Photo; Release



Prospects for sugar not so sweet

Elizabeth Farina

Director President,
Brazilian Sugarcane Industry Association (Unica)

Solange Monteiro

IF THE CURRENT BRAZILIAN ECONOMIC situation makes most productive investment projects very costly, sugar industry projects are even more expensive. Already dozens of sugar mills have closed, and the economic crisis has pushed others to file for bankruptcy, with debts estimated to total some US$80 billion. The industry is waiting for the government to define its policies so it can work out a recovery strategy. "The important issue is what is expected of ethanol—this is a decision that the sector cannot make," says Elizabeth Farina, who has been Director President of the Brazilian Sugarcane Industry Association (Unica) since late 2012. Farina reiterates the productive potential of ethanol in Brazil and criticizes government intervention in fuel pricing, pointing out, "Sugar mills are still bleeding."

***The Brazilian Economy*—Last year, Unica hardened its position on ethanol, stating that the government had ruined the ethanol sector. How do you see the return of the Contribution for Intervention in the Economic Domain (Cide) for gasoline and diesel and the increase in the proportion of ethanol added to gasoline C?**

Elizabeth Farina—They are positive steps. The Cide tax established in December 2001 was applied throughout the period when the

Ethanol brings a range of benefits to society that are not reflected in its pump price.

ethanol industry expanded in the 2000s, until it was eliminated in 2012. By raising the price of other fuels, the Cide tax was able to make ethanol competitive. We have called for the return of the Cide tax, recognizing that ethanol brings a range of benefits to society that are not reflected in its pump price, which constitutes remuneration for positive externalities generated primarily in terms of environmental benefits. The increase in the proportion of ethanol added to gasoline from 25% to 27% … creates a demand for ethanol associated with gasoline of about 1 billion liters a year. We are hopeful that these decisions are part of a longer-term vision for ethanol in the Brazilian energy matrix, not just emergency measures to raise tax revenues.

In other words, these actions are not seen as policy?

That's the big question today. It is still not clear whether the government has adopted a long-term goal for Brazil's energy matrix with a set of actions to enable this matrix. The recent measures are positive signs, but they will only succeed in improving the sugar industry if there is a longer-term view that ethanol has high value … from the point of view of both market supply and environment. The sugar industry has suffered as much from fuel pricing policies as [state-run oil company] Petrobras and has spent several years burdened by huge debt. It lacks confidence that things will change. The question is always: What if inflation rises too much and the government decides to eliminate the Cide tax again to control it?

Minister of Mines and Energy Eduardo Braga estimated that demand for gasoline would reach 26 billion liters by 2023. What is the minister's vision for ethanol? He estimates ethanol production by 2023 of 30 billion liters—about the same as today ... But the country will need an additional 26 billion liters of gasoline in the energy matrix that could be occupied by ethanol if investors and sugar mills had confidence in a long-term policy.

How many sugar mills are now in operation?

Since 2008, 80 sugar mills have closed, and another 67 have filed for bankruptcy protection. Of the 369 sugar mills now operating, we estimate that this year another 15 will be closing, though some only temporarily.

This year began with a risk downgrade for some companies. How do you expect to reverse this situation?

On the demand side, there is great potential. But the sugar sector crisis means that there are many difficulties in increasing supply. From the perspective of investment, if fuel prices are administered as they were in the recent past, great demand is of no use because the price is set by the policy of the government, whose goals may be different from support

for meeting potential demand. Sugar mills are still bleeding. It would have been worse if the government had not resurrected the Cide tax in 2015 and increased the amount of ethanol in gasoline, but sugar mills are still in very bad shape, burdened by high debt, low productivity, and sugarcane aging.

And the sugar market is not helping...

Exactly, the price of sugar is still very low, as there are still large inventories, which is not solving the problem of ethanol.

How does the exchange rate affect the competitiveness of ethanol and sugar prices?

At first glance, depreciation of the Brazilian real has a positive effect on those who export, but it's a mixed picture, because it benefits most those who export more sugar. It also depends on the debt profile of each sugar mill because, on the one hand, a weak real is positive to the extent that it helps make exports more competitive, but on the other it can be problematic for sugar mills whose debt is in unhedged U.S. dollars. Because each case is different, it is difficult to estimate the net benefit for the entire industry.

What is your expectation about export markets? Do you expect reduced demand from the United States, the main buyer of Brazilian ethanol?

Our sugar exports are more important than our ethanol exports. We export 60% of sugar production, which represents 43% of the international market. We used to export more ethanol, but in 2014, foreign sales of ethanol fell by 52%, totaling US$1.86 billion. There were several reasons. Lower international prices for corn makes corn ethanol cheaper … But there is also uncertainty relative to the U.S. renewable fuel standard (RFS), which defines the portion of the market that must be supplied with advanced (sugarcane) ethanol, conventional (corn) ethanol, and cellulosic biodiesel. … The figures are being reviewed, and there is a lot of pressure from the oil industry to reduce the importance of the RFS. This is a bad thing, because it generates uncertainty both here and there.

The sugar industry has suffered as much from fuel pricing policies as Petrobras.

To what extent could diplomatic efforts for closer ties between Brazil and the U.S. influence this agenda?

We worked positively for the RFS to recognize Brazilian ethanol as advanced ethanol, and I think it is important to participate in negotiations to preserve this recognition. The methodology for analyzing emission reduction continues to be improved and discussed, and we have followed it both in California and in the context of the U.S. Environmental Protection Agency (EPA). The United States has allowed countries to participate in hearings, public consultations on the proposals for public policy, and we must act accordingly.

For the sugar sector financing costs are growing. Today this is happening in all sectors, but the sugar sector is coming out of a major crisis with no fat to burn.

Currently, two U.S. corporations, CHS and Cargill, have investment projects in Brazil related to corn ethanol, in partnership with local companies. How might this affect the sugar market?

For now, they are still small initiatives; we will see how they will evolve. But … sugarcane ethanol has much higher energy conversion efficiency than corn. Ethanol is more effective in reducing emissions and in energy efficiency. On the other hand, corn is much more advanced in incorporating the productivity gains associated with genetically modified organisms (GMO). Sugarcane does not have any commercial GMO crops; and much research has been done, including in Brazil. There is a much larger space for sugarcane to gain in efficiency and productivity, both in conventional agricultural research and in biotechnology. I hope that translates into improved competitiveness.

The crisis in the ethanol industry has forced Unica to restructure itself. How was that done, and how has it affected Unica's working agenda?

It was a great adjustment. We reduced staff and changed working procedures. Unica's council decided to prioritize institutional actions, along with the federal and state governments, because we know that policies are fundamental to recover ethanol competitiveness and gain ground in the energy matrix. It is very important to define the future Brazilian energy matrix. If the government says it will prioritize ethanol as a substitute for gasoline and important for growth, we'll see what options here are to ensure more ethanol production. If government priority is to mix ethanol with gasoline, that is a different situation.

The important issue is what actually is expected of ethanol, and this is a decision the sector cannot make. Only when the rules of the game are clearly defined will the private investor seek profitability. In the energy sector, profitability depends heavily on government actions, especially in Brazil, because the recent past shows the importance of government intervention in fuel pricing, both in electric power and liquid fuels. So our agenda is first, to get a definition of Brazil's future energy matrix; second, to point out that the initiatives taken so far are positive but insufficient; and third, having clarified the role of ethanol in the matrix, to seek at what level the government actions might be relevant to change the situation of the sugar industry. All items related to this agenda—such as tax differentiation, changes in the Innovate Auto program, and changes in biomass auctioning—may have evolved, but none has been completed.

One of the main debates today is how to improve Brazilian productivity. What is Unica's agenda here?

Regarding manpower, we underwent a major technical change, mechanizing the entire sugarcane harvest. São Paulo state completed this transition to meet environmental requirements, ending burning of sugarcane during the harvest. Initially this mechanization has had a negative impact, and we are still paying for the learning curve, including design of appropriate equipment and introduction of new agricultural practices. Productivity is expected first to fall and then to rise again. Our projections are to recover by 2025 the historical productivity levels of tons of crushed sugarcane, 85 million tons, and then raise it further. This season, average productivity in the Mid-South was 74 million tons. The drop this year had some special causes, such as drought and crop failure in São Paulo state. Nevertheless, productivity has been below the historical average since 2011. Unica has also developed programs to train workers being released from harvesting to become machine operators and work in maintenance and to train others for activities outside the sugar sector. Today there are better jobs, but fewer. And that continues to weigh significantly on budgets.

Have research and development been affected?

The private sector has made an effort to prioritize R&D as a productivity factor. People in the sugar industry have a strong commitment to R&D. We have discussed this a great deal with Agriculture Minister Katia Abreu, who has shown interest in supporting the sugar sector. Of course the necessary measures go beyond the Ministry's purview. But despite the crisis the agricultural sector has been making significant investments. The Sugarcane Technology Center (CTC), a private institution whose shareholders are sugarcane businesses, continues to invest in technology, studying GMO varieties, improvements in agronomic practices, developing second-generation ethanol in some plants, and seeking ways to recover levels of productivity and gain efficiency.

A weak real is positive to the extent that it helps make exports more competitive, but it can be problematic for sugar mills whose debt is in unhedged U.S. dollars.

Now conditions are deteriorating. We understand that fiscal adjustment is necessary. However, an interest rate of 9% for the harvest plan (a fairly high increase for renewal of sugar cane fields) and the limited availability of BNDES resources has both raised production costs and made investment in technology more expensive. We are at a very difficult juncture because sugar sector financing costs are growing. Today this is happening in all sectors, but the sugar sector is coming out of a major crisis with no fat to burn. ■