

# ***FUEL PRICING IN BRAZIL: INTERNATIONAL LESSONS***

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## **Overview**

The world energy sector is undergoing a strong energy transition process, towards a low carbon economy. This transformation in favor of decarbonization promotes profound and irreversible changes in the way of producing and consuming energy. In this sense, adopting policies that benefit fossil energy sources, which are major carbon emitters, is going against the grain of the energy transition, as fossil fuel subsidies jeopardize the construction of a cleaner and more sustainable energy system within a feasible period so that the goals outlined in the Paris Agreement, on tackling climate change and reducing greenhouse gases, are achieved (LOSEKANN E TAVARES, 2021).

In Brazil, despite the fact that fuel prices have been formally free for almost 20 years, the adoption of market intervention policies is a frequently debated topic. In recent years, Petrobras (a state-owned company and the main agent in the sector in Brazil) has been trying to implement a policy of international price parity in refineries. This new pricing policy has faced a lot of political resistance. In 2018, a truck drivers' strike in the country, caused by the increase in diesel prices, forced the government to create a subsidy for diesel, since this fuel is an important input in several sectors of the economy, having an impact on road freight transport and passengers, in agriculture and in the production of industrial goods (TEIXEIRA, LOSEKANN E RODRIGUES, 2020).

In addition, the diesel subsidy program took place because it was no longer viable in political and legal terms to use Petrobras' cash as a way of moderating increases in oil product prices. Additionally, Petrobras sold two refineries and reduced its participation in the country's fuel supply.

With the global economic recovery, after restrictions to stop the advance of the covid-19 pandemic, demand for oil has increased in recent months. Thus, the rise in the price of a barrel of oil on the international market had an impact on fuel prices in Brazil. The rise in fuel prices due to the increase in oil prices and the devaluation of the real in 2021, led to new discussions on the final price of derivatives to consumers, especially diesel and gasoline. Thus, several measures have been debated, ranging from stabilization funds to tax reform, to soften the impact of prices on consumers. This does not only occur in Brazil. In Portugal and South Korea, for example, flexible tax was resumed in a one-off situation after the recovery in world prices resulting from the covid-19 pandemic.

The difficulty of approving significant measures in terms of tax relief made the Brazilian National Congress debate the creation of a price stabilization fund, such as the bill (PL 1,472/2021) that creates mobile fuel price bands, financed by various sources of resources linked to the oil sector. This new strategy, which can be considered a fuel subsidy, has been gaining strength and is not supported by more careful assessments, which represents a real threat to the current process of opening up the fuel market in Brazil, in addition to going against the new directions of the energy sector brought about by the energy transition, as promoting the fossil industry only exacerbates the climate crisis. In addition, several countries are reducing or withdrawing subsidies to fossil fuels (OECD/IAE, 2021).

In view of the above, this article aims to analyze international lessons from fuel price stabilization policies, focusing on countries that reconciled price stabilization policies with a fuel sector open to competition. For this, this research will address three policies: i) price stabilization funds; ii) flexible tax policies; and iii) direct consumer subsidy programs.

## **Methods**

The methodology consists of analyzing international experience and extracting good practices from fuel price stabilization policies and evaluating their application in Brazil. For this, this article will follow three steps:

i) Investigate, based on international experience, regulatory tools that mitigate volatility and that can be applied in Brazil (ALMEIDA, OLIVEIRA E LOSEKANN, 2015);

ii) Discuss public policy options that can be applied in countries with competitive fuel markets: a) price stabilization programs through stabilization funds (ALMEIDA, OLIVEIRA E LOSEKANN, 2015); b) flexible tax policies (COADY et al, 2012); and c) direct consumer subsidy programs;

iii) Recommend fuel price policies for Brazil, considering the following points: social welfare; energy transition and recovery of fuel prices after the covid-19 pandemic.

## Results

It is hoped that the analysis carried out in this article will be useful in the effort to raise awareness of society and mobilize public authorities to face the problem of fuel price volatility in Brazil. The results show that, although stabilization funds and flexible taxes mitigate the volatility problem, other problems arise such as deterioration of the fiscal situation (in the case of the flexible tax) and the need for capitalization (in the case of the stabilization fund).

In view of the technical and political difficulties in implementing stabilization fund policies and/or flexible taxes, the direct transfer of income to the most vulnerable portion of fuel consumers has been gaining ground in the countries of the Organization for Economic Cooperation and Development (OECD). This is because this policy does not create competitive distortions in the fuel market and responds to political demands to mitigate the impacts of fuel prices on the most vulnerable layers and those exposed to fuel prices.

Thus, the recommendations to face the problem of volatility and high fuel prices in Brazil are: i) to maintain the current policy of price freedom and parity of domestic prices with international prices; ii) improvement of taxation on fuels, through specific taxes with *Ad Rem* rates and the design of automatic formulas for the variation of rates to compensate for the volatility of prices in the international market and exchange rates; iii) priority for direct subsidies to consumers, as already exists for low-income consumers for Liquefied Petroleum Gas (LPG) and for diesel for artisanal fishermen, with the design of a policy for independent truck drivers; iv) promotion of competition and transparency in the fuel market, an essential measure to ensure that the reduction in taxation translates into relieving pump prices and not increasing margins in the links in the supply chain.

## Conclusions

The investigation of stabilization fund programs shows that this form of market intervention is not sustainable, as they face challenges related to the difficulty of establishing an adequate price level to avoid their decapitalization, high political cost to maintain a balance in the fund, as the government tends to decapitalize it to meet populist policies, and the need for frequent capitalization. Flexible taxes are an option to stabilization funds. Through this policy, it is possible to design tax mechanisms so that taxes vary inversely with oil prices in order to reduce price volatility. In addition, flexible taxes are not sustainable when they depend on government discretion, as it is politically difficult to raise taxes at times when prices are low.

Analysis of price stabilization programs has made it clear that this form of market intervention is hardly sustainable. It is difficult to maintain financing of the funds from resources collected in the fuel market itself, since there is a high political cost to readjust prices in periods of sustained increase. There is also great difficulty in predicting the trajectory of oil prices in order to establish a neutral taxation policy. The analysis indicates that it is very difficult to structure sustainable price management mechanisms that do not imply tax burdens or distortions that delay the adoption of clean technologies for transport. International fuel price parity is the most appropriate guideline for the liberalized context of the Brazilian oil industry and we propose the combination of flexible tax mechanisms and transfers focused on more vulnerable consumers as more effective ways to deal with price volatility.

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