FUEL PRICING IN BRAZIL: INTERNATIONAL LESSONS

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August 2, 2022.

1. Introduction

- The world energy sector is undergoing a strong energy transition process, towards a low carbon economy. In this sense, adopting policies that benefit fossil energy sources, is going against the grain of the energy transition;

- 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 has been trying to implement a policy of international price parity in refineries, which 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;

- 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;

1. Introduction

- 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;
- 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, which represents a real threat to the current process of opening up the fuel market in Brazil. Promoting the fossil industry only exacerbates the climate crisis. In addition, several countries are reducing or withdrawing subsidies to fossil fuels;
- 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.

2. Stabilization Funds

- Stabilization funds work as follows: the government sets a fixed price with periodic adjustments and the supplying companies receive from the fund or pay to the fund the difference between the international oil price and the price fixed by the government. In addition, these funds are usually accompanied by some pricing rule, such as price ranges and moving averages, and these mechanisms are used to cushion price shocks in the short term;

- The experience of stabilization funds in Chile, Peru and Colombia shows that this form of market intervention is unsustainable, as these funds end up running deficits and need financial support. In these countries, capitalization of the fund turned out to be necessary;

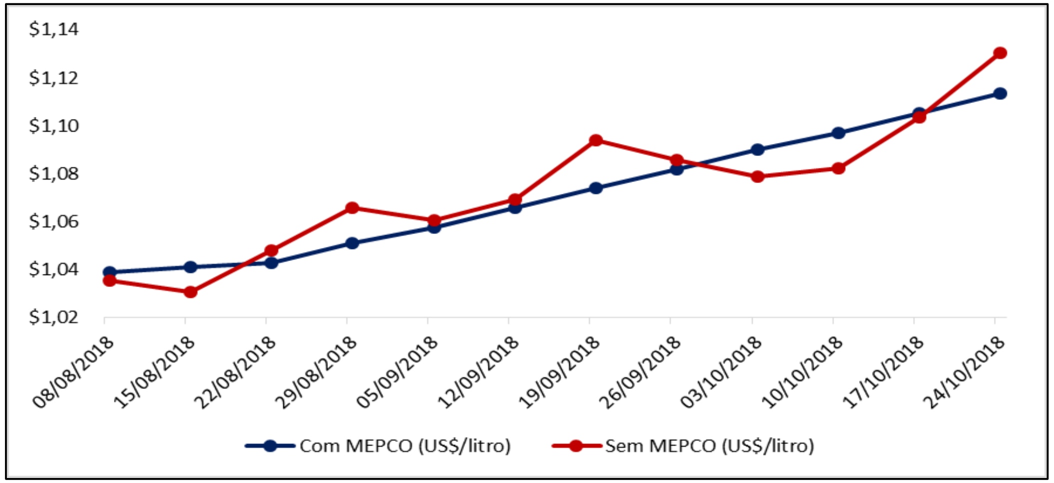
- In recent years, the Fuel Price Stabilization Fund (FPSF) in Peru and Colombia has shown deficits and high fiscal costs, becoming dependent on large contributions from public resources, which compromises its long-term sustainability;

- In 2014, the Chilean government implemented changes to its flexible tax policy through the implementation of the Fuel Price Stabilization Mechanism (FPSM). Thus, FPSM aims to smooth price volatility through a weekly adjustment of the variable component of the Specific Fuel Tax (SFT), including gasoline, diesel, LPG and natural gas;

- For this, the tax mechanism acts by influencing the price of fuels through tax increases or reductions, since the prices of a barrel of oil can rise or fall in the international market;

2. Stabilization Funds

Graph 1 - Comparison of the FPSM effect in US$/liter of gasoline (93 octane) in the period 08/2018 - 10/2018



Source: Own elaboration based on data from Bernal (2021).

- It is noted that the mechanism preserves the price trend, but reduces volatility, fulfilling its objective, which is to reduce the deleterious effects of rising prices to the final consumer. Thus, the Chilean government does not need to fix prices in the short term or implement stabilization funds, as these have shown that they are not sustainable in the long term;

3. Flexible Taxes

- Taxes on petroleum products are an important source of government revenue. This is because taxing fuel is one of the easiest ways to increase revenue: on average, fuel consumption is less sensitive to price changes, and more sensitive to income, guaranteeing revenue to the public coffers as income and taxes increase;

- When fuels are taxed at ad valorem rates (% of sales value), the volatility of a barrel of oil in the international market is not only passed on to final consumers, but is amplified;

- It is possible to vary the tax rate in order to reduce volatility and impacts for consumers at times of rising fuel prices. In this case, the government can set a collection target and increase taxes at times of lower oil prices and reduce taxes at times of high prices. Flexible taxation that would act as an automatic smoother for volatility;

- Several countries have already used flexible fuel taxation, such as China, India, Italy, Portugal, France, Mexico and South Korea and Chile. In the case of Italy, until 1994, fuel prices were regulated by the government, when there was complete liberalization. In order to minimize price fluctuations, an automatic tax mechanism was implemented to reduce the taxes levied on oil products whenever oil prices rise in the international market. This measure was abandoned due to the deterioration of Italy's fiscal situation and the need to maintain revenue in times of high prices;

3. Flexible Taxes

- A similar situation occurred in Portugal and France between 2000 and 2002. In France, a flexible tax known as *tipp flottante* was implemented. However, the great importance of fuel taxes in revenue (1.2% of French GDP) led the government to abandon this policy and prioritize tax collection in a context of strong imbalance in the country's public accounts;

- In Portugal, the floating tax was also abandoned months after its adoption, in the early 2000s. However, it was resumed in an occasional situation after the recovery in world prices resulting from the covid-19 pandemic. In 2021, the Portuguese government decided to lower the tax on petroleum products (TPP) by 0.02 euros for gasoline and 0.01 euros for diesel;

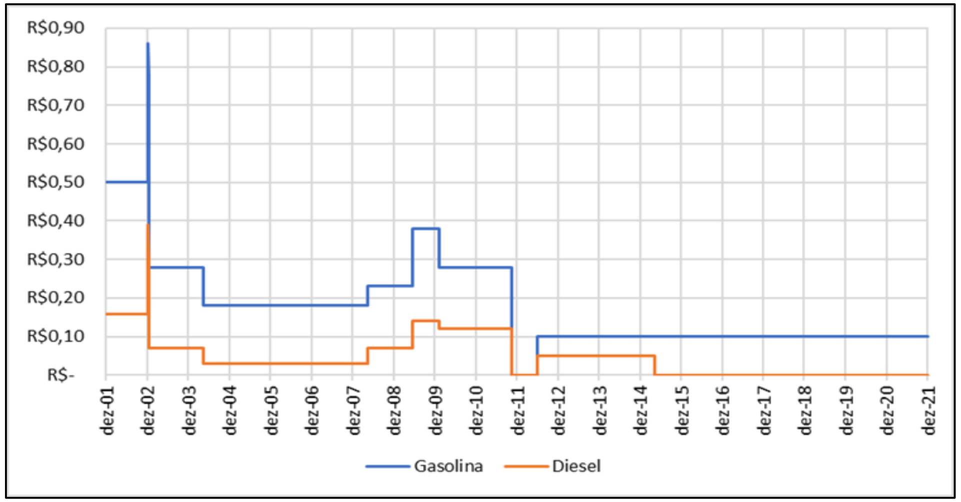
- In China and India, flexible taxation was used in a scenario of falling prices. In August 2014, a barrel of brent cost more than US$ 100.00; in January 2015, the price was below US$ 50.00. To avoid lost revenue, the Chinese government raised fuel taxes three times between November 2014 and mid-2015 in response to lower oil prices;

- In turn, the Indian government raised taxes during the same period to prevent derivatives prices from reaching very low levels, as it would face enormous popular resistance to make readjustments when prices recovered and rose again;

3. Flexible Taxes

- In Brazil, the CIDE could be used as a flexible tax, since it is a federal tax and, therefore, the same for the entire country. However, this tax does not have an automatic variation rule that takes into account oil prices in the market. It is up to the government to assess the convenience of changing the rate. With the reduction and maintenance of the a rate at very low levels as of 2011, CIDE lost its ability to cushion increases in fuel prices at times of rising oil prices, as seen in Graph 1:

Graph 1: Evolution of CIDE, in R$ per liter, since its creation



Source: Own elaboration based on data from the Ministry of Infrastructure (2021).

4. Direct Subsidies to Consumers

- In the OECD, subsidizing policies targeting fossil fuels has become a form of state intervention to help the poorest. Thus, direct subsidy policies given to specific groups are increasingly common. Thus, it is important to highlight that such policies are directed to the final consumer;

- In the case of Spain, in 2021, the country established lower prices for LPG, tax exemptions for diesel used in electricity production, navigation and rail transport. In addition, the government reduced taxes on diesel fuel used in some types of engines, such as agricultural tractors, and provided partial tax refunds for road transport activities, including freight, taxis, and some regular passenger transport, as well as for agriculture and farmers;

- In addition, in October 2021, the French government announced a subsidy of 100 euros to compensate for the increase in fuel prices. The benefit is intended for French people who earn less than 2,000 euros net per month, being paid through a single check. Employees, unemployed and retired individuals can receive the benefit. The idea is to serve 38 million people, so that they do not lose their purchasing power;

4. Direct Subsidies to Consumers

- The government of Portugal created Law nº 24/2016 to establish a fuel tax refund regime for companies that transport goods by road. In September of the same year, Ordinance nº 246-A/2016, which determined guidelines and rules for the Portuguese Tax System for Professional Gasoil, known as the partial refund regime of the Tax on Petroleum Products (TPP) for companies that transport goods by road. Thus, such a tax regime was intended to increase the competitiveness of the Portuguese economy, boost some inland regions and recover tax revenue lost to other countries such as Spain.

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.

Thank You!

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