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How Brazil Broke Its Oil Habit

Government's Central Role May Prove Unpalatable to U.S.

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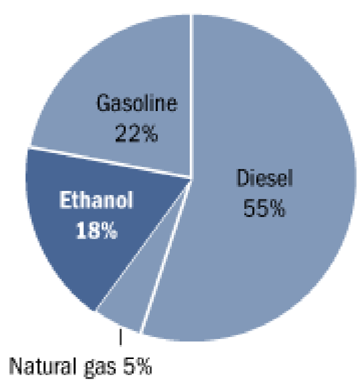
Brazil, once deeply dependent on Middle Eastern oil, has managed to do what President Bush has laid out as a goal for the U.S.: end its "addiction" to imported oil in part by using alternative fuels.

But Brazil's experience shows that to successfully copy its example, the U.S. may have to make political choices that U.S. politicians have ducked in the past, including raising gasoline taxes, ending government support for crucial agricultural products such as sugar and corn, and opening protected agricultural markets.

"To change a country's energy habits, you need determined public policies," says Eduardo Carvalho, head of the Sao Paulo state sugar-growers association that accounts for most of Brazil's ethanol output.

Role Model

U.S. energy-policy makers may be reluctant to take cues from Brazil, which relied on government edicts such as mandating ethanol sales at filling stations (left) to wean itself from imported oil. Share of Brazil's overall transport market by fuel:



Note: Includes trucks   Source: Brazilian government

Making ethanol a success in Brazil took determination that at times seemed foolhardy. The country launched its ethanol program in 1975, but it took until a few years ago for the fuel to become competitive with gasoline without government support. For many years, the international price of gasoline was so low compared to Brazil's home-grown ethanol that many Brazilians felt the project was a waste of time and taxpayer money.

But the government stuck with it, using a mixture of industrial-policy tools to produce the fuel, reduce its cost and make it widely available. The government mandated that filling stations offer ethanol and ensured that consumers would buy it by ordering that it be significantly cheaper at the pump than gasoline -- making up the difference through subsidies. Eventually, demand for the new fuel allowed producers to invest in new technology that helped lower its price below that of gasoline.

The government helped make ethanol affordable through free-market policies, too. Brazil's ethanol is made from sugar, which had been coddled with subsidies for decades. When the cost of the ethanol program became prohibitive in the early 1990s, Brazil slashed its subsidies and forced its farmers to become more productive to survive and thrive in a global market. Since growing the sugar represents by far the biggest cost in making Brazilian ethanol, trimming sugar prices was the key to making more affordable fuel.

Transplanting those lessons from the sugar fields of Brazil to U.S. corn fields -- the source of most U.S.-made ethanol -- would be difficult. Consider the idea of a gasoline tax. While U.S.-made ethanol is becoming competitive with gasoline given high oil prices, and does enjoy tax breaks, any dip in oil prices could cause consumers and producers to abandon the fuel before technology has a chance to help lower its production cost.

Over the years, U.S. presidents have become more wary of government mandates and overt industrial policies. Republican and Democratic presidents have paid dearly for raising gasoline taxes -- including Mr. Bush's father, who approved a small gasoline tax to help reduce the federal-budget deficit.

Even certain free-market tools might have a hard time in Washington. A Brazil-inspired ethanol program would mean ending federal support for U.S. corn and sugar farmers. That would probably raise prices in the short run as less efficient U.S. producers failed, but eventually help lower the price of the crops as more-productive farmers stepped in, agricultural analysts say.
For that scenario to unfold, the U.S. would have to slash farm subsidies that are protected by a powerful farm lobby and a majority in Congress. At the same time, to get the full benefit, the U.S. would have to open up its protected sugar and ethanol markets, which are blocked by restrictive tariffs and quotas.
"A free market in something like sugar would definitely help lower prices eventually. But protections for the industry have been in place for decades," says Paul Drazek, a former trade adviser to the U.S. Department of Agriculture.

Opening up the ethanol market itself might make strategic sense for a government concerned that windfall oil revenues in the Middle East help bolster terrorist activities world-wide.

"It makes no sense to tax ethanol coming in from friendly countries like Brazil when we do not tax oil imported from countries like Saudi Arabia," says Gal Luft, executive director of the Institute for the Analysis of Global Security, a Washington think tank that specializes in energy-security issues.

Another possible role for U.S. politicians may be to ensure ethanol is widely distributed in gasoline stations that might be hostile to a rival product. In Brazil, the government simply ordered state-run oil company Petroleo Brasileiro SA, or Petrobras, to distribute the fuel.

In the U.S., about 500 gas stations carry the fuel. Without competition from more filling stations carrying ethanol, distributors have little incentive to try to undercut gasoline prices, denting ethanol's attraction. Auto makers such as **Ford Motor** Co., which are ramping up production of flexible-fuel vehicles that run on ethanol or gasoline, say the government needs to offer bigger tax incentives for gas stations to offer ethanol.

"We can produce the flex-fuel vehicles, but we can't do it all alone. We need government policy to do its part," says Curt Magleby, Ford's public-policy manager.

Many critics of industrial policy argue such programs invariably become handouts to industries that should make the investments on their own. The U.S. has had a string of failures in this regard, including an effort to make gasoline from coal under President Carter, and a project to produce a nuclear breeder reactor under President Reagan.

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