moisture and other deposits that can be absorbed by ethanol and thus alter its state during transport. So far, the volume of ethanol-blended gasoline has not been large enough to warrant the required adjustments to pipelines to rid them of the deposits.

Ethanol is also more expensive than MTBE. Because ethanol is not shipped via pipelines, it must be blended at the terminal which requires separate storage tanks for the gasoline and ethanol and special blending systems. These added transportation and blending costs have discouraged the use of ethanol in many markets.

Still, several factors have kept ethanol competitive with MTBE. The biggest of these has been an exemption from a portion of the federal excise tax on gasoline containing ethanol. This tax break amounts to 5.3 cents per gallon of gasoline containing 10 percent ethanol. Some states, mostly in the Midwest, provide additional fuel tax incentives. Moreover, since ethanol contains almost twice as much oxygen as MTBE, roughly half as much is required to meet oxygen standards.

While MTBE became the most widely used fuel additive, significant concerns over its safety began to surface in the mid-1990s. Studies have shown that when MTBE spills, it can enter the water supply because it does not bind well with soil. At certain concentrations, drinking water contaminated with MTBE has a foul taste or odor, making it unfit for human consumption. MTBE has also been listed as a possible carcinogen for humans.

As a result of these findings, several states have banned MTBE as a fuel additive. The most significant ban has been in California where most of the gasoline must have oxygen additives, making the state a huge market for MTBE. The California ban takes effect January 1, 2004, and has left the state looking for alternatives to MTBE to meet minimum oxygen requirements.

California and other states are looking to ethanol as a safe alternative to MTBE. Ethanol not only helps reduce carbon monoxide emissions and replaces harmful chemicals in gasoline, but it is also non-toxic—and is even safe for human consumption.

Amendments to the Clean Air Act boosted growth in the ethanol industry, and now bans on MTBE could propel it even further. In the meantime, policymakers are debating a new national energy policy that could open doors even wider for ethanol. Under proposed legislation, energy policy would eliminate oxygenate standards and instead encourage clean air through the greater use of renewable fuels including ethanol.

Congress appears committed to laws that are environmentally friendly and address energy independence. A proposed Renewable Fuels Standard (RFS) would require a small portion of the U.S. energy supply to be supplied by renewable sources. Ethanol and its soybean-based counterpart, bio-diesel, would both meet this standard for fuel energy. And due to concerns about safety, the legislation would also completely phase out MTBE over the next four to five years. If the new energy policy contains such a standard, the ethanol industry believes demand might accelerate even faster than under the current clean air rules.

Support for an RFS stems not only from environmental concerns about MTBE but also from concerns about the nation's growing reliance on imported oil. Currently, the nation imports nearly 60 percent of its oil. The Energy Information Administration in the Department of Energy projects this number will approach 70 percent by 2012. Many policy officials believe such dependence on imports carries great risk for the nation given the unstable political climate in many major oil producing regions of the world.

Ethanol is a renewable fuel that helps extend the fuel supply—23.8 gallons of ethanol displace one barrel of imported oil. It is easy to see why using more renewable fuels would help decrease the nation's dependence on foreign oil. According to a recent study, an RFS for motor vehicle fuel would

The Rise of Ethanol in Rural America, continued from page 2

have a positive effect on reducing the nation's dependence on foreign oil.

How will increased demand reshape the ethanol industry?

Environmental legislation in the 1990s helped propel an ethanol industry that has grown to a scale of roughly 2 billion gallons produced annually today. Ethanol production and consumption is currently concentrated in the Midwest. An RFS would boost ethanol demand, requiring the industry to expand. The expansion would not only boost prospects for producers but also raise important questions about the future structure of the industry.

Ethanol production is concentrated in the Midwest so that plants can be close to cornfields. In 2001, 1.77 billion gallons of ethanol were produced by almost 60 ethanol facilities across the nation, about 90 percent of which are in Midwestern states. Triggered by the MTBE ban, ethanol facilities with a capacity totaling roughly 400 million gallons will begin producing this year, and dozens more are in the planning stages. By yearend, ethanol production capacity is expected to exceed 2.7 billion gallons, with nearly 80 percent of this capacity located in Illinois, Iowa, Nebraska, and Minnesota. If Congress sets an RFS, the National Corn Grower's Association projects the ethanol industry to grow to more than 5 billion gallons by 2012.

In the short run, this growth will mean more than just new facilities and more production. It will also mean more of the nation's corn crop will be devoted to ethanol production. Corn producers stand to benefit from the expansion for several reasons. First, and most obvious, the price of corn would rise due to increased demand. Ethanol uses about 6.5 percent of the nation's corn crop, adding up to 30 cents to the price of a bushel of corn. In total, ethanol accounts for an estimated \$4.5 billion in net farm income. If Congress enacts an RFS, an additional 1.4 billion bushels of corn will be needed over the next ten years.

Ethanol also provides opportunities that transcend higher corn prices for farmers. Farmer-owned cooperatives account for at least half of the new capacity created during the industry's expansion of the last decade. This value-added activity allows producers to benefit from an additional market for their commodity. But it also offers producers the ability to reap the returns from having an ownership interest in processing ethanol. The combination of modest increases in corn prices and returns from ethanol processing will provide an important boost to farm incomes. One industry group concludes that ethanol production

adds value for farmers by converting \$2 worth of corn into \$5-6 worth of ethanol and ethanol co-products.

In the long-run, the ethanol industry will also be reshaped by supply-side factors. Technology will be a major driver in determining the competitiveness of ethanol as a renewable fuel. The industry continues to push for improved technologies. Developing higher value by-products is one area the industry is studying to help reduce net costs of corn ethanol production. And technology is now in progress to produce ethanol from other biomass such as grasses, plant waste, and fast-growing trees. These plants are potentially cheaper sources than corn. Thus, there is potential for ethanol to be much more cost competitive with regular gasoline.

Questions linger over the path the ethanol expansion will take. Who will own the plants? Will they be small or large? Many plants built recently are small and farmer-owned, helped in part by state and federal incentives. Some industry observers argue, however, that efficiencies can be gained by building fewer, larger plants and capturing economies of size. Larger plants are more likely to be owned by agribusinesses, fueling debate about who benefits from the excise tax exemption. Once again, legislation will play a key role in the future course of the industry.

How does ethanol benefit rural America?

A growing ethanol industry will have economic implications for rural America that reach far beyond higher corn prices. Rural communities could benefit from more jobs, more income, and broader indirect effects when the ethanol industry comes to their town. But questions still swirl around the industry's future structure, and these questions hold important implications for how the benefits will be distributed throughout the countryside.

Even if farmers don't build the ethanol facilities, rural communities have much to gain from having an ethanol plant in their area. Ethanol plants bring jobs to rural areas that often have difficulty attracting businesses and industry. The plants boost employment opportunities for residents. Some relatively high-paying positions provide an incentive for young leaders to stay in their community. Jobs are just one aspect of the total economic impact ethanol may have on rural America. A wider impact will be felt through all the other jobs and businesses created as a result of the ethanol facility—the so-called multiplier effect. A 1997 report on ethanol's economic impact concluded that the industry added nearly 200,000 jobs to the U.S. economy, a number

The Rise of Ethanol in Rural America, continued from page 3

that has increased in recent years as the industry has expanded. Another study projects that an additional 214,000 jobs will be created throughout the economy over the next decade if an RFS is enacted.

As the ethanol industry creates new jobs, it also creates a larger tax base for local communities. More jobs and additional income ripple through the rest of the economy as money is spent in local businesses. With more money flowing through the economy, more taxes are collected and returned to local and state governments. A boost to the local tax base is especially important in rural areas where declining populations and economies have made it doubly difficult to support public schools and infrastructure.

While the overall benefits to rural America are clear, it is not clear which communities will benefit. The question of where future plants will locate remains unanswered. There certainly cannot be an ethanol plant to revive every rural community. The industry will likely continue to expand where the corn grows. Longer term, ethanol produced from other types of biomass could result in new plants located near metro centers on the east or west coasts. But in the end, ethanol's future remains highly dependent on public policy—and the value the nation is willing to put on clean air, clean water, and energy generated from renewable sources

## Are Consumers Buying More Private Label (or Store Brand) Products? \*

by Gene German, Professor Emeritus, Department of Applied Economics and Management, Cornell University

Over the past few years, supermarkets, drug stores and general merchandise stores have been selling more of their own store brand products at the expense of nationally advertised manufacturers brands. The forecast is that this trend will continue.

Twenty years ago supermarket chains offered consumers store brand products that attempted to duplicate the most popular manufacturer brands, but were priced slightly below these products. In most cases the quality of these store brand products was "as good" or "nearly as good" as their manufacturer brand counterparts. Because these products were produced by or for the supermarket chains they incurred no selling or advertising costs and therefore even when they were sold at a retail price that was slightly lower than comparable manufacturer brands they returned a higher gross profit margin for the retailer.

Over the years retailers have continued to follow most elements of this strategy and consumers have found more and more satisfying store brands that include traditional canned food and packaged goods as well as personal care products such as toothpaste and deodorant.

During the 1990's sales of store brand products in supermarkets increased approximately 13.5 percent of store sales to nearly 16.0 percent. The number of units sold increased from about 17 percent of the total number sold in supermarkets to over 20 percent during this same period. During the past year

private brand sales in supermarkets grew more rapidly than manufacturer brands. Store brands grew at 6.3 percent compared with a 4.1 percent for all manufacturer brands.

Last year store brand products had a greater market share than the strongest manufacturer brand in nearly 30 percent of all categories within the supermarket. Store brand ranked number one in 79 out of 266 individual product categories (categories such as pasta, cheese, baby food, ice cream, etc.) Store brand products were either the number 1 or number 2 brands in 131 product categories – nearly 50 percent of the 266 categories in the store.

This strength in store brand performance in recent years can be attributed to several factors. Perhaps of most importance is the new approach that supermarket companies have taken in the marketing of store brand products. The new marketing approach includes better packaging, improved quality and specific advertising and promotional programs designed to increase customer awareness and sales of store brand products. Also, during the 1990's many supermarket companies began to develop premium quality store brand products as well as new and unique products that were not being offered by national brand manufacturers. For example, in upstate New York, Tops Supermarkets introduced a premium quality line of private label products called

continued on page 5

\* Article from June 2001 issue of Smart Marketing, a monthly marketing newsletter from Cornell University.



*Are Consumers Buying More Private Label (or Store Brand) Products? , continued from page 4*

“President’s Choice”; Wegmans introduced a premium quality line of pasta and related products under its “Italian Classics” line. This trend has been adopted by other supermarket chains and has resulted in consumers changing their perception of store brand products from one of low quality to one of premium quality. As the quality of store brand products has increased so have prices. The result is that not only are consumers buying more store brand products than ever before, but they are also paying higher prices which has contributed to a higher overall spending level for store brand items.

Although grocery chains such as A&P and Kroger have sold store brand products since their inception more than 100 years ago the concept is relatively new to retail drug chains and general merchandise companies such as K-Mart and Walmart.

Retail drug stores have found that consumers are receptive to private label products and sales have increased in recent years. Between 1993 and 1999 the number of units of private label products sold in drug chains increased from about 8 percent to nearly 14 percent of all items sold. In mass merchandise stores the sale of private label products increased from just over 8 percent to slightly over 12 percent of total units sold during this same time period.

At the end of last year retail executives from supermarkets, drug stores and mass merchandise firms

were asked to forecast the growth in sales of private label products during this year (2001). Retail executives from mass merchandises were the most optimistic with a forecast of 15.9 percent growth followed by drug store executives who forecast a 8.1 percent growth and supermarket executive who projected a 6.7 percent growth of private label products in their stores.

What does this mean for the overall food system? Certainly it is a signal to national manufacturers of food and grocery products that competition from store brands will continue to increase. As retailers focus more on their own brands they will focus less on manufacturer brands; especially on nationally advertised brands that have a weak marketing program and small market shares. These weaker brands will be in jeopardy of being eliminated from the shelves of retail stores. Retailers will want to use this space for the ever-increasing number of store brands that the company offers to consumers. Customers could also benefit from a wider variety of higher quality store brand products to choose from and these products, in most cases, can be purchased at prices lower than comparable manufacturer brands.

Consumers should look for drug stores and general merchandise stores to add store brand products at a faster rate than supermarkets. The product mix in all types of retail stores will continue to change, but look for the shift to favor the stores own brands.

## Building your brand with brand line extensions

*by Nancy Giddens, agricultural extension value-added marketing specialist, Missouri Value-added Development Center, University of Missouri; and Amanda Hofmann, student research assistant*

**T**his article is third in a five-part series on building and developing a brand in the market. The first article outlined the importance of branding and the process of creating a brand for a new product, while the second examined flanker branding strategies. This series continues with discussion of brand line extensions.

### What is a brand line extension?

A company introduces a brand line extension by using an established product’s brand name to launch a new, slightly different item in the same product category. For example, Diet Coke™ is a line extension of the parent brand Coke™. While the products have distinct differences, they are in the same product category and the extension (Diet Coke™) is very dependent initially on customer recognition of the brand name Coke™.

**More than half of all new products introduced each year are brand line extensions.** New flavors, package sizes, nutritional content or products containing special additives are included in this definition.

### Why are brand line extensions important?

Brand line extensions reduce risk associated with new product development. Due to the established success of the parent brand, consumers will have instant recognition of the product name and will be more likely to try the new line extension. As a result, promotional costs are much lower for a line extension than for a completely new product. More products expand the company’s shelf space presence – enhancing brand recognition.

Building your brand with brand line extensions continued from page 5

For example, consider Campbell's Soups™ – the strength of the Campbell's™ brand lowers costs of launching a new flavor of soup, such as Creamy Chicken Noodle™, due to the established brand name and package design. Consumers who have enjoyed Campbell's Chicken Noodle Soup™ are likely to try Campbell's Creamy Chicken Noodle Soup™, even with minimal impact from advertisements and promotions.

In general, firms with broad product lines have

- More potential customers
- The opportunity to sell more to each customer
- Greater marketing efficiency
- Greater production efficiency
- Increased profits at the introduction and growth stages of product line extensions
- Lower promotional costs of product line extensions

**Brand line extensions do present two potential threats.** First, if the new line extension fails to satisfy, consumers' attitudes toward other products, carrying the same brand name may be damaged.

Second, there is potential for intra-firm competition between the parent product and the line extension, or between two or more line extensions. The key to avoiding intra-firm competition is to clearly differentiate between products. Although similar, the products must be different enough that they will not compete with one another as much as they will rival other companies' brands.

**Will brand line extensions work for you?**

A brand line extension strategy is not for every company. There are a number of questions that must be answered in order to make the best decision for your situation. The most basic questions include:

- Can my company develop a product extension with characteristics that clearly differentiate it from the established product?
- Are these characteristics believable and needed?
- Does my company have the resources necessary to develop a differentiated product?
- Will net combined sales of the established product and the line extension product be greater than sales of the established product alone?
- Will the cost of product development and promotion be covered by the sales of the new brand?
- Is there already a high level of diversity in the product category?
- Will my company have to borrow a large level of funding from the established brand in order to fund the line extension?

Successful brand line extensions are not entirely new products; they are simply new branches on the main plant. In order to optimize the power of the overall brand, line extensions have to make sense, be part of a long-term plan and reflect the core images and message of the brand.

The next article in the "Building Your Brand" series will examine another type of branding, brand leveraging.

**... and justice for all**

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA,

Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964. Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Stanley R. Johnson, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

**Permission to copy**

Permission is given to reprint ISU Extension materials contained in this publication via copy machine or other copy technology, so long as the source (Ag Decision Maker Iowa State University Extension) is clearly identifiable and the appropriate author is properly credited.