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Getting the Facts Right on U.S. Sugar Lobby's Erroneous Claims About Brazilian Sugarcane Industry

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The Brazilian sugarcane industry is one of the best, most efficient and competitive examples of tropical agriculture in the world today and an example of the power of farmers to overcome adversity and compete in the global economy.

The U.S. sugar lobby continues to pursue a market isolation strategy, supported by a government-backed program of price support, trade quotas and market manipulation instead of learning to compete in this global marketplace. This protectionist policy has served the sugar lobby at the expense of American consumers who are paying more with every spoonful. But that has not been enough for the U.S. sugar lobby. Now attacking the competition is the name of the game.

In a recent report, the American Sugar Alliance (ASA) reveals the desperate need of the American sugar industry to keep the U.S. market closed and protected from competition. ASA engaged in hyperboles and misrepresentations about the Brazilian sugarcane industry to ask the U.S. Congress to maintain current U.S. sugar policy, shielding consumers from the benefits of competition in the sugar market.

GETTING THE FACTS

The ASA alleges that the Brazilian government inappropriately supports the sugarcane industry with its rural credit system and the ethanol program to the tune of \$2.5 billion per year. Specifically, ASA singles out seven areas of government support. Unfortunately, as we show below, they are flat wrong.

1. ASA incorrectly alleges one third of the Brazilian government support for the sugarcane industry comes in the form of reduced retirement pension payment costs for agricultural workers.

FACTS:

- Brazil has a retirement pension system that is funded by contributions from workers throughout society. The Brazilian Constitution sets forth in differentiated pension contributions “based on the economic activity, the intensive use of labor, the size of the company or the structural condition of the labor market.”
- In order to increase the participation of rural and agricultural workers, who historically have been left out of the formal economy (and tax base), and to guarantee access for all of its population to social security benefits, the Brazilian National Institute of Social Security (INSS) has assessed constitutionally-sanctioned, differentiated contribution rates for these

workers. Specifically, in the case of the sugarcane industry, the bulk of INSS rates are based on the gross revenue, a factor that helped the formalization of labor contracts

- Calling these social security contributions a subsidy does not pass the laugh test, even under World Trade Organization (WTO) rules. First, there is no requirement under the WTO's Agreement on Agriculture (AoA) to report policies associated to pension funds and social security systems, not even in the Green Box. Countries are not required to report such policies because there is no favorable treatment embedded in them. This contribution is an obligation and the contribution has to be made at the expense of the cash income of farmers and companies. Second, under the WTO's Agreement on Subsidies and Countervailing Measures (ASCM), a policy granting subsidies is in place only if a government transfers funds, if a government revenue is foregone, if a government provides goods or services other than general infrastructure, or purchases goods, and if a government makes payments to a funding mechanism which differs from practices normally followed by governments. Brazil's current social security contribution system cannot be framed in any of the above definitions.
- Bottom line: *Differentiated pension contributions are not a subsidy but a tax that, like a progressive tax system in place in the United States, seeks to include all sectors of society, each contributing at differentiated levels.*

2. ASA engages in hyperboles about the assistance provided to the northeastern Brazilian sugarcane farmers.

FACTS:

- The Brazilian government provides a small level of assistance for sugarcane farmers in the northeast of Brazil, a historically disadvantaged region of the country that accounts for less than 10% of Brazil's total sugarcane production.
- This program is aimed primarily at supporting small sugarcane growers. Based on most recent available data, this program provided around \$40 million benefiting some 43,000 small farmers, providing less than \$1,000 per farmer. About 91% of the beneficiaries produced less than 1,000 tons of sugarcane, which means they harvested about 35 acres each. The total support benefits a production of 15 million tons of sugarcane, which represents less than 3% of total Brazilian sugarcane production.
- The Brazilian government has submitted details of this support program to the WTO on an annual basis. Brazil reported less than \$24 million in 2009/10 and \$30 million in 2008/09, which is equivalent to 0.15% and 0.25% of the production value of the corresponding years.
- Bottom line: *The Brazilian government provides a miniscule amount of money to small-scale farmers in the disadvantaged northeast region of the country. This support is reported annually to the WTO under the de minimis clause.*

3. ASA uses fuzzy math to distort calculations and exaggerate Brazilian government financing support to the sugarcane industry.

FACTS:

- It is unclear why the ASA study decided to make distorted calculations considering that subsidies associated to soft loans are fully notified by the Brazilian government to the WTO. Although the approach used is not necessarily wrong, since it estimates the subsidy as the difference of the soft loan interest rate and the opportunity cost of the money raised by the government (the Selic rate), the method used was designed to overstate the equivalent subsidy on loans provided by government sources.
- The Brazilian government submits to the WTO the level of support it has provided in the form of preferential loans for production, marketing and investment credit annually. In its latest submittal, Brazil provided \$2.4 billion in non-product specific support for the period corresponding to the 2009/10 crop year.
- The sugarcane industry received about 7% of the total loans to the agricultural sector during the 2009/10 period. Consequently, using the ASA's simplistic approach, about \$170 million in preferential loans could be attributed to the sugarcane industry, not the \$400 million miscalculated by the U.S. sugar lobby.
- Bottom line: *The Brazilian government has been transparent in its disclosures of soft loans as required by the WTO but the amounts are significantly lower than those alleged.*

4. ASA extrapolates data from three companies to overstate potential tax settlement action by Brazilian government.

FACTS:

- Due to the complex and cascading tax system and strong labor laws in Brazil, it is not uncommon for companies, domestic and foreign owned, to end up in litigation over tax disputes. At times, the Brazilian government has opted to receive the taxes with a discount rather than waiting for the lengthy court litigation.
- The Brazilian government has established a tax repayment program, commonly referred to as REFIS, to allow the government to recover taxes associated to tax owed by private companies, both domestic and foreign. The program generally covers federal taxes, such as Industrialized Product Tax (IPI), Social Integration Program (PIS) and Social Security Financing (COFINS) contributions as well as employer's social security cost share.
- By taking data from public financial statements of three sugar & ethanol companies listed in Brazilian stock market (Tereos, São Martinho and Cosan), ASA guesstimates the total outstanding debt of the sugarcane sector, which is comprised of about 400 companies. ASA's hyperbole leads to the erroneous conclusion that the sugarcane industry has over \$7.8 billion in tax debt.



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- In addition to hyperboles, ASA got its math wrong. Following the same (albeit inappropriate) methodology adopted in the ASA study, the real outstanding debit was \$3.8 billion *before* renegotiation (extrapolated to the whole industry using the simplistic 25% share) and \$2.3 billion *after* renegotiation. Then using \$2.33 billion, rather than \$7.8 billion, and assuming that all other ASA study assumptions are correct (again, we disagree), the implied subsidy associated to REFIS would have been \$163 million a year, two thirds lower than ASA's exaggerated claim.
- Overstating the implied subsidy, however, is not the only mistake of the study. Under the WTO's Agreement on Subsidies and Compensatory Measures (ASCM), the REFIS is not a product-specific program, even if it had a built-in subsidy in the interest rate of the future payments of the debit after renegotiation. REFIS application conditions apply across-the-board for all industries in Brazil, including subsidiaries of foreign companies. By definition, the REFIS program does not support any specific sector, market or product. Consequently, REFIS does not infringe on WTO rules, compensatory measures cannot be imposed against it, nor are notifications required.
- Bottom line: *Calling the guesstimated \$163 million a year a subsidy is more a rhetorical argument than a practical one because the program is not only consistent with WTO rules but also helps the Brazilian government collect taxes (not disburse subsidies) under legal dispute.*

5. ASA cries foul over Brazilian sugarcane industry efforts at diversifying its product base to include ethanol and other renewable products.

FACTS:

- The Brazilian sugarcane industry has diversified its production output to meet the world's growing demand for sugar and ethanol. The interactions between the sugar and ethanol markets can swing from positive to negative. For instance, the profit margins of ethanol production are close to zero or even negative today. So, contrary to ASA's assertions, there are no "cross subsidies" benefitting sugar in Brazil right now. Quite the opposite, ethanol production is currently reducing the sugar margins for Brazilian mills.
- The requirement for blending ethanol in gasoline has been in force for well over thirty years, helping not only reduce the country's dependence on imported fossil fuels but, more importantly, reduce greenhouse gas emissions. Various independent experts, including the U.S. Environmental Protection Agency (EPA), have recognized the superior environmental performance of sugarcane biofuels and their associated positive economic impacts.
- Bottom line: *Diversification in production is good for farmers as it reduces their exposure to one commodity and increases competition in the economy. The U.S. sugar lobby should try some diversification and competition.*

6. ASA appears confused over Brazilian support for renewable fuels at the pump and in the vehicles.

FACTS:

- The Brazilian government does have a de-facto control in fuel prices by virtue of its control of oil giant Petrobras. However, contrary to ASA's claims, this control has hurt the competitiveness of sugarcane ethanol at the pump. Over the past three years domestic gasoline prices have been set below the prices of imported gasoline. Last year alone, Petrobras loss more than \$600 million from selling imported gasoline cheaper in the domestic market. And, with the exception of a 5% increase in January 2013, gasoline prices at the refinery level have been flat for more than six years despite average inflation of about 5% annually. As a result, this policy has subsidized fossil fuels, not the sugarcane industry.
- As in other countries, Brazil has at times assessed differentiated property taxes on vehicles, depending on engine size or fuel use. While the state-level Property Tax on Motor Vehicles (IPVA) is currently the same for both gasoline and flex-fuel vehicles (FFVs), the federal IPI tax on vehicles, there have been frequent changes in recent years in order to stimulate vehicle sales, just as in the United States (e.g., cash for clunkers and even the E85 carve out in CAFE standards). The only market segment where FFVs have an advantage in Brazil today is the medium to large vehicles, where the taxes for FFVs are a few percentage points lower. However, these are the segments where there is less consumer demand as compared to the booming light vehicle market where FFVs compete with regular gasoline cars at same tax rates. The option for FFVs has been driven by consumer demand, not necessarily government intervention. According to the National Association of Automobile Vehicle Manufacturers (ANFAVEA), over 85% of passenger vehicles licensed in 2012 were FFVs, 7.5% gasoline and 5.5% were diesel vehicles.
- Bottom line: *Diversification in production is good for farmers and consumers as it reduces their exposure to single commodity volatility and increases competition in the economy. The U.S. sugar lobby should try some of that diversification and competition.*

TIME FOR SOME COMPETITION

In sharp contrast with the situation of U.S. sugar producers, the Brazilian sugarcane industry is fully integrated into the world market. **While Brazilian policies for sugar and ethanol have an equivalent subsidy of 0.15% of production value according to the WTO notification and 0.23% according to the OECD, the equivalent subsidy for sugar in the U.S. is 38.7% and 35% respectively.**

Sugar policies in the U.S. are based on instruments that were abandoned in Brazil during the 1990s and in the European Union in 2006. While the Europeans have reformed sugar policies, replacing price support mechanisms with direct payments, the U.S. is still subsidizing its sugar industry by keeping domestic prices high, which results in a need for border controls through tariff rate quotas and government interventions in the domestic market.



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Not only is the ASA report misleading from a technical perspective, overstating the amount of subsidies from Brazilian policies for the sugar and ethanol industries, it is also wrong from a conceptual perspective when, intentionally, it fails to compare them with U.S. policies.