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Ethanol: The Bottleneck
By Marcos Jank

Rising ethanol prices at the pump in Brazil have caused consumption of the renewable fuel to plunge in recent weeks, as drivers replace it with gasoline in their flex-fuel vehicles throughout the country. With simultaneously rising food prices come several accusations, some true, others false. The facts must be carefully analyzed.

The main reason behind skyrocketing sugar and ethanol prices is the sharp decline in growth experienced by the Brazilian sugar-energy industry. From 2000 to 2008, the sector grew in excess of 10% per year, more than doubling the annual production of sugarcane. Ethanol consumption surpassed total gasoline use and supported the strong expansion of the flex-fuel vehicle fleet.

However, the global economic crisis in 2008 severely impacted the industry, causing significant financial and corporate restructuring. Since then, growth has dropped to about 3% per year, with the bulk of investments directed to mergers and acquisitions instead of new mills.

The second reason lies in two consecutive harvest failures caused by unfavorable weather conditions. The worst situation was the severe drought that damaged the cane crop in 2010, which explains the reduced supply of ethanol for the current inter-harvest period.

A third, more complex reason that is rarely explained with clarity, has to do with the use of cane to produce more sugar instead of ethanol. If in fact it was more profitable to produce sugar in the last two years, it is also a fact that this flexibility is restricted to a maximum of 10% of the harvested cane. In 2010, this resulted in the production of 5 million additional tons of sugar. Nevertheless, most of the sugarcane continued to be directed to ethanol production.

Without flexibility, this additional amount of sugar would have produced an extra 3 billion liters of ethanol with great losses in profitability. Meanwhile, the crop loss caused by last year's drought was equivalent to 5 billion gallons of ethanol. And the post-crisis economic downturn in the industry was equivalent to losing 11 billion additional liters of ethanol this year, or about 48% of total domestic ethanol consumption projected for this year.

It is vital to stress two additional points that are often overlooked. The first is that price fluctuations is a defining feature of all commodities. What happens to ethanol also occurs with tomatoes, soybeans, iron ore and oil. So why so much complaining when it happens with ethanol? Because ethanol is always compared with gasoline, whose price has varied only marginally in Brazil for years because of price controls enacted by Petrobras, the government-controlled oil giant.

If the price of gasoline in Brazil followed international oil prices, price volatility at the pump would be worse than that of ethanol and Brazilian consumers would undoubtedly complain rather vigorously.

The second point is that Brazil is the only country that offers the consumer the opportunity to choose between two fuels at the pump. Ethanol is a renewable option, less polluting and more affordable for most of the year. If ethanol didn't exist, the only available option would be gasoline, which performs poorly in all of the above requirements.

Obviously no one is satisfied with slower growth in the sugar-energy industry or the volatility of ethanol prices, which ultimately affects producers, distributors, retailers, consumers and the government. We believe it is time to seek conditions for a new cycle of sustained growth in the industry, which involve aspects that go well beyond the issue of funding, which is definitely not the current bottleneck. The key is a combination that involves making ethanol more competitive by harmonizing taxes, improving the infrastructure and supply system, reducing agricultural and industrial costs and making flex-fuel engines more efficient.

For years, the sugar-energy industry has been one of the most dynamic, innovative and admired industries in the country. The challenge now is to resume growth with economic, environmental, and social sustainability, avoiding peaks and valleys of instability.

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Marcos Sawaya Jank is president and CEO of UNICA, the Brazilian Sugarcane Industry Association.