Should we punish or promote ethanol?
By Marcos Jank

The global financial crisis of 2008 barely grazed the Brazilian economy and may have been little more than a slight jolt for certain industries and areas of activity. But those that had been expanding with sizeable investments, like the sugarcane industry, were affected much more drastically by the dramatic loss of liquidity that year. That is where the problems now being experienced by Brazilian ethanol were born.

Sugarcane production grew by 10.3% annually from 2000 to 2008, doubling in just eight years the output Brazil took nearly 500 years to reach. After 2008, a third of the industry faced tremendous financial difficulties, which resulted in an intense process of financial andf corporate consolidation. With investments focusing on bailing out companies in trouble instead of building new mills, expansion fell to 3% per year. Today, we have fewer companies that are better structured and feature improved governance, but sugarcane production is stagnant.

The daunting challenge now is to find a way to grow steadily and sustainably, while avoiding the volatility of the never-ending stops and starts that have characterized the recent history of this industry. The question that begs an answer is: what policies would best ensure the harmonious growth of this unique industry, which produces such an impressive range of renewable products, including food, biofuels, bioelectricity and bioplastics?

This is the scale of the challenge ahead: to understand that greater regulation seems to be necessary where the industry's energy component is concerned, keeping in mind that excessive intervention may take away flexibility, inhibiting instead of encouraging investments so essential to achieve growth.

The first major mistake at this stage is believing that the problem lies with the price of sugar. While it may be true that in the past two years it has been more profitable to use cane juice to produce sugar instead of ethanol, the flexibility of sugarcane processing mills to choose what to produce is limited to only 6% of sugarcane production. The last harvest yielded nearly 5 million tons of additional sugar, which could have been 3 billion liters of ethanol instead, but with significant losses in profitability for companies.

As it happens, the drought observed in the second half of 2010 resulted in crop losses equivalent to 5 billion liters of ethanol. Additionally, the post-2008 slowdown in the industry's expansion was equivalent to a reduction in cane production that could generate another 11 billion liters of ethanol this year, or almost half the country's consumption for the entire year. The real problem, therefore, is not the substitution of ethanol with sugar, but the absence of investment in sugarcane production to produce both.

A misguided diagnosis, which pins the current situation on an increase in sugar production at the expense of ethanol, led to a series of threats involving punitive policies that would only bring about added insecurity, scaring away investment and further hindering expansion in the industry. Measures such as taxing sugar exports or reducing the ethanol blend in gasoline to less than the current 20% legal limit, both openly contemplated in the past few days, would only produce the opposite of what needs to happen.

Let's consider the possible consequences of just one of those suggestions: an export tariff on sugar. Brazil accounts for about 20% of production and more than 50% of global sugar exports. Sugar ranks fifth among Brazil`s top exports, answering for US$ 13 billion in revenues last year. Considering Brazil's weight and relevance on the global sugar market, taxing sugar exports would cause an immediate price increase, generating inflationary pressures and food insecurity in Brazil and around the globe. Brazil would certainly lose market share and credibility in its historical positions at the negotiating table, always favoring the elimination of agricultural trade distortions. Moreover, the measure would jeopardize the results obtained in the WTO litigation against the European Union, giving the Europeans new elements to resume exporting subsidized sugar. Our international reputation as a food supplier would also be harmed, since Brazil would be openly recognizing the difficulty in fulfilling the demands of both the food and energy markets.

It so happens that the industry sees investing in mills dedicated to ethanol production as a difficult proposition, given the great uncertainty that surrounds domestic gasoline prices, which are controlled by Petrobras and have been kept at the same level since 2005, regardless of what has happened with the price of oil. With the rising costs of sugarcane production, margins have declined and investors fear the lack of clear rules allowing two very different markets - diverse and competitive ethanol and the near-monopoly that is gasoline - to coexist and compete effectively. Measures such as taxing sugar or ethanol exports would only increase the level of uncertainty and drive away new investments.

There are certainly better alternatives to regulate the sugar-energy industry, restore the competitiveness of hydrous ethanol and thus allow new investments to flourish. If no change in gasoline pricing policies is to be contemplated, a possible set of solutions would include harmonizing federal and state taxes to bring down rates for ethanol, bioelectricity incentives, improvements to infrastructure and the commitment to secure the supply of biofuels, increased productivity, cost reductions and greater efficiency of flex-fuel engines. Within this context, it is entirely feasible to imagine the construction of dozens of new mills dedicated exclusively to the production of ethanol and bioelectricity and geared towards meeting the growing demand for clean, renewable energy in domestic and global markets. That's the positive agenda we are pursuing with all our will and enthusiasm.

A version of this article appeared in the April 13, 2011 edition of the Brazilian daily "O Estado de São Paulo".

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