

## **Overcapacity created by new subsidized ethanol refineries, coupled with falling demand makes ethanol a loser**

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May 4, 2005

Back in late 2002, the US Department of Energy correctly predicted an overcapacity problem for ethanol.

"An unintended consequence of the RFS [Bill stalled in Congress since 2002 to require the use of 5 billion gallons of ethanol annually] might be an ethanol plant construction boom leading to overcapacity and depressed prices. ...An ethanol industry consultancy has indicated that banks financing ethanol plant construction could be expected to refrain from lending on projects leading to possible oversupply."

From: Renewable Motor Fuel Production Capacity  
September 2002  
Office of Integrated Analysis and Forecasting of the Energy Information Administration,  
US Department of Energy

Although DOE's forecasting record is far from perfect, it was almost clairvoyant with this prediction. But agri-business did not listen. According to DOE, US ethanol production in 2002 was 2.2 billion gallons annually. The Renewable Fuels Association (the ethanol refinery association) states that by the end of 2005 US production will be 4.5 billion gallons annually (more than double the output in 3 years!). And there are at least 60 new ethanol distilleries in the planning/approval stage. Almost all of this new volume is from *new farmer-owned ethanol refineries*, like the one proposed by Penn-Mar Ethanol in Greene township, Franklin County, Pennsylvania (building the first ethanol distillery in the Northeast, where corn costs over \$.50 more a bushel than it does in the Midwest casts more doubt on Penn-Mar Ethanol's business judgment). Penn-Mar and other new ethanol distillers ignored the laws of supply and demand, and relied on government sponsored, taxpayer funded ethanol support to make new ethanol refineries economically viable. It was not enough.

So agri-business is lobbying Congress (and many states) to force America to buy a product that can not gain market acceptance because it does not reduce pollution and smog (according to the prestigious National Academy of Sciences), lowers gas mileage (according to the AAA), and ethanol refineries generate significant air pollution and odor (according to the EPA).

Even if an Energy Bill *requiring* the use of 5 billion gallons of ethanol annually passes, it will not solve the problem. By 2006, when the requirement would take effect, US ethanol production will be well over that artificial demand of 5 billion gallons.

The problem is now worse than DOE expected because while supply has exploded, demand for ethanol has not grown. In fact ethanol has lower market acceptance than it did in 2002.

Even with corn subsidies, grants to build distilleries, fuel tax credits (\$.52 a gallon), and forced use if the current Energy Bill passes, ethanol is still a “highly speculative” investment, according to Standard and Poors and other rating companies.

The stock market knows that high supply and low demand is a recipe for disaster. The giant agri-business conglomerate, Archer Daniels Midland, watched its stock plummet 17% in April 2005, because it has such a large stake in ethanol.

**Investors and banks who ignore the current low ethanol prices caused by ever increasing capacity and low demand, and the predictions that low prices will continue due to over-building of distilleries despite limited demand, will get stuck with ethanol companies that can not make money.**

*Sidebar: Great Britain tried unsuccessfully to use the “throw money at it” methodology to control the opium/heroin market in Afghanistan. There, they wanted to decrease or eliminate opium/heroin poppy production. So they offered to spend taxpayer funds to pay farmers for existing poppy crops (to destroy the poppies), and then subsidize the farmers to plant other crops in the future. Of course, the market meddling backfired. When Afghani farmers heard the government had money for poppy growers, many planted a poppy crop (like the US farmers building ethanol distilleries, they were quick to jump on the subsidy wagon). This created a record crop (overcapacity). The program did not have enough money to buy it all—so the world market has been flooded with cheaper heroin. Worse yet, Afghani farmers are continuing to plant poppies, believing, like ethanol distillery farmer-owners here in the US, that the government just will have to come up with more money next year.*