

INFRASTRUCTURE



National Confederation of Industry
Brazil
CNI. THE STRENGTH OF THE BRAZILIAN INDUSTRY

ENERGY INPUTS: COSTS AND COMPETITIVENESS

- *High fuel costs are one of the factors that reduce the competitiveness of the Brazilian industrial sector.*
- *Energy-intensive sectors are especially harmed and end up contaminating manufacturing sectors downstream of the production chain.*
- *Energy prices were liberalized in the early 2000s without competition on the supply side being stimulated, which explains why energy prices in Brazil are well above the levels observed in the international market.*
- *The reform to promote competition in the gas and liquid fuels sector will necessarily involve three initiatives: changes in the current structure of industry, regulatory changes, and increased engagement of competition defense agencies.*

The Brazilian economy has been progressively losing competitiveness in relation to its competitors in the international market, resulting in the country's increasing lower share in the trade in manufactured goods.

High fuel costs and low competitiveness in fuel supply in Brazil are factors that affect industry's competitiveness. Economies that are better positioned in terms of the availability and low cost of these inputs have been enjoying greater comparative advantages in production.

The cost of these energy inputs is a key factor especially for energy-intensive sectors engaged in the production of semimanufactured goods: paper and pulp, chemical products, pelletizing, steel, ceramics and non-ferrous metals.

The current configuration of the natural gas industry prevents competition in supply and makes it possible for companies operating in it to enjoy high profit margins at all stages of the gas production chain. Average fuel oil prices charged in the country are well above those charged in North America, in the United Kingdom, and even in Asian countries that do not produce this input. Likewise, LPG prices for the Brazilian

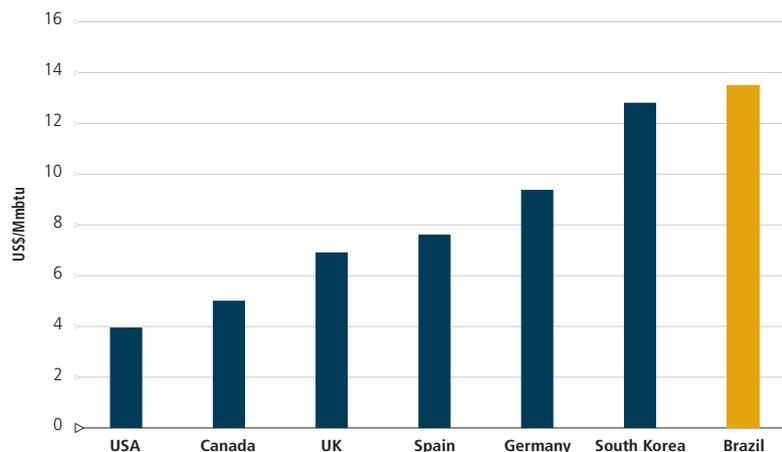
industrial market are well above those charged in the international market.

The rise in energy prices in Brazil is related to the liberalization of prices in the fuel market without competition in the supply of fuels to the final market being encouraged. Currently, a single company accounts for virtually all the supply of petroleum and natural gas derivatives and plays a significant role in distributing and reselling these products.

Energy-intensive industrial sectors are particularly affected by such high energy prices and they end up contaminating manufacturing sectors downstream of the production chain. **In the year 2017, the Brazilian energy-intensive industry spent R\$7.38 billion more in average than its foreign competitors, as the costs of natural gas, fuel oil and LPG in Brazil are higher than those charged in the international market.**

The time has come for a deep reform in the gas and liquid fuel markets to be carried out in Brazil resulting in competitive final prices in line with those charged in the international market.

AVERAGE NATURAL GAS PRICE FOR THE INDUSTRIAL SEGMENT IN SELECTED COUNTRIES IN 2017* (US\$/MMBTU)



*Prices in July 2017 for Brazil

Source: Prepared by CNI based on IEA data. Energy prices and taxes. Paris. International Energy Agency, 2017 and Brazilian Ministry of Mines and Energy (MME). Boletim Mensal de Acompanhamento da Indústria de Gás Natural, 2018.

The reform to promote competition in the gas and liquid fuels sector will necessarily involve three types of initiatives:

- changes in the current structure of industry, **para to promote market deconcentration in the gas and liquid fuel segment;**
- **regulatory changes to reduce barriers to entry of new suppliers** and to promote competition in the final market; and
- **greater engagement of competition defense agencies in monitoring** and promoting market competition.

Main recommendations

1 The natural gas distribution assets of state governments should be privatized.

2 Petrobras' distribution assets should be sold to as many new buyers as possible in the divestment process.

3 States should be encouraged to take further steps to liberalize the distribution market by taking the following actions:

- improving existing concession contracts with the aim of making them compatible with the best regulatory practices;

- creating and/or strengthening state-level regulatory agencies by introducing mechanisms of independence (such as a mandate for the board of directors) and financial autonomy;
- regulating free consumers, independent producers and independent consumers with the aim of stimulating competition in the supply of the molecule;
- conducting periodic and transparent rate review processes; and
- holding auctions where distributors can buy natural gas.

4 Petrobras' interest in selling its refining assets should be taken advantage of to attract new private investment and **promote deconcentration in this segment.**

5 The domestic fuel market, should be monitored with the aim of inhibiting abusive practices, particular that of charging prices above those charged internationally. This should be done by maintaining the free price policy without interference from the federal government that may affect Petrobras' ability to invest and compete.

6 The tax policy for the gas and fuel market should be reviewed.

The full version of the document can be accessed through the QR code on the side or at: <http://www.cni.com.br/eleicoes2018/downloads/> This summary is part of the series Proposals of Industry for the 2018 Elections comprising 43 documents. The series, which is based on the *2018-2022 Strategy Map for Industry* is a CNI contribution to the new federal administration and presents analyses and proposals of priorities to increase Brazil's competitiveness. Any part of this publication may be copied, provided that the source is acknowledged. Brasília-DF, July 2018.

