

BIOFUELS

As part of the governments' climate policy they have decided to implement mandatory biofuel targets for fuel retailers. One of the primary issues for the transport industry stemming from this regulation is the effect that a minimum biofuel sales target will have on the price of fuel.

The timing of the scheme is as follows. Starting at some yet to be determined point in 2008, fuel companies will be required to sell 0.53% as much biofuel as they sold total fuel over the same period in 2007. This target will then be gradually increased to 3.4% by 2012 and constantly benchmarked against the previous year.

Given the size of these targets there are a number of channels through which the biofuel regulation will increase the price of fuel:

1. Channel one: Costs associated with setting up the biofuel infrastructure and supply channels will need to be passed on, this will partially occur through the price of standard fuel,
2. Channel two: The potential risks with biofuels in some car types will reduce demand for biofuels relative to other fuels. This could lead to some 'cross-subsidisation' of bio-fuel prices in order to sell the target amount, driving up the price of other fuels,
3. Channel three: The global market price of biofuel is high. If it is higher than the price of standard fuel, then the impact of the mandatory sales target will drive up the price of standard fuel to at least the same price biofuel is sold for.

Two types of biofuel will be sold by fuel retailers to reach the target: biodiesel and ethanol based fuels. Biodiesel is the relatively low cost option, both in terms of production and infrastructural investment – however the problem is that we just don't have access to enough of it, and what we do have access to is currently being used for alternate purposes (eg Tallow).

As a result, the country will have to import, distribute and sell ethanol based fuel. This type of fuel requires special tanks and as a result would lead to additional costs for both the distributor and seller of ethanol fuel which would be partially passed on through higher fuel prices. As the fuel companies have to sell some biofuel, they will be forced to increase the price of standard fuel in order to make biofuel attractive for motorists.

The second and third channels for biofuel price increases have weakened over the past year as advertising has been used to illustrate that the risk from biofuel is minimal, and the world price of oil has risen to a level where importing ethanol fuel is now economical.

Overall, the impact of the mandatory biofuel regulation on fuel price (and especially diesel) prices is likely to be relatively minor, as current fuel prices would have convinced fuel companies that some degree of investment in biofuels is sensible – with or without the regulation. However, if the price of crude oil fell, the mandatory biofuel regulations would act to hold fuel prices up, by forcing retailers to sell an uneconomical product. 

