

ePURE's POSITION ON EU TRADE NEGOTIATIONS WITH MERCOSUR

Trade policy should go hand-in-hand with domestic policy choices and market realities. The EU's approach to ethanol in trade negotiations therefore requires a fundamental review. ePURE has always favoured the exclusion of ethanol from trade negotiations with Mercosur. This position is fully justified and has been continuously reinforced by the developments of the EU energy and climate policy since 2004. However, should exclusion not be attainable, a substantial reduction of the EU's initial market access offer to Mercosur is paramount.

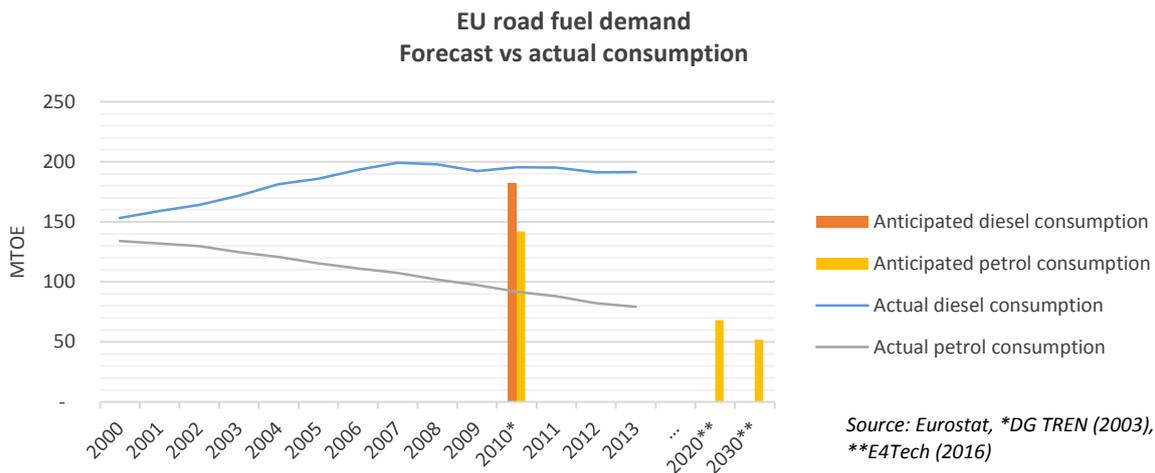
1. The EU's offer in its historic context

The EU's 2004 market access offer¹ was based on overly optimistic market forecasts in anticipation of a stable policy framework. In 2004 the EU's demand for ethanol in transport was expected to reach some 8.1 MTOE (12.7 million tonnes) by 2010 based on the 2003 EU Biofuels Directive². The offer would have represented 8% of the EU's anticipated fuel ethanol demand by 2010, or 5% in the absence of a WTO agreement.

1.1. Unforeseen road fuel market developments

At the time these forecasts were made, EU demand for petrol and diesel was still growing and diesel consumption was only marginally higher than petrol consumption. This trend was expected to continue. A forecast by DG TREN of 2003 expected petrol demand to reach 142 MTOE by 2010³.

In reality petrol demand has declined continuously and at an increasing rate since 2003. As a result by 2010 the actual petrol demand was already 50 MTOE lower than anticipated, a reduction of 35%, reducing in parallel also the demand for ethanol.



1.2. Policy uncertainties around biofuels

Following the adoption of the Renewable Energy Directive (RED) and Fuel Quality Directive (FQD) in 2009, EU Member States collectively forecasted a fuel ethanol consumption of 7.3 MTOE (11.5 million tonnes) by 2020, of which 3 MTOEs (4.7 million tonnes) would be imported from third countries.

However, EU Member States have not implemented their National Renewable Energy Action Plans (NREAPs) as anticipated. The single largest reason for this is the cloud cast over first generation biofuels by the Commission's proposal to limit the use of and eventually phase out any support for first generation ethanol in the European Union. This proposal initiated by DG ENER and DG CLIMA was based entirely upon the supposed impacts of increased EU demand for biofuels on emerging markets. These included land grabbing in developing countries, food price increases impacting food security in developing countries, the failures of non-EU land-

¹ The EU's market access offer to Mercosur included a tariff rate quota (TRQ) for fuel ethanol (CN 2207) with an in-quota tariff reduction of 50%, for an initial volume of 600,000 tonnes, with an additional 400,000 tonnes conditional on the conclusion of the WTO Doha Round, to be gradually phased in over 10 years, starting with 60,000 tonnes the first year.

² Calculation based on the 5.75% biofuels target of the 2003 EU Biofuels Directive and anticipated petrol demand by 2010 of DG TREN, European Energy and Transport Trends to 2030 (January 2003)

³ DG TREN, European Energy and Transport Trends to 2030 (January 2003)

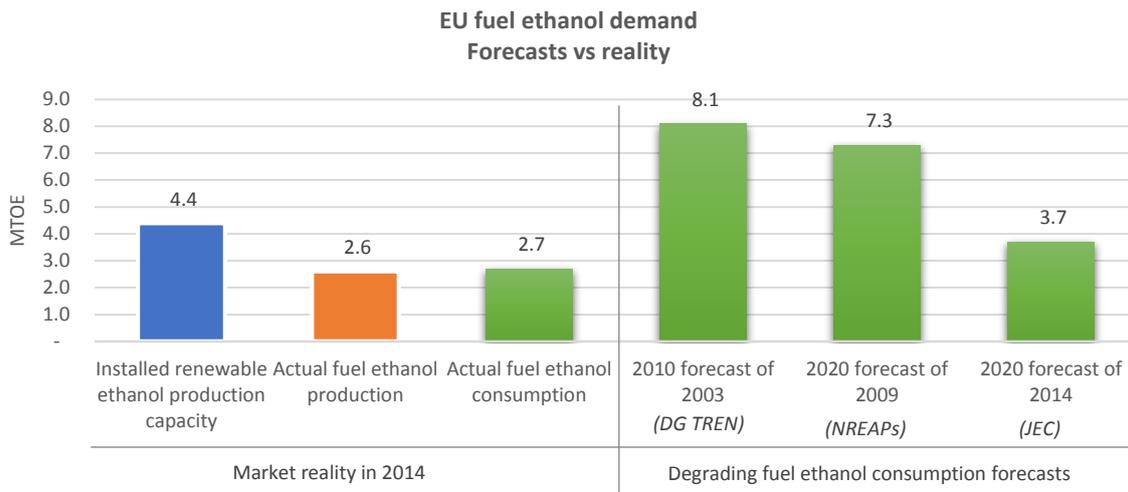
using activities to adhere to EU sustainability standards, and deforestation in places like the Amazon. No adverse impacts were ever identified from EU biofuels policy from the direct impacts of production within the EU itself. In other words, domestic EU biofuel policy since 2009 has been driven strongly by the belief that the benefits of biofuels are turned into social and environmental problems when they are not produced within the EU.

Unable to ban all foreign biofuels, for obvious reasons, EU domestic policy instead has limited both domestic EU biofuel demand (by capping the use of first generation biofuels) and supply (by banning Member States from granting state aid to first generation biofuels). This unstable and uncertain policy environment has put on hold Member State implementation and further investments in the sector.

Market forecasts therefore continued to deteriorate. In 2014 the JEC revised its fuel ethanol projection to a mere 3.7 MTOE (5.8 million tonnes) in an optimistic scenario where E10 would account for 36% of the petrol market by 2020. This is half of what was forecasted in 2009.

It should be noted that the 2014 JEC scenario is still optimistic, given that E10 is currently only present in five EU Member States. Reaching the JEC projection of 3.7 MTOE would require a fuel ethanol market growth of 37% in only 5 years, with all Member States introducing E10 as successfully as France, where it is introduced since 2009.

In 2015 the 'ILUC Directive' capped at 7% the contribution that first generation biofuels could make to the objective of 10% renewables in transport by 2020. Post-2020 no specific EU policy framework for biofuels is foreseen. Worse, the Commission has repeatedly expressed the view that it would be inappropriate to establish new targets for renewables in transport and that first generation biofuels should not receive public support after 2020.⁴⁵⁶



1.3. A sharp contrast to biofuel policies in Brazil

The Brazilian ethanol industry has a long history of strong government support. The industry started to develop in the 1970s on the back of government subsidies, which continue to exist in different forms today.

Brazil still protects its domestic market despite being the world's second largest ethanol producer. For instance, Brazil applies a discriminatory tax restitution scheme on PIS/COFINS for domestic ethanol production, which is not available to imported ethanol. Furthermore, the National Bank for Social and Economic Development provides specific credit lines for ethanol producers to fund investments on sugarcane production, expansion of capacities and logistics.⁷ No comparable schemes exist in the EU.

Brazil also has a much more ambitious and flexible biofuel policy than the EU. Whereas the EU has capped at 7% the contribution of first generation biofuels to the renewable in transport target, Brazil currently mandates

⁴ A policy framework for climate and energy in the period from 2020 to 2030 (COM/2014/015 final)

⁵ COM(2012) 595 final

⁶ Consultation: Preparation of a new renewable energy directive for the period after 2020

⁷ USDA GAIN Report, Brazil Biofuels Annual (2015)

a minimum of 27% ethanol in gasoline. In addition, Brazil can adapt its blending obligation to the market conditions. The law explicitly provides for variations in blending obligations between 18% and 27.5%. For instance, the minimum ethanol content in gasoline was as low as 20% in 2014 when ethanol supplies tightened on rising global sugar prices. Brazil can therefore exercise considerable influence on the domestic ethanol production and prices by adapting blending obligations.

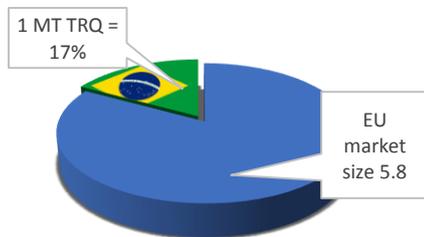
In short, Brazil has maintained or expanded its state aid to ethanol over the past decade, while all state aid in the EU has been removed. Remarkably, Brazil is continuing to expand its ethanol production, now from maize, and it is expected to surpass EU maize ethanol production in only a few years. Likewise, Argentina has arisen as a major maize ethanol producer, benefitting from strong state support.

2. The EU's 2004 offer in its present context

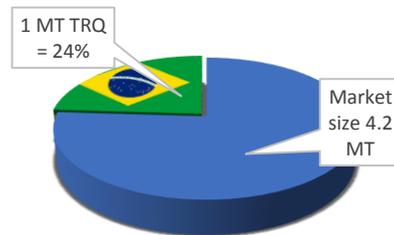
2.1. A disproportionate concession based on actual market developments

Taking into account the revised and still optimistic market forecast of the JEC, the EU's market access offer would represent 17% of the estimated total EU fuel ethanol market by 2020. When comparing to actual EU fuel ethanol consumption in 2014 the offer would represent 24% of today's EU fuel ethanol market.

2020 EU fuel ethanol market based on the revised Renewable Energy Directive of 2014



Actual EU fuel ethanol market in 2014



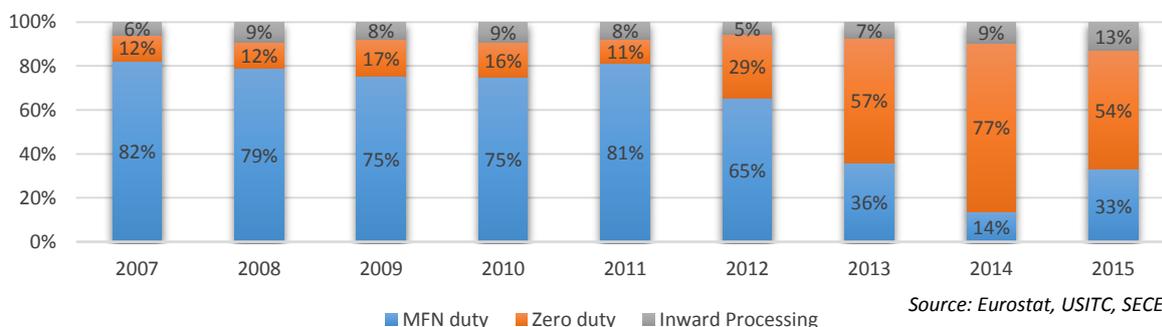
2.2. Third country ethanol imports are no longer required to meet demand

The EU is able to supply its current and anticipated demand through domestic production. The installed renewable ethanol production capacity of 4.4 MTOE (6.9 million tonnes) is already sufficient to meet the JEC's 2014 optimistic market growth forecasts of 3.7 MTOE (5.2 million tonnes) by 2020.

2.3. The EU already has access to duty free ethanol imports

Since 2004 the EU has granted duty free access for ethanol to many ethanol producing countries. Tariffs with countries producing ethanol from sugarcane such as Costa Rica, Peru, Bolivia and Guatemala have been completely liberalized. Pakistan has duty free access to the EU under GSP+. Ukraine and South Africa will both receive a duty free TRQ for 100,000 tonnes of ethanol per year. Ethanol exports from Canada to the EU will be fully liberalized once CETA enters into force. While these countries are relatively small ethanol producers, when

**EU ethanol imports
(including CN 2207 and ethanol in blends)**

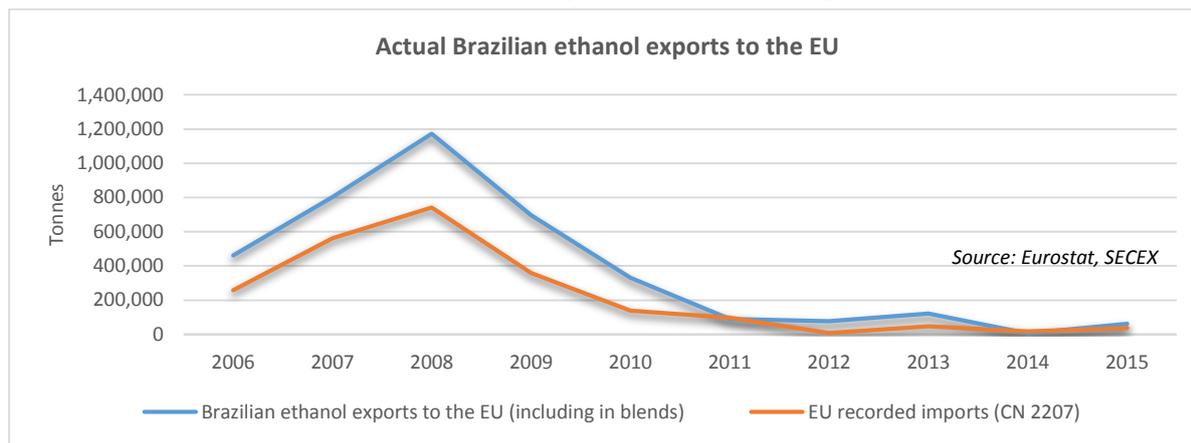


comparing to total global ethanol production, the cumulative effect of these trade concessions is significant, especially when considering the overall lack of market growth in Europe. As a result most of the EU's ethanol imports since 2013 are already duty free.

2.4. The offer risks seriously disrupting the EU ethanol market

Brazilian ethanol production cannot provide stable, long-term supply, but has the potential to seriously disrupt the EU ethanol market. The Brazilian ethanol market is heavily influenced by three main factors: domestic ethanol demand, world sugar prices and weather conditions. Volumes available for export will greatly fluctuate year on year. For instance, in 2013 the Brazilian production surplus was about 1.9 million tonnes, but only 0.4 million tonnes in 2014.

Exports from Brazil to the EU could therefore be significant over a certain period of time and relatively minor during another. The result will be a much more volatile EU ethanol market as EU producers will not be able to rapidly increase production to cover demand during years of supply shortage from Brazil.



Brazil could still occasionally return to higher surpluses, for instance when global sugar prices drop or weather conditions favour higher sugarcane harvests, or as its corn ethanol production capacity expands. It would not require further investments as the production capacity is already present. A return to 2008 export levels is by no means an unrealistic scenario.

3. The EU needs an updated trade policy that is consistent with its energy and climate policy

Brazil continues to pursue very ambitious and effective biofuel policies, actively promotes the uptake of first generation ethanol (from both sugarcane and maize) in transport through positive government mandates, and promotes the production of first generation ethanol through various forms of state aid and government support mechanisms. Other Mercosur countries, such as Argentina are also catching up.

In contrast, the EU has completely reversed its energy and climate policy since the start of the EU-Mercosur negotiation. The main driver for the EU biofuels policy U-turn were alleged and to date unsubstantiated claims on adverse social and environmental impacts, such as food price increases or land use change in third countries. The EU's domestic policy response to these concerns now limits the supply and demand of first generation ethanol in the EU by capping its use in transport and prohibiting state aid. Yet the EU has not adapted its trade policy accordingly and continues to grant improved access to third country first generation ethanol producers. The end result will be the outsourcing of an entire industry to the EU's trade partners, together with 50,000 jobs directly and indirectly connected to the industry.

Trade policy should go hand-in-hand with domestic policy choices and market realities. The EU's approach to ethanol in trade negotiations therefore requires a fundamental review. ePURE has always favoured the exclusion of ethanol from trade negotiations with Mercosur. This position is fully justified and has been continuously reinforced by the developments of the EU energy and climate policy since 2004. However, should exclusion not be attainable, a substantial reduction of the EU's initial market access offer to Mercosur is paramount.