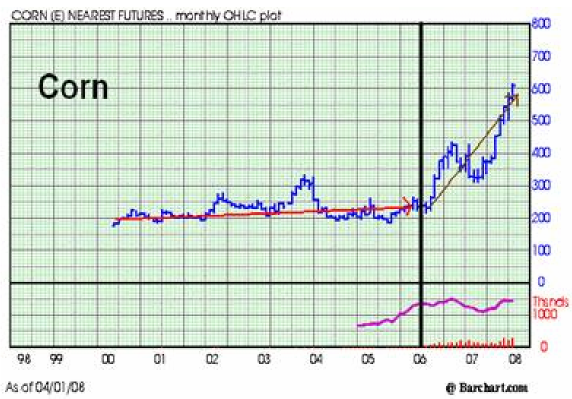
2005 Energy Bill and Grain Prices

The 2005 Energy bill mandated that 4 billion gallons of renewable fuel (mostly corn-based ethanol) must be added to the gasoline supply in 2006. That amount rises to 4.7 billion gallons in 2007 and 7.5 billion in 2012. This still represents a small fraction of the estimated 140 billion gallons of gasoline the US consumes every year. But it is the subsidies and tax credits that have made this ethanol market what it is - without government interference, consumer-driven demand would be nothing and the ethanol market would be SIGNIFICANTLY SMALLER.

Look at the monthly charts for corn, wheat, and soy below - I've placed a line denoting the start of 2006. Notice that all of the commodities were increasing gradually from 2000-2005, but from the beginning of 2006 until the present, these commodities have sky-rocketed. This coincides exactly with the beginning of the ethanol mandate on gasoline.



To be fair, we can also see that the number of contracts traded rose significantly in early 2006 and have gone up steadily ever since. Prior to 2006, not many people traded or invested in the grains markets – however, this has changed drastically over the past couple of years. This is contributing to the higher prices as well, because more buyers lead to higher prices (not many are shorting these commodities). Also, there has been tremendous index buying the past couple of years (Goldman-Sach's/S&P Commodity Index, Dow Jones-AIG commodity index ,for example), which is contributing to the high volume and higher prices – these index funds have allowed the general population to "safely" invest in commodities now, a market that used to be only for the brave, bold, and informed.

It is clear to see that these two things came together just at the right time to push grains through the roof the past couple of years. However, this would not be what it is, were it not for the government-forced ethanol mandate.