

Transcript of remarks by Allan Hubbard, Assistant to the President For Economic Policy

And Director of the National Economic Council

USDA's Agricultural Outlook Forum

Arlington, VA

March 1, 2007

MR. HUBBARD: I never thought George Bush would be President of the United States. I can tell you that. (laughs)

[Laughter.]

But I never thought any of my friends would be president of the United States.

[Laughter.]

And I am so proud of this president, and I feel so lucky to get to be a part of his administration. And I can tell you that George Bush is so proud of his Secretary of Agriculture Mike Johanns.

Before you all applaud, I just want to tell you, this is the honest truth -- he is a superstar in this cabinet. And he has just done a remarkable -- if George Bush were here, this is what he would say -- he has done a remarkable, remarkable job.

And what the President loves about Mike is, he has spent so much time traveling the country with his sidekick Chuck Conner the deputy secretary, listening to farmers and hearing what is on their mind, what their concerns are, in anticipation of putting together a Farm Bill proposal, which he announced a few weeks ago. And it is a fantastic bill that obviously went through the White House, and was reviewed by the President, approved by the President.

But I can tell you, the President was easily persuaded by Mike's recommendations, and he adopted Mike's recommendations. And the reception has been very, very positive, and I know we all look forward to working with Congress to getting a good Farm Bill passed.

But Mike is truly, he's just been fantastic. And I think we ought to all give him a big round of applause.

[Applause.]

Now I never told Mike this. I've been a business guy my whole adult life, and I was no farmer growing up. But I grew up in a farm community, believe it or not. And I was thinking about that as I was driving over here. I grew up in West Tennessee, and back then cotton was what was grown. And in my home town which was small at the time --

it's actually grown considerably since then --

But to a little kid there seemed to be as many cotton gins in our little town as there were gas stations. And in fact I was asking Hunter Morehead who's the special assistant to the President for Agriculture -- because now when I go home there are no cotton gins. I said, "Well," Hunter, "where are the cotton gins today?" Because we still produce cotton. He explained, "They are now these gigantic gins."

But back then we just had these little ones all over the place. And I can remember in school learning how the cotton gin worked and all that, and actually going to a cotton gin. My dad was a doctor, and many of his patients were farmers. I remember every Christmas we'd get all these gifts of food -- you know, corn and fruit and things they grew, which was fantastic.

Well, I'm here to talk about energy, which is, I think it's fantastic that you talk to an agricultural community, audience, about energy and the fact that these two industries are really being married, we're in the process of marrying these two industries, and the future just looks so, so bright. I don't know. I get so excited about it.

You know, we have the senior staff -- I'm sorry I'm getting off my -- I get excited thinking about what's going on. We have a senior staff meeting every day in the White House, and they go around and Josh Bolton goes around and asks everybody what's going on and I couldn't resist talking about the announcement yesterday that Secretary Bodman made, the sixth cellulosic plants that DOE is going to be partially funding. And these are the first six cellulosic plants in America. I think it's the first of many, many cellulosic plants.

So I've got this little slide show I'd like to share with you all. I don't know who's operating it. Is there a hand somewhere? Oh, do I operate it? I'm operating it. Oh my God, this is trouble. What do I do here? (laughs)

[Laughter.]

I wondered why it wouldn't move. Let's see if we can go to page 2. There we go. Yep.

Okay, you all can read the agenda. I don't have to go through it with you. There we go. This is a remarkable slide. I'm sure you all know this, but it just reinforces what has happened over the last 40 years. I remember, this was when I was with George Bush when we had the first Arab oil embargo in the early '70s. And we had to wait in line to get gasoline. Then we went to every other day. And back, President Nixon saying we were going to get oil independence, then President Ford. It seems like every president we've had has talked about how we've got to get energy independence. And we can see how successful we've been.

Imports have just grown, grown, grown. That shows you how the government does things. But anyway, I can tell you, well we'll go through this. You're going to see this

change because of what agriculture is going to do and what American innovation is going to do. But you can see, we have a gigantic problem if we're worried about imports, and we are in fact worried about imports. I'll get into that in just a minute.

Next slide. Just giving a little overview. You can see we consume about a fourth of the total oil production, 80 million barrels a day and we consume about 20 million barrels a day. The big growth has been in China, as everyone knows, and India. That's why we have such a tight market today. I think China's grown by about 100 percent in the last four years.

Next slide. There we go. In reserves, if you look at so many of those countries are our enemies and are funding our enemies, like Iran. You know, like Venezuela. Obviously Russia is not a totally reliable supplier. Nigeria is not a total reliable supplier. This is what worries our President is that we have to -- you know this oil market we have to rely on not only unreliable suppliers but suppliers who literally are funding our enemies in this war on terror.

Next slide. You can see how we use oil. You know, most of it goes for transportation.

Next slide. Then in the transportation sector, you know 97 percent of it is oil. Just to give you a little overview. Then you look at the Strategic Petroleum Reserve (SPRO). We all know what that's for. Obviously the number of days represented by the Strategic Petroleum Reserve has dropped dramatically because our imports have increased dramatically. And that creates an extra vulnerability that if we have a serious interruption of oil, we've only got less than 60 days where at one point we had over close to 120 days.

Next slide. Let's see. So you know, given all this background information, what does it mean? Obviously, it creates economic risk, risk that there will be an interruption of oil, the price of oil will go up, and it will have a very negative impact on our economy.

The remarkable thing about our economy is, despite higher oil prices, we're such a flexible economy today that we've been able to withstand those higher prices. But I can assure you if those prices went from \$60 bucks to \$120 or \$150 bucks, you'd see a very significant negative impact on this economy. And that's why we have to do something about our vulnerability to oil, to the risk of our oil supply.

But secondly, the national security risk. And this is what I've already alluded to. You know, the high prices today give money to Iran and Venezuela that they are using to fight us in our war on terror. It makes us much more vulnerable, not only vulnerable economically but vulnerable in terms of our national security. And this very much concerns our President. I know it concerns most Americans. And that's why the President has decided that oil is -- he's a big believer as I know most if not all of you are -- in free markets. I mean, free markets have over the last 200 years resulted in our country having the highest standard of living in the world, a remarkably fast-growing economy, improving standard of living for most all Americans.

But because of these two, the economic risks and most importantly the national security risk, the President decided, yes, we shouldn't just rely on the free market to solve this problem. We should actually intrude in that marketplace in a minimalist approach to try to encourage alternative fuels so we will become less dependent on foreign sources of oil, particularly foreign sources of oil from countries that we cannot rely on.

So the President came up with a plan, and so we have this 20 and 10. I'll tell you this little story. We developed a plan with the idea -- the President asked us, figure out, push the envelope, guys. Figure out the most aggressive thing we can do to achieve energy independence as quickly as possible or reduce our energy dependence as quickly as possible. And we did that, and we presented him with a proposal which to be honest we presented him with several proposals.

He chose the most aggressive. And it never occurred, this 20 and 10 idea never occurred to us. Three days before the State of the Union the communicators were involved, and they figured out that the plan we'd come up with actually resulted in a reduction of our dependence on gasoline by 20 percent in 10 years and so they came up with a 20 and 10. I know most people would think we came up with this idea of 20 and 10 and then made the numbers fit, but it actually worked the opposite way.

Obviously also a big part of it is, the two big components are we're going to develop an alternative supply that will represent 15 percent of anticipated gasoline consumption in 2017, reduce our demand by 5 percent, and then aggressively push technology development.

So what are our steps to accomplishing this? Obviously, increase the diversity of energy and transportation, increase production, and increase our ability to manage risk.

So how do we increase diversity? Obviously we want entrepreneurs, we want venture capitalists to invest in alternative energy. Now they take technology risks every day, but the big challenge in the energy field is, we all know that Saudi Arabia could wake up tomorrow and decide, hey, you know this \$60 buck oil is going to result in all these alternative sources and maybe oil will become less important to the world, so we'll just cut the price to \$25 by increasing our production. And every, entrepreneurs and venture capitalists all recognize this. So that has always been a big impediment to investment in alternative fuels.

So our challenge was to figure out a way to provide more certainty to these investors in alternative fuel. So to be perfectly frank, we looked at a number, three different ways of doing that. They've all been sort of discussed and debated in publications, and policy folks over the last several months if not several years. One idea was to come up with a price floor so we'd say, oil would never drop below, pick your number, \$45 bucks a barrel. We looked at that but we decided that would be more intrusive than necessary, very administratively difficult to handle. And also if technology comes through like we believe it will, it would be very expensive to the country.

The second approach would be to use a variable subsidy which essentially is the same thing, but you'd be doing it a different way so you set a price at say \$45 and if it drops below \$45 then you'd subsidize alternative fuels on the difference between the market price and \$45.

And it again has the same problem, that if you're successful you've ended up with a huge cost to the American taxpayer.

The third approach is to expand the fuel standard, which is basically expand the requirement in terms of alternative fuel. And our conclusion was that this was the least intrusive in the marketplace, and if we're successful in terms of new technology which we believe we will be, and the President and I last week met with leading scientists in cellulosic ethanol as well as in battery technology. And I'm confident as he is that we're going to be successful with the new technology.

And if we're really successful this expanded fuel standard will actually end up costing the country nothing.

So here's what we -- it came out at 15 percent but that wasn't what our goal was. Our goal was to come up with a number that we thought wasn't pushing the envelope number. And we came up with 35 billion gallons by 2017, which represents about 15 percent of what we expect to consume in gasoline in 2017.

Our decision was that we would expand it to include all alternatives to oil. This will provide a large certain market for investors. Again if we're successful the cost to the consumer will be very low, if absolutely nothing. It automatically sunsets with success.

We also -- and Secretary Johanns made absolutely certain of this -- that we had safety valves in place that if the technology doesn't work, if there are droughts in the agricultural market, or other unanticipated events, that the Secretary of Agriculture, Secretary of Energy and the EPA administrator would have the ability to waive or partially waive the 35 billion gallon requirement. Obviously it's going to gradually grow over time; as you know now the requirement is 7.5 billion by 2012.

We've talked about this. This we think not only if we're successful and we believe we will be -- will not only slow price growth but it could actually end up reducing price. That would be a huge benefit, and it is a major goal. We would like to see the price of oil drop. Not only would all of us pay less for gasoline, which I know we'd all enjoy, but more importantly Venezuela and Iran would no longer be making the kind of money they're making today, which they are using to fund our enemies. And that's very important.

The other thing, going to the second point, which is reducing consumption -- as I said, our goal is to reduce consumption by 5 percent by 2017 by increasing CAFÉ standards. Our suggestion to Congress is that we give the Secretary of Transportation the ability to do that in a scientific cost benefit way, taking safety into consideration and making it part

of the analysis when she comes up with what she believes is a reasonable expectation in terms of improvement in CAFE.

Now what would be done on an attribute basis so you'd have big cars competing with big cars, little cars competing with little cars because the President believes very strongly, we don't want to change the way the American people live. You know, if you're used to, like farmers, having pickup trucks, you want to continue to have pickup trucks. We just want you to have more efficient pickup trucks. But we don't want to force you into driving golf carts out on your farm. You need those pickup trucks.

So the idea is, it will be attribute based, based on science, based on safety, based on technology and what technology is available. And it will be a cost benefit analysis. And we believe, and we don't know the answer because the research hasn't been done, but we believe there's a reasonable chance that the CAFE standards can beginning in 2010 start growing by 4 percent a year, the result of which would be the demand for gasoline would drop by 5 percent.

It's interesting when you look at auto efficiency. Friend of mine showed me this slide which I think is absolutely remarkable. If you look at the passenger cars, there's been no improvement in auto efficiency over the past 25 years or is it 45 years? I can't read the slide. But if you look at what's happened with air travel, it's been dramatic with airplanes improved. Now the cost of flying a mile on an airplane in terms of fuel consumption is no greater than it is driving a car.

Why have cars been level? It's not because technology hasn't been improving. I think we all know the answer is because we -- I don't blame the auto companies. All they are doing is responding to the marketplace. We want to buy heavier cars, bigger cars with more power. So power and weight has increased by about 30 or 35 percent over the past 40 years. But fuel efficiency has been -- at the expense of improving fuel efficiency because the technology as we all know has dramatically improved over the last 45 years.

Again I've actually gone into all this about how we expect the CAFE to be reformed, done in an intelligent way, and what the results would be. Finally the third step, this gets back to SPRO. Because we import so much of our oil, we are vulnerable to a serious interruption of oil. And I think it was President Ford who originally came up with the idea of the Strategic Petroleum Reserve. It's very important. As you know, we've not used it very often. It helped us enormously though during Katrina, which I was right in the middle of, where we did have a big interruption.

And by the way, the oil industry was remarkably proficient and just fast at reacting to what happened when all the refineries were knocked down and worked very closely with the Department of Energy to get the oil and gasoline flowing again. But Strategic Petroleum Reserve was invaluable in making that happen.

But as you remember from the earlier slide, SPRO relative to the amount of imports has dropped dramatically, and so the President for national security reasons believes we need

to double the size of SPRO, which will take 20 years and increase it to 1.5 billion barrels from the current 750 million barrels.

So to just summarize, we believe this is a bold, bold plan. It is pushing the envelope. By the way, if you compare it to what other people have proposed, we are very, very aggressive. And but we think it's doable. We think the technology is going to be developed by many of you out here in the audience I'm sure are involved in that. You know, Americans have always come through with new technology when the country needed it. The technology will be used not only to develop cellulosic ethanol, to develop new battery technology, but it will also be used to make our cars more efficient, and so that the end result, we believe we can achieve that 20 percent reduction in demand for gasoline in 10 years.

The other side benefit is, if we do achieve it, carbon dioxide emissions from automobiles will actually peak around 2015 and the amount we emit will actually start declining.

Then finally, again if we're successful obviously our technology will be available to anyone in the world. We look forward to our entrepreneurs being able to sell that technology to China and India and Europe, all over the world. The end result will be not only a dramatic reduction in the world's dependence on oil but also will start addressing the CO2 challenges that the world faces.

So that's, I think that's my last slide.

That lays out what our game plan is in the energy area. I'm happy to answer -- I don't know how much time I've got but I can answer a couple. Do you have a couple questions? I'd be happy to answer a couple questions about what's on your mind. Yes, sir, back here?

QUESTION: (off-mike) passenger automobile.

MR. HUBBARD: I'll repeat it. I can hear you.

QUESTION: You said you'd put the emphasis on incentives for passenger automobiles. Considering that there's another large user of gasoline, apparently fossil fuel in this country, for transportation every day, which is a trucking industry, what incentive ideas do you have to help reduce the use of gasoline by the trucking industry as well as passenger cars?

MR. HUBBARD: That's a very good question. What I've been talking about, and I've only talked about, I use the word "cars," but we're also talking about light trucks -- the Secretary of Transportation right now has the ability to reform CAFE along the lines I discussed for light trucks which her predecessor did and she will be doing again under our plan. Again, we think we can, the improvement in CAFE currently in the regulations is 2 percent a year, and we think that because of improved technology that can be increased to 4 percent. But again the assessment hadn't been made. I'm embarrassed to

say this but with respect to heavy trucks we have not addressed that like we should. I don't know the answer. So the one thing I learned early on is, don't make up an answer. So I will not make up an answer. But I'm going to tell you this, I'm going to make a note of what you just asked me, and if you'll give me your card I will send you an answer. So I apologize.

QUESTION: (off-mike)

MR. HUBBARD: Biodiesel is absolutely, which we very much believe in. By the way, that's one of the alternative fuels that -- I mean that is certainly classified as an alternative fuel.

In the back? Yes, sir.

QUESTION: Thanks for taking my question. Could you please discuss the role you think coal or other fossil fuels might play in the alternative standard and what the implications for biofuels might be at the higher end of that spectrum?

MR. HUBBARD: Well, what we're going to propose to Congress -- we're actually meeting this afternoon on this -- but what we're going to propose to Congress is classified as alternative will be coal to liquids which that technology I think was developed in South Africa but I know in Wyoming right now there's a very big plant being built in South Eastern Wyoming, and we think there's a lot of promise there. Obviously coal is going to be important for the foreseeable future to the electric power industry. And as battery technology develops the electric power industry is obviously critical to battery technology. We believe that plug-in hybrids will be in the next two or three years we'll be able to buy those on many of the cars being sold. So coal is very important to our future. Fortunately we are the Saudi Arabia of coal. We've got 250 years supply.

What about one more question? Yes, sir.

QUESTION: Hi. Thank you very much. Thank you for your hard work and dedication to this policy which is clearly very much needed. The one question I have is, clearly the cornerstone of the policy is the expanded requirement in terms of standards, taking it from 7.5 billion to 35 billion. And but my real question is about the ability to waive the standard, because if that's the cornerstone of the policy and we've seen corn prices at 10-year highs, we have a drought this summer, everybody in this room knows that corn prices can go through the roof as can soy. So I'd have thought the probability that you have to waive the standard is relatively high. My question is, how likely do you think it is we're going to have to waive the standard, one? And two, how much are we really dependent on technological breakthroughs like cellulosic ethanol? And when do you expect them to come through? Thank you.

MR. HUBBARD: Those are very good questions, and I appreciate it because I actually wanted to address those concerns. First off, with respect to corn ethanol, our expectation is that it will not get much above 15 billion gallons. We think that's sort of the capacity

of the agricultural community. We do expect the number of acres, and I'm sure I'll get this wrong, but I think there's 78 million acres currently in corn. Is that right? Something like that? And I know that the projections are for this year that's going to increase dramatically. So the market will respond. You know, when there's \$4 buck corn out there, people will move, go from cotton to corn or from soybean to corn or whatever. I think you're talking about a very double-digit percentage increase in the amount of acres that are going to be devoted to corn.

I think I'm meeting today with a research person from Monsanto. I know they are coming up with some remarkably improved seeds for corn that are going to make the yields significantly greater. So we think the market is going to respond to this, like it always does when prices go up. And that's what's so wonderful about the free market. You know obviously if a drought occurs, we've got this great Secretary of Agriculture who will be looking out for the --

[Laughter.]

The pig farmers and cattle farmers and chicken farmers, etcetera.

The other thing that's so interesting, and I know this much about this, but Monsanto's developing seeds that will allow the byproduct of corn ethanol production to be used as feed when today it can't be. It's going to be more nutritious and it's going to be able to be used for chickens, I think, which now it can't be used for chickens.

So again, the marketplace is working. Technological innovation is working. But at the same time we want someone that's really bright and thoughtful like Secretary Johanns to be able to make sure that there are no significant interruptions that need to be addressed.

The most exciting thing is this cellulosic. I tell you, I'm again last week we met with, the President and I met with the leading research folks in cellulosic ethanol from all over the country including one fellow who works for one of the Department of Energy labs in California named Yves Chauvin, who actually won the Nobel Prize a few years ago in chemistry, and is just a remarkably impressive person. And we met in the Roosevelt Room about 10 or 12 scientists, and to a person they all said, "This is going to happen, the only question is when." But we think 2012 is a very realistic date, and it may happen before then. The important thing is to start commercializing it and then you start going down the learning curve.

And they're talking about new enzymes that would drop the price significantly below what corn ethanol costs to produce. The great thing about the cellulosic, when you think about it, we will be able to produce it in every corner of this country, from switch grass and all different kind of plants that can be planted in drier areas and areas that now are not particularly fertile for our normal crops. You know, the impact this is going to have on rural America is going to be remarkable. I just think it's so exciting. Then obviously what's most exciting though that we should never forget, this is going to reduce our dependence on oil from our enemies and unreliable suppliers and provide the kind of

security this President is committed to providing for all Americans.

So anyway, I really appreciate the opportunity to speak with you all, and thanks so much for your interest. And thanks for everything you're doing to make this vision happen. Thank you very much.

[Applause.]