

I Hate Ethanol And So Should You

Josef Stalin was a great student of organizational management, and I have no doubt in another time and place he could have made a terrific consultant, especially when downsizing was indicated. He understood the best way to promote comity amongst his subordinates was to make sure no one would ever be wrong.

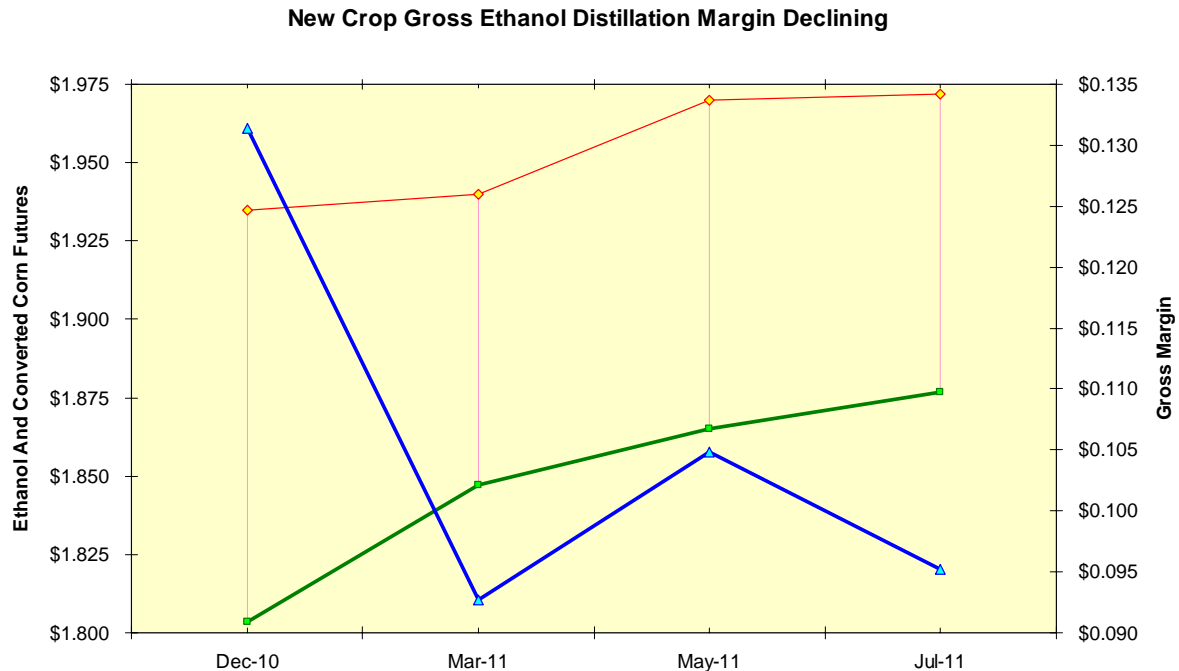
Huh? He made sure all of the underlings understood there would be a price for failure; they in turn understood they had to pretend each other's actions were right or else they would all end up in the Gulag. Uncle Joe was quite the team-builder.

I think something similar must be operating in America's otherwise inexplicable obsession with ethanol as a motor fuel; ethanol as a beverage is a far easier program to swallow. Let me say right off the bat if we could produce all of our motor ethanol from non-food sources such as cellulosic waste (wood chips, waste paper or remaindered copies of every political campaign book ever written) or, better yet, from algae, I might feel a little different. We would still be left with the fact ethanol is difficult to store and transport as it draws moisture from the air (put a little Bacardi 151 on your tongue as an illustration) and becomes corrosive. It also has about 85% of the energy content of straight-run gasoline.

But we still seem determined to pay fealty to farm-state Senators who find government spending deplorable except in the case of agricultural subsidies; there are proposal to expand the ethanol content of normal motor gasoline blends from 10% to 15%. As we saw in 2007 and again in 2008, this demand can put upwards pressure on corn prices in the U.S. and sugar prices from Brazil and elsewhere. Firms such as VeraSun Energy went into bankruptcy and former highfliers such as Pacific Ethanol have retreated from \$44.50 in May 2006 to less than \$1.00 today.

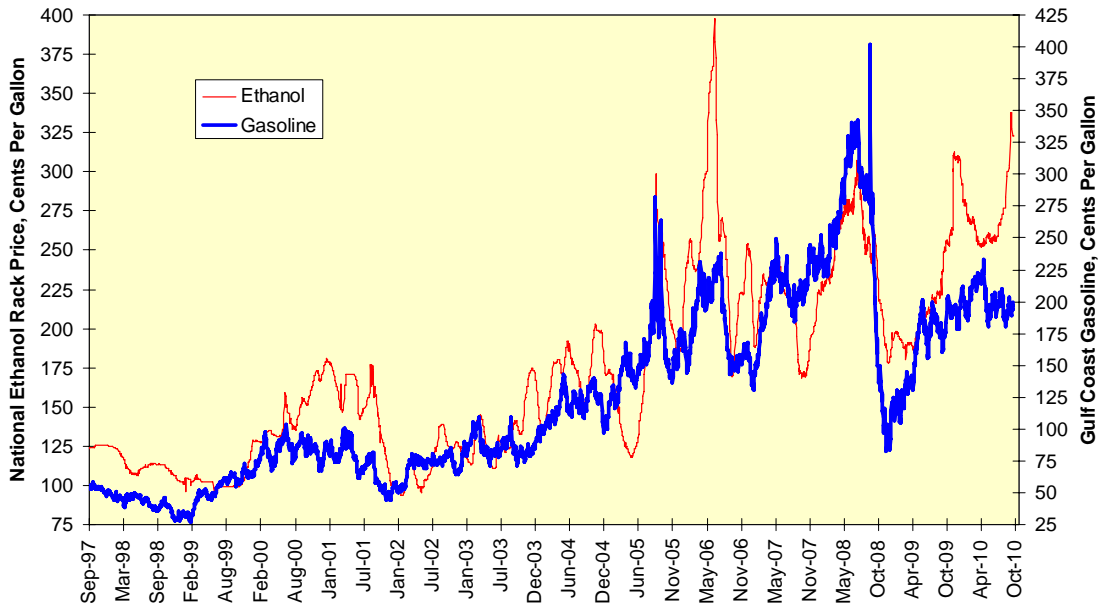
Corn Squeezin's

The rise in corn prices has led to a compression of gross distillation margins for the new crop. Corn for December harvest and carried forward into July 2011 is in a normal carry structure, while the forward curve of ethanol futures has flattened in anticipation of negative price pressures.



This is not to say ethanol is cheap; no, not by any means. While wholesale prices for gasoline at the U.S. Gulf Coast have been in a trading range most of the year, ethanol prices have shot higher and have disconnected from the previous tight relationship to gasoline.

Ethanol And Gasoline Prices



If the central principle of Austrian economics, prices determine costs, held, the price of the inferior ethanol would have to fall to be bought by gasoline blenders. However, the ethanol blending mandate forces blenders to pay more for an inferior fuel. If ethanol prices and production were not subsidized, distillation margins would be negative and the folly would end.

But no; that would mean that someone would be wrong. The list of candidates for an all-expenses-paid train ride to Siberia would include advocates of “energy independence,” whatever that is, farm state politicians, Greenies who ignore the negative environmental externalities of ethanol and the distillers themselves.

Stalin had another maxim: “When there is a man and a problem, eliminate the man and the problem disappeared.” That Joe was a can-do guy, was he not?