

## THE DIFFICULTY RELATIONS BETWEEN THE BRAZILIAN GOVERNMENT AND *USINEIROS* (SUGAR MILL OWNERS)

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In March 2007 the then President of Brazil, Luiz Inácio Lula da Silva, stated that “the *usineiros* of sugarcane, who ten years ago were seen as bandits in the agrobusiness of this country, are becoming national and global heroes.” At that moment, this statement was showing that there was a certain convergence of interests between the government and the producers of ethanol. But the relationship between them had never been so good. This was not always so, nor did it last for long. After a short honeymoon period, relations between the government and the *usineiros* have been showing signs of an accelerated deterioration since the end of 2010. In January 2011, barely having taken office, the new president, Dilma Rousseff, expressed dissatisfaction with the increase in ethanol prices and demanded that the minister of agriculture, Wagner Rossi, adopt a strong posture in discussions with the *usineiros*. In April 2011 the government once again toughed its relations with the *usineiros*, transferring to ANP the regulation of the ethanol chain. However, which factors provoked this rapid change in relations between the govern-

ment and the *usineiros*? And how did these factors affect the behavior of the government and the sugar alcohol sector?

The recent increase in the ethanol prices in the Brazilian market, its impact on the final price of gasoline and its effects on the growth of inflation has been the focus of the government recently and a determining factor in the development of relations between the Executive and ethanol producers. For example, the value of the monthly indicator of hydrate alcohol released by the Esalq/USP Center of Advanced Studies of Applied Economics increased 77.80% from April 2010 to March 2011, when it reached R\$1.4219 per liter. In the case of anhydrous alcohol, which is compulsory mixed in gasoline, the indicator valor grew by 161.44%, from R\$0.90 in April 2010 to R\$2.37 a year later. The continuous increases in the price of ethanol have contributed to increase its share in the final price of gasoline, reaching 16.19% in March 2011. In April 2011 fuels were considered the principal influence on the formation of the Broad Consumer Price Index (*Índice de Preços ao Consumidor Amplo*

- IPCA), corresponding to 0.39% of this index. In the same month inflation measured by IPCA surpassed the limit set by the government (6% for 12 months). Concerns within the government with the impact of fuel on the inflation index, and the growth and distribution of income have generated increasingly dissatisfaction with the *usineiros*.

Reacting to the increasingly clear signs of dissatisfaction on the part of the government, alcohol producers have argued that the price increases are due to two reasons: 1) the sugarcane inter-harvest period and 2) the increase in the cost of fuel production factors. During the sugarcane inter-harvest period the scarcity of raw material increased pushing ethanol prices upwards. The increase in alcohol production costs was a result of increased petroleum prices on the international market and of other raw materials. The price of land, for example, has sharply increased since the 2000s. According to Informa/FNP research, the average value of land in Brazil reached R\$5,017.00 per hectare in the last two months of 2010, 9.1% higher than in January 2010. In the areas of the greatest concentration of sugar mills in the state of São Paulo, such as Ribeirão Preto and Sertãozinho, a hectare costs up to R\$24,000.00. In addition to the question of land value, *usineiros* highlight the growth of prices of almost all factors of production, such as equipment, fuel, agricultural raw materials, labor, credits etc.

The producers' discourse, nevertheless, is less emphatic in the analysis of the role played by the price of sugar in the dynamics of

the relative prices evaluated by the *usineiros*. The difference between the value of a kilogram of sugar and a liter of ethanol always represents a fundamental parameter of the evaluations and decisions of producers in relation to the composition of its production in alcohol and sugar. It determines the principal variable to be analyzed, namely, the cost of choosing to produce a great part of biofuel. In March 2011 the price differential between products from the sugar-alcohol sector reached 40% in favor of sugar. A change of this type in relative prices can be very attractive to *usineiros*, encouraging them to

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substitute part of ethanol production for sugar. *Usineiros* might even believe that by producing ethanol even when there are strong incentives not to do so, they are fulfilling their part of the 'contract' with the Executive. However, for the government the choosing of present profits by *usineiros* at a moment when cooperative behavior is expected in the fight against inflation can be considered opportunistic behavior which needs to be combated. In this situation the fact that ethanol (from corn) has to be imported from United States in order to attend the domestic demand does not help the cause of the *usineiros*.

The ascendant trajectory of ethanol prices at a moment of rising oil prices might be the principal reason for the degradation of relations between the government and the sugar mills in recent months, but it is not the only one. More structural elements also need to be considered, such as the historic standard of interaction between these actors. For various governmental actors linked, above all, to energy

policies, the production of fuel from biomass is an important variable in the offer of energy, but is considered a variable with uncertain behavior, since the offer of ethanol involves important contractual risks. From the point of view of the Executive, the central problem still resides in the commitment of private interests to government objectives. The acute problems in the supply of ethanol experienced at the end of the *Pró-Álcool* period (1980/90) are still present in the memory of Brazilian public administration. Recent events have thus had a negative effect on the trust between the government and the *usineiros* since sugarcane industry arguments can be interpreted as a manner of legitimating opportunistic behavior solely related to private interests. On the other hand, it is quite possible that the sugarcane sector will consider the governmental behavior as a new and unjustified demand, highlighting the government's lack of knowledge of the problems faced by sugar mills. Since a government which has just taken office, which is facing an inflationary situation, and which needs to establish credibility, is generally rather unwilling to accept arguments justifying an increase in prices, the problems of trust reappear and conflicts, many of them historic, become more intense.

In this context it is not surprising that the Executive is redefining the type of relations established with the sugar-alcohol sector and seeks to strengthen its control over the productive chain. The recent reclassification of ethanol as an 'agricultural product' for 'fuel' is an initial step in this direction. In this initiative (Provisional Measure 532), the Executive granted ANP the power to interfere in the monitoring, sale and storage of ethanol, while the bio-fuel is now treated in a similar fashion to hydro carbonates. To complement ANP's regulatory

action, the Executive ordered a change in the obligatory anhydrous alcohol mixture bands for gasoline. The 20% - 25% band was changed to 18% - 25%. This not only signified that the government was expanding its capacity to control the volume of the demand for ethanol but also showed the agents in the supply chain that the administration will not admit opportunistic behavior or the dragging of feet in the fight against inflation.

In order not to leave any doubts about its capacity to influence the 'rules of the game' in the ethanol market, the government is accelerating Petrobras' – a semi-public energy company – actions in the sector and the range of BNDES – Brazilian Bank of Economic and Social Development - loans to the sugar alcohol sector. Petrobras, which already has investments in sugar mills, will reinforce its position in the industry through the purchase of existing mill and the construction of others. With these actions the Ministry of Mines and Energy expects that Petrobras' share of ethanol production will reach 15%, as against the actual 5%. In order to expand the offer of ethanol, the government is also working with the question of access to financial resources. On the one hand, BNDES has shown itself to be active in the allocation of credit for the construction of new sugar mills and expects recover its investments in a sector that has seen the number of new mills fall from 31 in 2008 to 10 in 2010, with only five forecast for 2011. On the other hand, it is investing in technology projects capable of improving processes and raw material, as well as developing new products and fuels – such as second generation ethanol.

The more aggressive actions of the government are probably not to the taste of the *usineiros*. According to them, this restricts the

space for private arrangements, increases the costs of opportunities and marks a lack of trust in the sugar market. In reaction to the government initiatives, the sector has sought to protect itself on various fronts. For example, the new leaders of the sugar alcohol sector have tried to maintain good channels of communication with public authorities, seeking to guarantee the priority of the production of anhydrous alcohol by the industry. Moreover, they have made efforts to minimize the role of the sugar alcohol sector in the inflationary process, highlighting the rise of commodity prices, in particular that of oil. In the international markets to restore part of its image, the principal representation of the sector has reinforced its task of qualifying as a 'green' fuel, as well as implementing numerous actions aimed at guaranteeing the mechanization of the production and thus the improvement of its social indicators. In the internal scenario it has sought to assume the task of collectively organizing the improvement of the conditions of supply.

Very recently the price of gasoline has been falling at petrol stations, reducing the source of tensions between the government

and *usineiros*. Nevertheless, it needs to be recognized that the relations between the sugarcane industry and the government have been going through difficult moments recently. Although this is not an unprecedented situation, since the promulgation of the 1988 Constitution the government and *usineiros* have gone through more serious crises, the current situation strongly contrasts with the confident climate prevailing at the beginning of the second half of the 2000s. As well as reflecting a set of factors specific to the current political and economic moment and the preferences and beliefs of the actors involved, this situation is also a reflection of a history of distrust which is reinforced in the current contest, but whose origins go back to old fights. It is probable that this characteristic will last for a while more, showing that it is part of the actual dynamics of the relations established between them.

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