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# Will the Ethanol Sector in Brazil See Major Changes?

Inter-American Dialogue's Latin American Energy Advisor

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***Q and A: Will the Ethanol Sector in Brazil See Major Changes?***

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Brazil's Sugarcane Industry Association (UNICA) further decreased its forecast for the 2011-2012 harvest in the south center region, which is responsible for 90 percent of the country's production. The organization now expects a drop of some 12 percent from the 2010-2011 harvest of 557 million tons. Among the reasons for the fall in output are lower agricultural productivity, unfavorable weather conditions and new diseases and infestations. Is the ethanol sector likely to see similar problems in the future? What role will biofuels play in Brazil's short to medium term energy future? Is the government likely to make any significant changes to policies regarding biofuels?

**A: Eric Lundin, global outlook for alternative liquids manager at PFC Energy:**

"While little can be done about the weather, most of the other issues affecting the sugar cane crop have to do with lack of investment in fields and maintenance, resulting from major financial difficulties in the sector since 2008. Currently, ethanol production capacity far outstrips supply of sugar cane, and the country's most urgent need is for restoration of productivity from existing fields. However, domestic demand will begin to catch up with distillation capacity in the next few years and a significant number of new ethanol plants will need to be announced within the next year in order to support demand growth by the 2015 timeframe. It is unclear whether this investment is forthcoming given the government's control of gasoline prices (targeted at taming inflation), which has prevented ethanol prices and production margins from rising. Still, Brazil's vast natural resource endowment allows for a doubling of ethanol production within the next 10-15 years, sustaining its significant share of Brazilian total liquids production. Reflecting this potential, large energy players including Shell, BP and Petrobras have recently increased their stakes in the industry. In terms of policy, the government has made ethanol growth a priority, but in general, the measures taken thus far have limited value in terms of incentivizing the investment the country badly needs to restore its fuel balance and support future demand. Efforts currently underway to ease foreign direct investment to the agricultural sector will help, if successful, but still may not be sufficient to bring about the production increases needed."

**A: Leticia Phillips, North America representative of Brazil's Sugarcane Industry Association (UNICA):**

"Brazilian sugar cane ethanol is recognized globally as the only biofuel currently available at a commercial scale to efficiently and economically reduce greenhouse gas levels. The Environmental Protection Agency's Renewable Fuel Standard and California's Low Carbon Fuel Standard have classified cane ethanol as an advanced biofuel and its calls for increased amounts are expected to drive demand. In the short- and medium-term, there is an urgent need for clear policy frameworks that will enable increased, yet sustainable, production. Brazilian ethanol is produced in a sustainable way without subsidies. Yet, its access to key markets, such as Europe and the United States, is heavily restricted. Markets have to be liberalized if ethanol is ever to become a globally tradable commodity. The Brazilian sugar cane industry has to continuously work on reducing costs, increase efficiency gains and productivity, as well as develop and disseminate new technologies. However, clear policies will attract investments to fund the renewal of fields and product storage, which are two of the major challenges for a successful harvest in Brazil. The demand for ethanol in Brazil will continue to grow due to the country's continuous economic growth. UNICA expects Brazil to reinstate the 25 percent ethanol blending in gasoline—which was temporarily reduced nationwide to 20 percent last month—after the next sugar cane harvest, provided that the harvest is strong and depending on the relative price between sugar and ethanol. The industry is committed to overcoming these challenges in order to continue to provide this sustainable biofuel for Brazil and abroad."

**A: Arnaldo Vieira de Carvalho, lead energy specialist at the Inter-American Development Bank:**

"Despite the reduction in total sugar cane crushed volume, production so far has privileged anhydrous ethanol (the ethanol form that is blended with gasoline) in such a way that the anhydrous ethanol total output this harvest reached 7.49 billion liters so far, surpassing the 7.41 billion liters produced during the entire previous harvest. That is helping meet the increased demand for liquid fuels (gasoline and ethanol combined), which has grown 7 percent in the last 12 months, according to latest reports from the ANP. As for hydrous ethanol (the form used as straight fuel in flex-fuel vehicles), the opposite situation occurred. Its production this season has shown a 29 percent drop compared to the same period in the previous harvest. This is reflected in its end-user price, which is not favorable compared with gasoline prices: the relative hydrous ethanol/gasoline prices averaged 74 percent for 2011 so far, compared with 66 percent in 2010, whereas the equilibrium relation is 70 percent, due to the difference in the corresponding fuel consumption of vehicles using gasoline blends vs. hydrous ethanol. The Brazilian National Association of Motor Vehicle Manufacturers indicates in its November report that licensing of new light vehicles in Brazil for the period of January-October reached 2.8 million vehicles, 5.1 percent higher than the same period in 2010. The participation of flex-fuel vehicles has shown a decrease to 83.3 percent from 86.4 percent in 2010, explained by the unfavorable hydrous ethanol prices and the increase in the participation of imported vehicles (not all imported models offer flex-fuel capabilities). Hopefully in the coming years, the weather will improve and the ethanol sector will not see similar problems. The role of biofuels in Brazil's short- to medium-term future shall continue to be relevant since demand for ethanol will keep increasing fast for gasoline blends and, if hydrous ethanol prices are more favorable, also as straight fuel for flex-

fuel cars. If policies change, it certainly would be to stimulate investment in the sector and not penalize production."

**A: José Goldemberg, physics professor at the University of São Paulo and former environment minister of São Paulo State:**

"The reasons for the 12 percent decline in the 2011 sugar cane harvest in the south-center region are well understood: Lower agricultural productivity because the renewal of sugar cane production areas was reduced as a result of the 2008 financial crisis. Three years of droughts and excessive rain made the situation worse, particularly because mechanized harvesting does not work well after heavy rains. Despite all that, ethanol consumption is growing at 13 percent per year due to the increase of the automobile fleet and its conversion to flex-fuel motors, leading to ethanol imports from the United States. Sugar cane producers are well aware of that and there is already an effort to renew the sugar cane plantations which will result in better crops from 2013 on. The main problem is that the expansion of ethanol production became less attractive because of the government's policy of keeping gasoline prices constant (since 2007) to reduce inflationary pressures. The reality is that ethanol production costs increased due to the increase of oil prices, which is reflected in fertilizers and other inputs to production, as well as mechanization and better working conditions (and wages) of the labor force. The solution adopted by the government was to reduce taxes on ethanol which seriously penalizes Petrobras and will probably not last long."

**A: Francisco Ebeling Barros, member of the board of Economics and Energy Policy of the Brazilian Institute of Oil, Gas and Biofuels in Rio de Janeiro:**

"It has been almost 10 years since ethanol began to grow again as one of Brazil's most important automobile fuels. Nevertheless, it now seems that optimism regarding this market has peaked. In order to understand ethanol's current situation in Brazil, and consequently assess its future, it is necessary to separate technical and economical from regulatory and industrial concerns. On the one hand, economic and technical issues are under control. Both Petrobras and private (including foreign) groups are investing in ethanol production and there should be demand for this fuel in the next decades, both internally and abroad. Brazil has managed to create a very efficient and productive biofuels R&D network, which is most likely to develop technologies to bolster productivity. On the other hand, the recent ethanol shortage that forced Petrobras to import gasoline to ensure the internal supply showed that regulatory and industrial matters were left behind. Since the 1970s, ethanol plants owe their growth to government subsidies. When the price of sugar peaked, instead of maintaining the ethanol output, those companies chose to produce more sugar. Peter Evans, an American sociologist who studied development patterns in Eastern Asia, uses the concept of 'embeddedness' to describe the degree of commitment of the elites toward a country's developmental projects. The current ethanol crisis shows that there is a missing 'embeddedness' in the Brazilian ethanol industry. In the midst of the crisis, the Brazilian government's response was to request tighter regulation from its petroleum department. But in the long term, I believe that the industry's values should be rethought. Heavy regulation shouldn't

always be necessary to ensure the regularity of ethanol supply. If those regulatory and industrial concerns are properly addressed, one can say that the future of ethanol in Brazil will be bright."

*The Energy Advisor welcomes responses to this Q&A. Readers can write editor Gene Kuleta at [gkuleta@thedialogue.org](mailto:gkuleta@thedialogue.org) with comments.*