**THE ECONOMICS OF PUBLIC ISSUES**

**ISSUE TOPIC: Ethanol Madness**

**Issue Summary:** Using ethanol as an additive to gasoline may have been beneficial 20 years ago, but it does not make sense today. How could such bad policy occur in a democracy in which all citizens have equal votes (one vote per person)?

**Major Economic Issue(s) Discussed:** Opportunity cost, unintended consequences (incentives), price (corn, gas) technology, efficiency, political economy, rational ignorance, information costs or transaction costs.

**Mythconceptions Surrounding the Issue:** Adding ethanol to gasoline has three major benefits that make it worth doing: 1) Less air pollution, 2) ethanol (corn) is a renewable resource, 3) Less dependent on foreign oil (Middle East).

**Economic Analysis of the Issue:** As attention for the environment has increased we are seeking energy alternatives (less carbon emission). There has also been a lot of attention given to the decline of the family farm, dependence on foreign oil (in particular from the Middle East) and rising gasoline prices. Ethanol has popped up as a possible solution to these concerns. The 2005 Energy Policy Act mandated the use of ethanol as an additive to gasoline and also subsidizes corn production. Both farmers and ethanol producers have responded to this policy in very predictable ways. More corn acreage (increase in supply) and more ethanol factories (increased demand).

But as it turns out it may not be that beneficial and could even make things worse in several ways.

It is inefficient to produce ethanol in terms of energy used to produce it relative to energy gained when used (No Bang for the Buck). Ethanol factories are also noisy and smelly and thus impose an additional cost on those living near ethanol plants. Canada and Mexico are our two largest sources of imported oil and ethanol currently represents less than 3% of all gasoline used. Therefore using ethanol may do little to lessen our dependence on Oil from the Middle East. In fact replacing all imported oil from the Persian Gulf with ethanol it would require using 50% of available farm land to grow corn (opportunity cost).

**The ‘Walk Away’ (Mythconception vs Reality):** So why ethanol? The answer is in the incentives facing both politicians and voters (special interest groups and individuals). Rational ignorance suggests that because costs of the energy policy are diffused widely across individuals in society they have little incentive o incur the cost of obtaining information or to protest the policy. Conversely, the benefits are concentrated (corn farmers and ADM) so that they have a strong incentive to lobby for the policy (campaign contributions). Similarly, if politicians want to get re-elected they have the incentive to pass such policies even if they do make economic sense.