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Ethanol Is Not Solution to Gasoline Crunch in the United States

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Unintended consequences happen when ethanol from corn and soybeans is used as the solution.

Story By Calvin A. Kent

There are two universally accepted economic laws: "supply and demand" and "unintended consequences."

If you ignore the first, you will be clobbered by the second. Case in point is the current controversy about gasoline prices. Last week, even when adjusted for inflation, pump prices hit an all-time high.

It is not surprising the U.S. House of Representative passed legislation to limit "unconscionably excessive prices" (whatever that means) for gasoline. Polls show the public thinks the villain is the major oil companies. There is nothing new about this. It has happened every time pump prices have risen since the Arab oil embargo of the 1970s.

Just because the feeling is reinforced by parts of the media does not make it valid. Often in this country, politics are more about playing to the public's ignorance than seeking rational policy. It is easier to find someone to blame than to ask why and what should be done.

This is where the law of supply and demand comes in. One of the primary reasons for high prices is that demand for gasoline has risen 2 percent more this year than last while supply has increased by only .5 percent. Americans are both driving and complaining more. Never forget the words of Pogo Possum, "We have met the enemy, and he is us."

Today's solution for achieving "energy independence" appears to be ethanol. What folks used to call "moonshine" is the savior of choice. But is this savior really the devil in disguise?

Forget for now that a gallon of ethanol will propel your vehicle only three quarters as far as a gallon of petroleum-based fuel because there is a greater problem. Our stomachs and our gas tanks are now in competition.

Corn and soybeans are the major sources of ethanol, and they also are major sources of animal feed and human food products. As more corn and beans have gone into the gas tank, food prices have increased dramatically.

The press south of the border points to the corn "tortilla crisis." Prices for this staple in the diets of low-income Latinos have risen almost 20 percent. One does not have to be a Ph.D. economist to know what is going to happen to both gasoline and food prices the next time drought hits the Corn Belt. Even the most ardent supporters of ethanol realize the goals established for its use in the future are unrealistic because of cropland constraints.

Crude oil prices, which are above \$60 a barrel, are only one-half the cost of a gallon. OPEC is not likely to push them down. There is an additional reason for high pump prices -- the shortfall of gasoline supply. We could supply more gasoline if we had the ability to refine it. Gulf refineries have not fully recovered from the impact of Katrina, and some refining capacity is not back on line. Further due to the impact of Katrina, many refineries delayed necessary maintenance that had to be postponed until this year.

Due to environmental concerns, no refineries have been built in the U.S. since the 1970s. An increasing amount of our gasoline must be imported. Imports now total more than one gallon out of 10. Strikes and political unrest in these foreign nations have led to cutbacks in refining, which have limited imports into the U.S. The end of the strikes and violence in Nigeria, a principal U.S. supplier, will ease the future situation.

U.S. refineries have doubled their capacity at existing plants in the past few years, but that has not been enough. In addition, refineries must switch from winter to summer blends of gasoline to meet environmental standards. That switch requires the reduction of refining capacity just before the summer driving season starts. Since all refineries are running at capacity, the argument that gasoline supplies are being kept off the market to drive up prices doesn't compute.

Since the government heavily subsidizes at 51 cents a gallon the production of ethanol (so its true cost is not obvious to the public), the construction of planned new petroleum refining capacity in the U.S. has been put on hold. With the push to expand ethanol production and its continuing government support, the investment climate for expanded petroleum refining capacity has become uncertain. These billion-dollar projects can't find the needed financing.

The law of supply and demand makes it clear that when demand goes up faster than supply, prices will rise. Unintended consequences happen when ethanol from corn and soybeans is used as the solution. Food prices rise, and the refining "choke point" is tightened.

The need to find alternative fuels is real. Energy independence must be one of our highest priorities. But there are better alternatives than having our vehicles gulp moonshine.

Calvin A. Kent, Ph.D., is vice president for business and economic research at the Marshall University Center for Business and Economic Research in Huntington. He served as assistant secretary and administrator of the Energy Information Administration of the U.S. Department of Energy from 1989-93.

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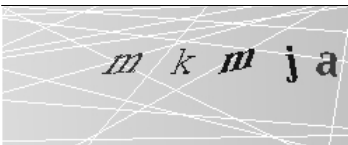
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