

EUROPAUDVALGET

Alm. del - bilag 38 (offentligt)

Medlemmerne af Folketingets
Europaudvalg og deres stedfortrædere

Asiatisk Plads 2
DK-1448 København K
Tel. +45 33 92 00 00
Fax +45 32 54 05 33
E-mail: um@um.dk
Telex 31292 ETR DK
Telegr. adr. Etrangeres
Girokonto 300-1806

Bilag
1

Journalnummer
400.C.2-0

Kontor
EU-sekr.

10. oktober 2000



Til underretning for Folketingets Europaudvalg vedlægges i forbindelse med det uformelle møde i Det Europæiske Råd i Biarritz den 13.-14. oktober 2000 Kommissionens meddelelse om EU's olie forsyning.

Version provisoire

The European Union's oil supply

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I. PRESENT SITUATION

Oil prices in the last few weeks have reached historical levels since the Gulf War. This increase in oil prices since early 1999 has triggered a debate over the three components of the prices paid by European consumers: 1) the price of crude oil; 2) refining and distribution margins and 3) the taxation of oil products.

The sharp rise in prices is clearly due to the crude oil market. It is essentially of course the result of OPEC's restrictive production policy, i.e. its decision on production quotas, a decision that was made as a result of the extraordinary low level of prices in 1998. The high growth in demand has also played an important role and, to a lesser extent, the weakness of the euro in relation to the dollar. That said, the other price components should also be considered to see if there is any room for manoeuvre in those areas.

Against this background, it is also necessary to consider the impact of this rise and new oil price volatility on growth and inflation in the European Union. If oil prices stay at around \$ 30 a barrel during the rest of the year the negative effect of the price increase on growth would be 0.3% for the year 2000 and 0.5% for 2001. The increase in price would add 1% to the inflation rate. A part of this impact was already incorporated for the forecast for the spring. The final consequences would depend on the combined effect of oil price and other components of growth and inflation. The impact of the price increase is, however, more significant for developing countries, their economy being more strongly dependent on oil.

Despite the concern caused by the increase in prices, the situation nevertheless needs to be seen in relative terms. Looking at a long period, it can be seen that prices, including taxes, have been higher during the last twenty years. In 1981, for example, the prices of diesel and petrol, at constant prices for the year 2000, stood at 1092 and 1510 euros/1000 litres, respectively, as compared with 908 and 1132 now. Diesel excluding tax was at 675 euros/1000 litres compared with 372 in 2000. In France, for example, at constant rates, the average price paid by motorists at the pump has been FF 6.6 on average in 2000, as against FF 5.9 in 1990 and FF 7.3 in 1985. There has also been a structural fall in consumption per kilometre for a number of years.

The key problem which has confronted the Union since 1997 is the strong volatility of prices. The fall in price to \$ 10 a barrel, the increase in demand and the reactivation of the OPEC cartel have produced a sudden reversal of price tendencies. At the same time, the excessive price increase during 2000 may exercise too strong a pressure on certain sectors of the economy and produce a deterioration of the economic climate.

The reduction in economic growth due to the increase in oil price also has an impact on employment. Nevertheless, for both 2000 and 2001 the Commission expects a net increase in employment, given the very favourable economic forecasts, even taken into account the increased oil price.

The vulnerability of the European Union to the increased oil price which it has experienced in recent months recalls the need for a policy of reduction in the energy intensity of our economies. A stable and predictable level of fuel prices could give rise to both economic and environmental benefits.

1. Crude prices

Apart from brief respites during April and towards the end of July, the price of crude oil now seems determined to stay around \$30 (for a barrel of Brent-quality North Sea oil). It reached that level in February 2000 following an interrupted rise since December 1998, at which point it had bottomed out at \$10 a barrel.

The slight fall in oil prices following the USA's decision to release a very small amount of oil stocks (two days' consumption) should be interpreted prudently. The psychological and speculative factors that explain the volatility of prices are just as important as the physical reality of the balance between supply and demand.

The main cause of the trebling in prices during 1999 and the first half of 2000 has to be sought in the restrictions on production adopted and actually implemented by a group of oil-producing countries (OPEC and occasional allies). OPEC's behaviour, as a cartel, on that occasion gave the lie to the view held widely since the mid-80s, namely that OPEC is a cartel in name only and that we have entered a period of low, stable prices, reflecting a market which has become competitive.

The major fall in price observed in 1998 to \$ 10 a barrel with the possibility of reaching \$ 5 a barrel acted contrary to this judgement to increase the solidarity among OPEC members, even if their long-term interests continue to diverge structurally, and some other producer countries.

The economic environment was also extremely favourable. With a price level of \$10 per barrel at the end of 1998, oil companies saw their profits collapsing. The number of exploration and production projects in some non-OPEC regions where production costs are high, such as the USA, the North Sea and the Caspian Sea basin, fell sharply.

The financial crisis in Russia, which was made worse by the collapse of its revenue from crude oil prospecting, and the rising public finance deficit in Saudi Arabia and some other major producer countries were also worrying factors which caused instability.

The tightening of production quotas imposed by OPEC in a situation of lively demand reduced oil stocks to a particularly low level in early 2000 and was the "physical" component of the rise in prices.

In geopolitical terms, there have also been the recent difficulties in the peace process in the Middle East, the embargo on Iraq and the uncertainty in developments as regards Iran and Libya, though it is not possible to define exactly what influence they have had on the behaviour of the OPEC members.

Lastly, one cannot ignore the financial impact of speculation brought about by the increase in "paper" transactions in the futures market (International Petroleum Exchange in London and New-York Mercantile Exchange in the USA).

Some of these factors are still enabling, and for the next year or two will probably continue to enable, OPEC to retain a certain amount of control over the market and to keep up the pressure on it by means of a production policy of holding stocks in the consumer countries at a low level. However, the expansion of non-OPEC production, notably in the Caspian Sea basin, which reacts sluggishly to price movements, could in

time complicate the equation for OPEC, like the situation following the oil crisis in the 1970s.

A major factor to be taken into account is OPEC's decision to introduce a price-band concept centring on a "target price" of \$25 per barrel, with a floor at \$22 and a ceiling at \$28 (based on a composite OPEC barrel). If the OPEC price falls below the \$22 floor for ten consecutive days or goes through the \$28 ceiling for more than 20 days in succession, the member countries have agreed to consult each other in order to adjust their output levels. These consultations would lead to market intervention in the form of cutting or boosting production by 500 000 barrels per day (1 million barrels per day = 50 million tonnes a year). A striking factor in this agreement is Saudi Arabia's support since, shortly before, it had again expressed a preference for a price band of between \$20 and \$25 per barrel for Brent quality, nearly \$4 lower than the "OPEC price band".

In fact, the "ideal price" from the producer countries' point of view must be a compromise between their wish to maximise their short-term income and consideration of the longer-term adverse effects of excessively high prices on that income (expanding non-OPEC production and alternative energy sources, curtailing demand). Given the objective differences in the situations in the producer countries (see section II.2.B), the "ideal price" necessarily differs for the various categories of producer countries: the decision on the range is therefore to some extent an unsatisfactory compromise (the "ideal price" in fact being close to the ceiling for some and close to the floor for others).

There is nothing automatic about this mechanism. Its effectiveness in stabilising prices is very relative. It should also be noted that it is extremely risky, if not impossible, to set production quotas to achieve a target price. OPEC always fears that it might decide to raise quotas too much, thus causing prices to plummet, as happened at the end of 1997 (that concern was indeed voiced once again by the Venezuelan Oil Minister at the end of July). In conclusion, therefore, it can be said that, although the agreement on this mechanism should make it possible to stop prices rising and staying above \$35, it does not guarantee stabilisation at the "target price" of \$25, even in the long run.

Everything seems to suggest that we are moving into a situation where oil prices will not in future fall back to the levels seen 18 months ago and will remain very firm over the months ahead in the context of an extremely sensitive geopolitical situation: troubled Middle East peace process, weak economies in some small producer countries, difficult reform process in Russia.

Our economy and policies will have to adapt to this new situation.

The Commission considers that the objective must be the stability of oil prices at a level neither too high nor too low. This level should be sustainable in the long term, responding equally to the needs of the producing countries and to those of the consuming countries.

2. Refining and distribution margins

The question motorists always ask when they see that the price at the pump has shot up is: "Does the increase really reflect a rise in the price of crude?" As shown by the appended graph comparing movement in average petrol prices in the European Union and "Brent" oil prices, the answer is "yes" up to March 2000. It can be seen that in 1999 there were two closely correlated trends, with the rise in petrol prices lagging slightly behind

that of crude oil. However, since March 2000 there has been a split, with petrol prices rising more slowly than the price of crude during the spring of 2000. Very recently, refining margins have therefore reached levels unprecedented since the Gulf War. It should, however, be pointed out that the policies of vertical integration applied by the national companies of several producer countries, in particular in the Middle East, and the opening up of the European Union market had made it easier for these companies to position themselves in the oil product storage and distribution sectors. Benefiting from upstream preferential transfer prices, the margins recorded by these companies could be significantly higher than those of competitor companies buying in on the market.

However, the main point to note is that there are major differences when comparing consumer prices for oil products, exclusive of taxes and duties, between Member States. For example, the price before taxes and duties of "Euro super 95" at the end of May 2000 was €452/1 000 litres in the Netherlands, but €344 in the United Kingdom (€346 in France), a difference of 31%. These differences, worrying as they are, existed before the current price surge and therefore have no causal relationship with it.

In recent surveys of the application of the Community Regulation on the control of concentrations, the Commission analysed the competitive situation in the fuel distribution sector in a number of Member States. It was stressed that, while some cost factors might vary between Member States, only oligopolistic behaviour and a lack of competition in distribution can explain the price differences. For example, British and French motorists benefit from the competition produced by non-specialist distribution (supermarkets).

On the basis of such an analysis, the question which obviously arises is whether or not there has been an infringement of competition law, in particular whether there are any cartels (pricing agreements). The national authorities in a number of Member States have begun to investigate this. In Italy and Sweden, the competition authorities have imposed sanctions on oil companies.

3. Oil product taxation

The final price of oil products (to the consumer) includes a large proportion of taxes. These taxes are of two kinds: excise duties, which are specific (fixed) duties, and VAT, which is an *ad valorem* duty (proportional to the selling price of the product).

The proportion of tax in the price of oil products varies considerably from one country to another. For example, the amount of excise duty on diesel for road haulage varies from €245/1000 litres in Portugal to €777/1000 litres in the United Kingdom, compared with a minimum rate of €245. It can therefore be estimated that the total amount of tax on fuels accounts for 50-60% of the consumer price in the countries with lowest taxes (Greece, Luxembourg, Portugal, Spain) and up to 75% in the -United Kingdom.

The sharp rise in the price of oil products has itself also increased the amount of tax. This "snowball" effect is quite simply due to the fact that VAT is expressed as a percentage of the selling price of the product. Oil price rises therefore result in an immediate increase in VAT for consumers, with the advantage that it is easy to collect. Revenue from excise duties, on the other hand, decreases if prices rise, as these duties are levied by volume.

II. MEDIUM- AND LONG-TERM PROSPECTS

1. Key figures

Since it is linked to population growth (8 billion inhabitants in 2020 and 10 billion in 2050) and an annual growth rate in the world economy which will approach 3.5% over the next two decades, world energy demand is expected to increase from 9.3 billion tonnes oil equivalent (toe) in 2000 to 15 billion toe in 2020.

World oil consumption should be about 115 million barrels a day in 2020, as compared with around 77 million barrels a day in 2000, an increase of 50%.

OPEC should cover 50% of this demand by producing about 55 millions barrels a day, as compared with 32 million barrels a day in 2000. OPEC's willingness to produce can be explained by the fact that production costs should remain extremely favourable, even in a low-price scenario. OPEC production costs currently average around \$2 per barrel. High profit margins will provide an incentive which it will be difficult for it to resist.

The volume of non-OPEC production, which currently costs an average of \$5 per barrel, but with a marginal cost of more than \$10, will be closely linked to price movements since reserves will continue to be plentiful. Some oil production areas in Russia and the Caspian Sea basin are extremely important for the European Union in this respect. It is estimated that a crude oil price of about \$20 should make it possible to guarantee the investment in production in non-OPEC regions which will be needed because of rising demand over the next twenty years.

The European Union is, and will continue to be, highly dependent on imports. This trend will increase since energy dependence will rise from 50% in 2000 to about 70% in 2020. Energy consumption, which currently exceeds 1 400 million tonnes oil equivalent (toe) can be broken down as: 16% solid fuels, 42% oil, 21% natural gas, 50% nuclear energy and 6% renewable energy sources.

If the current tendency continues in the absence of a strong policy of improving energy efficiency, of promoting renewable energy sources and of structural changes in the sectors that have the highest energy consumption, Gross domestic oil consumption in the European Union will increase in a significant manner. Compared with 12 million barrels a day (600 million toe) in 2000, it is likely to grow to 13.2 million barrels a day (660 million toe) in 2020 even though it should develop four or five times less rapidly than world demand. It should be stressed that 93% of this increase is likely to be accounted for by transport. The European Union (2.6 million barrels a day) plus Norway (3 million barrels a day) are expected to produce about 6 million barrels a day in 2020 as compared with 7 million barrels a day in 2000. With the prospect of the enlargement of the European Union, the ratio between production and consumption looks set to deteriorate considerably since none of the applicant countries, except Romania, is an oil producer.

In terms of the structure of the final energy consumption of oil in the European Union (402 million toe in 1995; 487 million toe in 2020), only the transport sector should see a significant increase in consumption from 270 million toe in 2000 to 348 million toe in 2020. This sector will therefore represent 71% of final demand for oil as compared with 7% for industry, 8% for the tertiary sector and 14% for the residential sector. As far as intermediate oil consumption by the electricity industry is concerned (75 million toe in 1995; 49 million toe in 2020), thermal power stations should not consume more than 7%

of our supplies in 2020. Non-energy consumption (*80 million toe in 1995; 92 million toe in 2020*), mainly by petrochemicals, should represent 14% of gross domestic consumption.

There is a major potential for households to switch to natural gas. The present principle, whereby the prices of natural gas are to a certain extent linked to the cost of oil, since there is no real competition between gas suppliers, is likely to affect consumers in terms of electricity and natural gas charges. Speeding up the completion of the internal market in natural gas is therefore a major objective in this respect.

Furthermore, in order to avoid an excessive concentration of upstream supply on a few exporting countries and therefore to strengthen competition in the long term, prominence needs to be given to the increasingly important part which liquefied natural gas (LNG) should be playing. However, this development will depend on the economies of scale which can be achieved in this sector and continuation of the introduction of new technologies, chiefly in the transport sector.

There is significant potential for substitution in the road haulage industry. In the short and medium term, electrically powered vehicles will make a comeback in the form of a hybrid electric car, with the use of NGV (natural gas for vehicles) meeting the highest environmental quality standards for captive fleets, and biofuels for all types of vehicle. Nevertheless it is necessary to take care that the global energy cycle and the balance of greenhouse gas emissions are duly taken into consideration before adopting the most appropriate technology and the consequent options in terms of fuels. Although biofuels help to cut consumption of oil products, the fact remains that their energy balance is negative at the moment. As they are relatively costly to produce, further research and experimentation are needed so that production costs can eventually be cut to the point where they are equal to the cost of oil, which will inevitably continue to rise. Lastly, the direct use of hydrogen as a substitute fuel or its indirect use in fuel cells also offers encouraging prospects.

2. Key factors to be taken into account

a) Environment

The European Union has set itself the target of reducing greenhouse gas emissions, under the Kyoto Protocol, by 8% between 2008 and 2012 compared with the 1990 level. In 2010, CO₂ emissions due to oil product consumption will account for more than 50% of total emissions.

The transport sector will experience a particularly sustained increase in emissions. If no voluntary action is taken, these are likely to increase by 35% by 2010 compared with the 1990 level. Efforts therefore need to focus on this sector.

Furthermore, the problems in this area are not limited solely to CO₂ emissions and climatic change, but also include atmospheric pollution due to other harmful emissions, particularly in the urban environment.

For all gaseous waste, transport is responsible for 12% of SO₂ emissions, 69% of nitrogen oxide emissions, 64% of carbon monoxide, 49% of volatile organic compounds (VOC) and 33% of particulates.

Although it is extremely difficult precisely to quantify the negative external factors due to transport, it is clear that the main areas calling for government action are the use of cars in towns and cities and long-distance road haulage.

The major effort that will have to be made in this area under the Kyoto Protocol will require radical action as regards the choice of transport modes. These policies will obviously involve reducing the consumption of oil products.

In addition, the growing environmental constraints in terms of the specifications for oil products and the change in the structure of demand for fuel are leading to major investment programmes in the refining industry which are likely to be reflected in a moderate price increase for products to the consumer, chiefly in the transport sector.

Lastly, the maritime disasters in connection with the transport of oil products by sea, the most recent being that of the oil tanker "Erika", have prompted the European Union to plan for stricter regulation of ship standards.

(b) Security of supply

(i) The geopolitical context

The European Union's dependence on oil imports, which is already particularly high at 75% of its oil supplies in 2000, is likely to increase yet further and exceed 85% by the year 2020. In 1999, 43% of our oil supplies came from OPEC countries, 30% of these from the Persian Gulf.

More than 70% of the world's oil reserves are in OPEC member countries. In 2020, 40% of the world's production will come from the Persian Gulf.

Recent events on the oil market tend to prove that, while OPEC is sometimes described as a weak, heterogeneous cartel, centralising forces are prevailing at the moment, even if Saudi Arabia, Venezuela, Iran and Kuwait appear to have had most influence on decisions taken over the last two years. The fact is that the interests of, and the constraints on, the sovereign States which make up OPEC are multiple and complex, and to a large extent diverging if not contradictory.

Although some of the member countries are in favour of maximising prices in the short term as they have low reserves, a large capacity for absorbing oil revenues and a high degree of production capacity utilisation or a relatively low GDP, such as Algeria, Venezuela or Iran, others, such as Saudi Arabia and other Persian Gulf producers, prefer to vary prices over the longer term as they have abundant reserves, a low absorption capacity and often surplus production capacity. They therefore wish to prevent the emergence of substitute energy forms and at the same time to maintain oil's position on the world energy scene in the medium and long term, together with their market share.

In the light of the above, it was no coincidence that Venezuela was one of the countries in favour of cutting production quotas in early 1999, when the price of crude fluctuated around \$10 per barrel, that Iran and Algeria were particularly reluctant to relax the production quotas agreed by OPEC in March 2000 and that Saudi Arabia discreetly released further quantities onto the market in order to reduce prices.

Geopolitical factors have also played a part in these developments. The differences of opinion within OPEC which emerged just as the Gulf War began, the internal tensions regarding the oil embargo against Iraq, the uncertainty surrounding developments as regards Iran and Libya as well as the common position of the Arab countries on the Israeli-Palestinian conflict are equally factors which do not facilitate the smooth functioning of the oil market.

Iraq's role in the years ahead is also a major unknown factor. During 1999, Iraq managed to increase production to 2.8 million barrels a day and achieve just over \$5.2 billion in oil exports as authorised by the United Nations Security Council resolutions under the "Food for Oil" programme. It can be estimated that, if the sanctions were lifted and with the assistance of foreign investors, production could relatively quickly rise to 3 to 4 million barrels a day.

Although there is no reason to fear a physical shortfall in the foreseeable future, it is not at the same time possible to anticipate OPEC's behaviour as a cartel and the political concerns which may occasionally affect its attitude. However, several factors stand out which are likely to have a decisive effect on price levels, namely the importing countries' growth rates, the progress made in curbing demand, the addition of new reserves and the tightening of environmental protection standards.

In the long term, taking account of the concentration of reserves in the OPEC countries, it is technological developments which will pose the principal threat to OPEC, namely new production technologies in difficult areas, using non-conventional oil, and the development of new substitute fuels and the associated technologies, chiefly in the transport sector.

The role of the countries of the former USSR may also prove to be particularly important for the European Union since, in 1989, they were still the world's leading oil producers with production of more than 11 million barrels a day. Production in this region could double over the next 20 years from 7.8 billion barrels a day in 2000 to 14 million barrels a day in 2020. The known oil reserves in the Caspian Sea basin (25 billion barrels) are about equivalent to those in the North Sea and the USA. Potential reserves could exceed 200 billion barrels, i.e. 25% of known reserves in the Middle East.

With regard more especially to the European market, the high degree of penetration of natural gas - a potential substitute for oil - should be an incentive for the European Union to cooperate more closely with the two main natural gas suppliers (Russia and Algeria) by providing support for gas extraction and transmission. At the same time, it should keep to its priority objective of diversifying sources of supply, in particular by means of LNG imports.

(ii) Strategic reserves

An event, such as a political and/or military incident, in an oil-producing or transit region could disrupt a major proportion of the world's oil supplies at any time. Emergency stocks and crisis measures, as provided for in the framework of the International Energy Agency and under Community legislation, are a partial response to this type of threat. Work in this area must be continued if not stepped up.

The role of the International Energy Agency

The key points as regards strategic stocks were laid down in 1974 by the signature of the "Agreement on an International Energy Programme", which created the IEA. At the moment, all EU Member States are IEA members.

One of the main commitments of IEA member countries is to maintain a level of stocks equivalent to 90 days' net imports of oil and/or oil products which can be used in the event of a supply crisis to replace all or part of the shortfall in supply.

The 1974 Agreement also establishes a mechanism for an interdependent, coordinated reaction in the event of a supply crisis. The main features of this mechanism, which is based on the principle of "equal misery", are:

- a "trigger" threshold at 7% of supply disruption;
- a uniform obligation for all member countries to reduce consumption (percentage reductions predefined according to the level of disruption);
- a centralised, predefined procedure for activation of stock disposal and allocation of available oil among member countries.

The essence of the mechanism is that, once it has been activated, the rights and obligations of each country are automatically calculated in accordance with predefined procedures.

In 1984, another crisis mechanism, referred to by the acronym CERM (Coordinated Energy Response Measures), was developed within the IEA. This mechanism is much more flexible than the 1974 mechanism: it can be activated below the 7% threshold and does not include a mechanism for allocating oil among states. It more simply involves each state making an equivalent effort to restore the market balance. The specific nature of the effort (reduction of consumption, stock disposal, raising of indigenous production, a combination of these) is decided by each member state.

European Union legislation

Community legislation in this field consists of the following:

- 1) *Directive 68/414/EEC, as amended by Directive 98/93/EC*

These Directives impose an obligation on Member States to maintain a level of stocks equivalent to 90 days' *consumption* for each of the three main categories of petroleum products for energy use (stocking crude oil instead of products is authorised provided certain rules are complied with).

Directive 68/414/EEC provides that the Commission arranges for consultation with the Member States before they reduce stocks below the 90 days' limit.

Note also that some Member States currently hold more than 90 days' stocks, which can be released before any Community consultation (see the attached table).

- 2) *Directive 73/238/EEC*

This Directive has two aims. Firstly, it obliges the Member States to be ready to act, i.e. to provide themselves with intervention plans, appropriate bodies and powers in particular to enable stocks to be released onto the market, to restrict consumption, to safeguard the supply of priority consumers and to regulate prices. Secondly, in the event of a crisis, the Commission is instructed to arrange for consultation among the Member States for coordination purposes.

The USA's Strategic Petroleum Reserve

This initiative goes back to 1975, two years after the first oil crisis. The Energy Policy and Conservation Act (EPCA) provided for the holding of strategic stocks of some 1 billion barrels of oil for use in the event of war or major disturbances leading to the disruption of supplies. The logical site for this reserve was in the Gulf of Mexico (Louisiana and Texas) where there are more than 500 salt mines.

This reserve currently contains 571 million barrels, an investment of about \$20 billion at today's prices. For the record, the USA recently decided to release 30 million barrels from this reserve, just under two days' consumption, in order to make up for an excessively low level of product stocks which might lead to a shortage of heating oil during the coming winter.

These mechanisms have all been developed to deal with a serious disruption of supply, but not as a means of responding to market factors such as high or volatile prices. However, it should be noted that the USA's intervention last week had a marked influence on the psychology of the market.

III. POSSIBLE ACTION

1. Relations with producer countries

While it is in the interest of both producer and consumer countries to see where prices are heading, these prices have to find their level in a competitive market and not through a group of producers intent on maximising monopoly revenues. Any other approach would be to be benefit neither of consumer countries, who would be obliged to step up investment into substitute products ahead of time, nor of producer countries, who would be faced with a long-term stagnation of prices due to falling demand. Furthermore, in the short term it is not in the interest of producer countries to jeopardise world growth, a possible outcome of their current production policy.

At political level it is important for the European Union to pursue its dialogue with OPEC and its principal member countries. As a major economic power and the second world consumer of oil, the European Union has to make its voice heard so as to obtain greater price transparency and, in the longer term, stable prices.

Our message to producer countries must emphasise the vulnerability of the world economy to the high prices that would result from irrational management of the world's natural resources and thus the need to start a constructive dialogue on how the market might operate better and how to achieve greater transparency.

Finally, the European Union should continue to focus on and lend support to countries on the Caspian Sea, in particular by way of the Community's INOGATE (Intergate Oil and Gas Transport to Europe) programme of technical assistance. A watchful eye needs to be kept on the Russian Federation's interest in the potential of the Caspian Sea basin and its transport infrastructure. This is why it has asked to play a greater part in this programme.

Rehabilitation and optimisation of the oil and gas networks of the former USSR, thereby freeing the resources of Russia and the Caspian Sea basin, should help in the long term to improve the oil supply of an enlarged European Union.

2. Competition policy in the oil sector downstream (refining - distribution)

It is essential to promote a more open and competitive structure in the fuel distribution sector. A critical factor lies with the development of a real internal market for refined products (in the wholesale market) to make for ready and competitive supplies to all distributors, including those which are not national refineries.

To this end a systematic comparison of the prices of oil products in the Member States would highlight disparities between them.

The Commission will maintain its contacts with national competition authorities in order to exchange experience and views in this area. The meeting that it organised on 29 September made it possible to examine how competition policy can help to make the fuel sector more competitive. This meeting clearly showed that the competition authorities (at National and Community levels) are ready to intervene immediately when the market operators appear to wish to exploit the situation by anti-competitive behaviour. The Commission will also continue to be vigilant in applying the merger control rules in this sector, as in the cases of BP/Amoco and TotalFina/Elf. Any abuse of a dominant position should be severely punished.

3. Use of tax instruments on oil products

Given the massive proportion of tax in the price paid by consumers, a fairly widespread idea, and one taken up by OPEC, is to offset the price of oil products by lowering taxes. Capitulating on this front would amount to transferring tax revenue to the member countries of OPEC and encouraging them to keep their rates artificially high since the effect of crude increases on consumer prices would be offset by tax reductions.

Utilisation of fiscal instruments must be compatible with political and economic orientations and the commitments made in terms of budgetary consolidation.

Piecemeal tax cuts are not fully compatible with European law, even if the latter is far from achieving genuine harmonisation of excise duty and VAT rates.

The sixth Directive on VAT provides that oil products should be subject to the "standard" minimum rate of 15%. Member States may not introduce lower levels of VAT into their national taxation laws for certain uses of oil products. Only the reduced rates that existed in 1991 may be retained as part of transitional measures.

In terms of excise duty Community legislation provides only for a very low minimum rate compared with the average levied, these level decided in 1992 have not been subject to re-evaluation since then. On the other hand, several special arrangements allow Member States to waive or reduce excise duty on oil products. Several exemptions or reductions are expressly provided for by Community legislation. A good example is the total exemption of excise duty on fuel used for commercial air navigation (kerosene) and commercial navigation in Community waters.

Community law also allows Member States to submit a particular request to the European Commission for applying exemptions from, or reductions in, excise duties other than those expressly permitted by Community legislation. Several Member States have recently announced reductions in excise duty on diesel fuel for road haulage. Some of these are covered by exemptions up to the end of the year 2000, others are not. The Commission is currently re-examining these requests with a view to preparing a proposal to submit to the Council, which has to give a unanimous decision. Although these derogations can be justified by very short-term factors they are not consistent with the European Union's objectives in terms of environmental, energy or transport policy.

One-off measures must also be assessed as to whether they constitute State aid within the meaning of Article 87 of the EC Treaty, which can distort competition and thus erect barriers to the completion of the internal market.

Upward harmonisation of tax rates between Member States is therefore unavoidable. And this is what the Commission is proposing in its draft directive on the taxation of energy products, which has been before the Council of Ministers since 1997. This recalls the need to evolve towards the qualified majority for certain aspects of decision making with regard to indirect taxation at the IGC.

In this way, the temptation to offset prices by tax cuts should be discouraged. It is precisely the opposite approach that is needed, with genuine harmonisation of excise duty on fuel.

The only conceivable adjustment mechanism relates to VAT. A decision could be taken to stabilise VAT revenue in the event of significant fluctuations in oil prices.

4. Achieving a balance between modes of transport

Transport is the largest consumer of oil products, more than 80% of which are consumed by road haulage. With economic growth boosting transport demand, this trend can only increase. By the year 2010, freight traffic is projected to grow by 38% and passenger traffic by 19%; this trend will be characterised by a growing imbalance at the expense of rail traffic. While in 1970, road haulage represented less than half of traffic, it now accounts for 80%.

Faced with the congestion of our main road routes and town centres, along with the environmental consequences of this, we must break this vicious circle and work towards a new balance between modes of transport, by:

- Revitalising the railways, notably by modernising public services and opening up to competition; Encouraging the development of short sea shipping.
- Reviewing the conditions for access to the road haulage profession and tightening up the enforcement of social and safety regulations. Over-capacity in the EU road haulage industry is estimated at 30%, so it should be restructured through social measures, not tax cuts.
- Infrastructure investments to avoid the bottlenecks in the rail networks and to develop the European rail network. This requires novel financial solutions, e.g. using investment funds fed by tolls on the competing road routes.

Finally, rationalising the use of private cars in city centres and promoting clean urban transport are also priority objectives. The question also has to be raised as to the competitive conditions between certain modes of transport, in particular air against high-speed rail connections, especially in the context of tax-exempt aviation spirit. The proposed directive concerning the taxation of energy products, on the Council table since 1987, would permit taxation of aviation fuel at Community level.

5. Making Europe's economy less oil-intensive

Europe's oil intensity has already been reduced by half compared with 1973 (thus making Europe's economy less susceptible to the recent price rises than during the oil crises of 1973 and 1979-80), even though in the past this reduction was due more to economic factors than to any deliberate action by the public authorities.

Developments on the energy markets show that in all sectors government influence on supply is constantly diminishing, whether in terms of opening up energy markets to competition, globalisation of companies, geopolitical influences or the impact of speculation on the oil market. Taking action on demand can be the only basis for a real energy policy.

The new context of high oil prices, which in large measure elude the policy-makers of consumer countries in terms of supply, heightens the need to develop a new strategy for demand geared to the gradual substitution of oil by other sources of energy, greater use of renewable and alternative sources of energy, demand management, greater energy efficiency and energy saving, particularly in buildings. These measures should help both

to protect the environment (in particular in respect of the problem of greenhouse gases) and to lessen the vulnerability of the European economy to energy supplies from outside. Unless the European Union can reverse the current trends in energy use and in transport, especially in cities, it will not be able to deliver on the undertakings it gave in Kyoto.

By the end of the year the Commission will be proposing regulations on energy saving in buildings, to replace the simple, relatively ineffectual incentive measures so far taken at Community level. It also plans to propose a programme, together with quantified targets, on the number of clean vehicles in Europe (as a percentage of the number of automobiles) and on fuel substitutes for petrol and diesel (as a percentage of total consumption). It is not unreasonable to imagine that a substantial percentage of petrol and diesel consumption could be replaced by 2010.

In the key sector of transport, managing fuel demand also implies redressing the balance between modes of transport, particularly for freight, in favour of rail and short sea shipping as well as more rational use of private cars in city centres and the promotion of "clean" urban transport.

These policies form an integral part of the Commission's strategic objectives for 2000-2005 and will be adopted shortly in a new White Paper on transport.

Fresh initiatives will help to reduce Europe's dependence on oil supplies, a weakness that had been forgotten over the past fifteen years.

IV. OUTLINES OF A STRATEGY

The current situation highlights the danger of too great a dependence on a form of energy whose production is concentrated in a limited number of countries. Moreover, the volatility of the market has revealed that it lacks transparency and pricing mechanisms. The European Union cannot allow its economy to be undermined on a permanent basis by rises and volatility in the price of a raw material on which it is overly dependent. It is against this backdrop that:

- The Commission intends to present a plan at the European Council in Gothenburg to save energy and diversify sources, both by improving energy efficiency, particularly in buildings, and by providing support for the development of a new generation of vehicles. This will focus on two priorities with precise targets for 2010.

On the vehicle front, technological developments will help to improve the fuel efficiency of conventional vehicles and to progress towards more efficient electric and hybrid vehicles as well as battery-driven vehicles. In terms of fuel, on the other hand, measures have to be stepped up in favour of fuel substitutes to make for greater use of natural gas in vehicles and, in the longer term, hydrogen and biofuels which the proposed directive on energy products envisages to exonerate from excise duties. In addition to the advantages of biofuels in terms of security of supply, they also open up new economic prospects for the world of agriculture.

- The future of and relationships between the different sources of energy (oil, coal, gas, nuclear, renewable) are the subject of a Green Paper on security of supply due to be adopted by the Commission by the end of the year. It will propose an overall strategy designed to bolster the security of internal and external supplies and will address the issue of the European Union's growing energy dependence on the outside, in the dual perspective of an enlarged European Union and commitments under the Kyoto Protocol to reduce greenhouse gas emissions.

Special efforts are required to redress the balance in favour of rail and short sea shipping by a substantial improvement in the economic effectiveness. The inevitable restructuring of the road haulage industry requires social rather than fiscal measures. The Commission will present a White Paper on transport policy by the end of the year.

- The European Union must set up an ongoing dialogue with producer countries, especially OPEC, to make for maximum market transparency and help establish stable prices. Attention must also be paid in this context to the hopes of certain producer countries in the light of political developments in the Middle East.

As regards market transparency, producer countries and market and industry players should be encouraged to improve pricing indicators, based notably on a global index reflecting the whole market.

We must resist the temptation to offset rises in oil prices by cutting taxes. Doing so would run counter to our environmental objectives, notably under the Kyoto protocol, and would amount to transferring tax revenue to the member countries of OPEC. Such an approach would also be incompatible with the orientations of economic policy and with the commitments of the Member States in terms of budgetary consolidation. It would also be desirable to develop a common approach and to examine its translation into the broad economic guidelines. We must make sustained efforts to harmonise

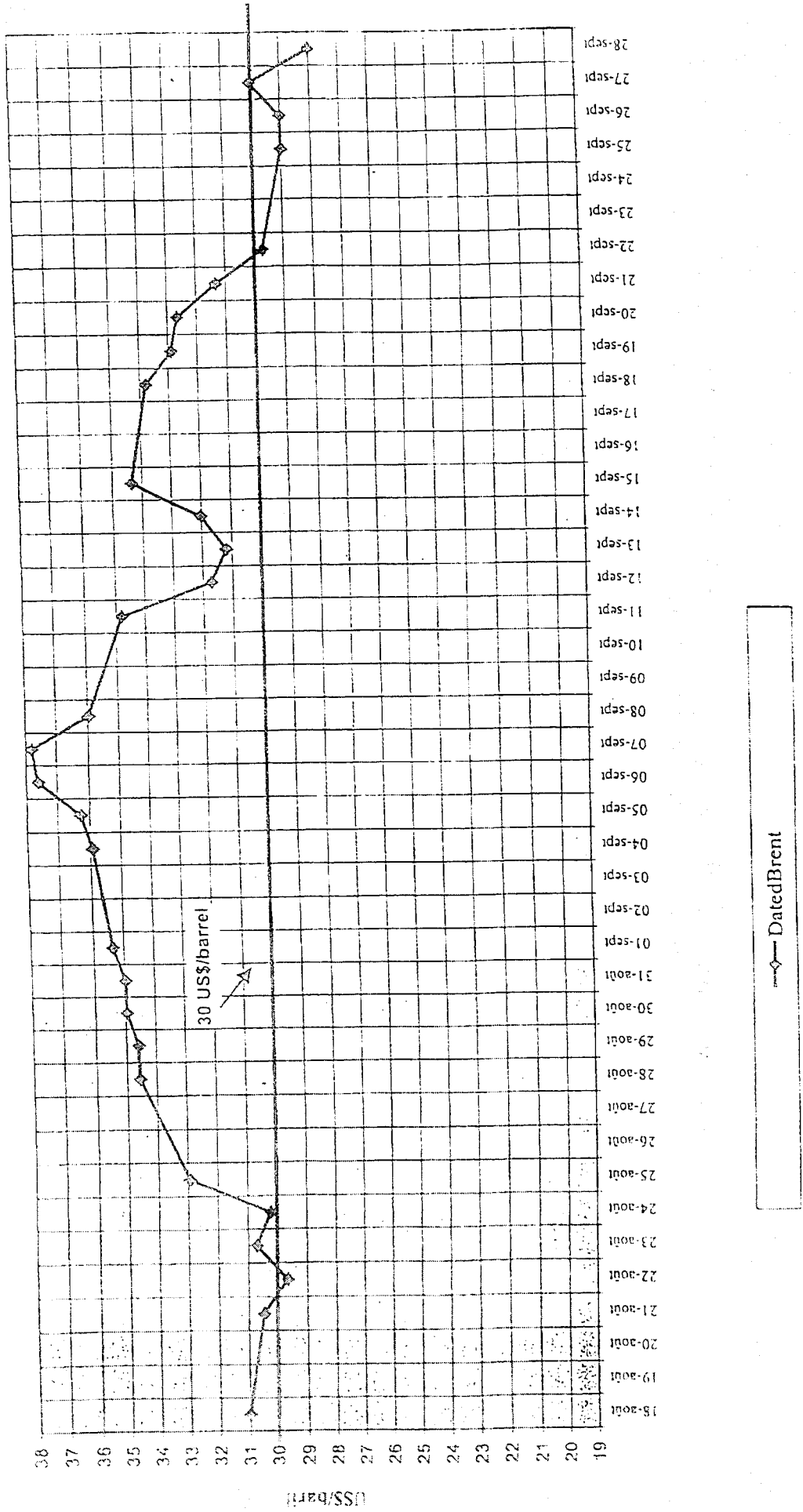
excise duties between Member States, mainly by raising the minimum rates as envisaged in the proposed directive on taxation of energy products, on the Council table since 1997.

- The Commission will look into the possibility of linking the alignment of fuel taxes with the higher rates (structural component) with a Community mechanism to help stabilise VAT revenue in the event of major fluctuations in oil prices (cyclical component).
- Greater cooperation is needed to **rehabilitate production and transport installations in Russia** and to capitalise on the prospects opened up by oil and gas from the **Caspian Sea basin**, in particular under the INOGATE programme.
- The Commission will actively develop, in cooperation with Member States, the scrutiny of the **competition rules in the sector of oil product distribution**. It will examine the compatibility with Community law of the contingency measures taken by Member States to lessen the impact of the recent increase in prices in certain sectors of activity. It is also important to ensure proper functioning of the oil sector "upstream".
- The increase in oil price strongly affects those levels of the population which are on the threshold of poverty and so risk to be further excluded in economic and social terms. The Commission intends to facilitate the exchange of experience on the appropriate means of alleviating the effects of the oil price increase for those who are most dependent on it and to reduce the risk of social exclusion in line with the conclusions of the Lisbon Summit.
- The Commission will look at ways of increasing **strategic oil stocks** by bringing their use into the Community framework. To combat **speculation** ways need to be found, like on the money markets, of **limiting price volatility**.

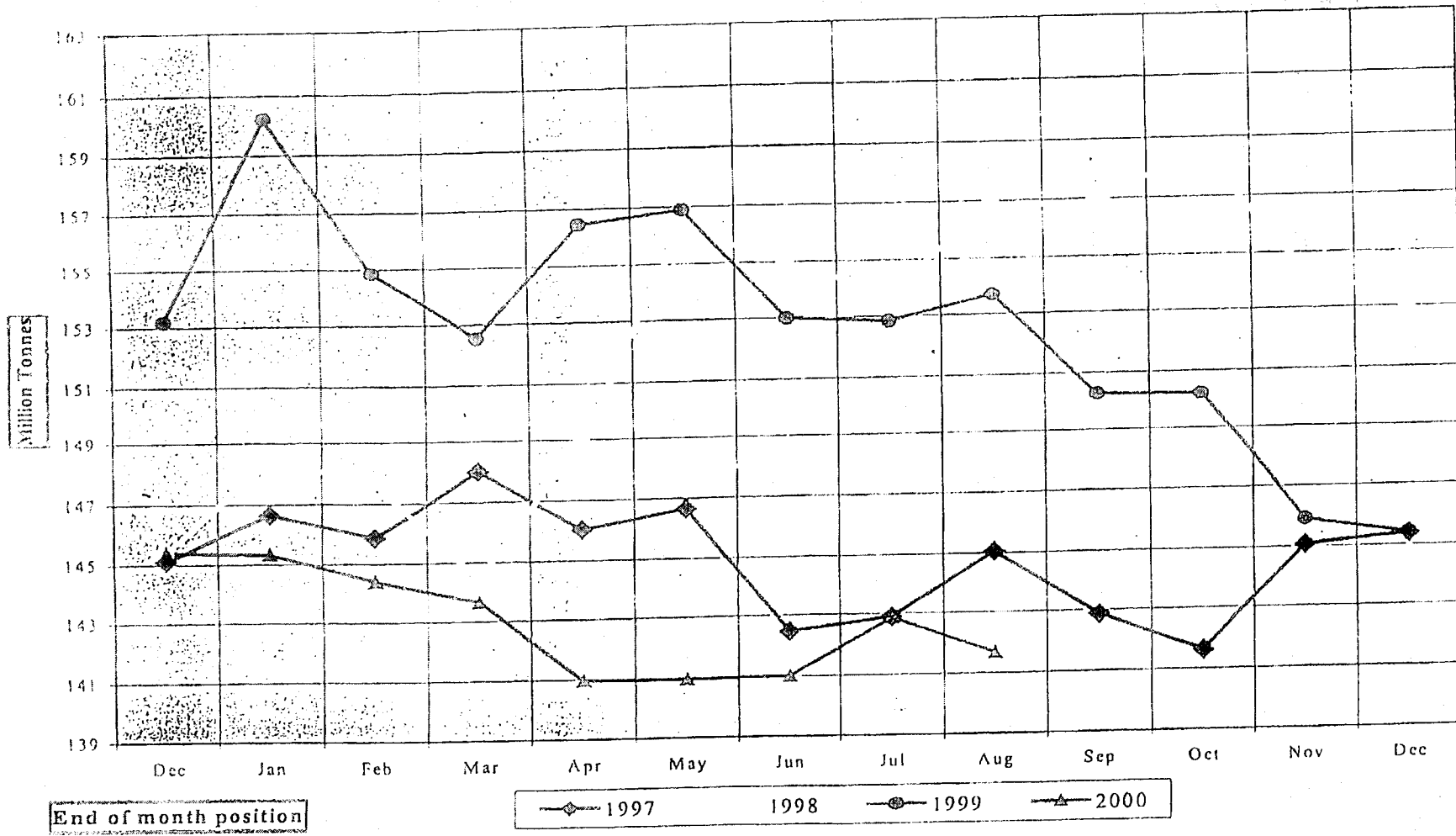
Annexes

- Graph 1: International price quotations of crude oil
- Graph 2: Trends in oil stocks
- Graph 3: Cost of production of the world supply in oil
- Graph 4: Cost of OPEC oil production
- Graph 5: Cost of non-OPEC oil production
- Graph 6: Comparison of prices, excluding tax, of Eurosuper 95 petrol
- Graph 7: Comparison of trends in average petrol and crude oil prices
- Graph 8: Structure of energy consumption in the EU (1998)
- Graph 9: Price of crude oil (OPEC basket price (1970-2000))
- Graph 10: Level of oil stocks in the European Union
- Table: Excise duties and VAT rates on motor fuels

Crude oil - International price quotations

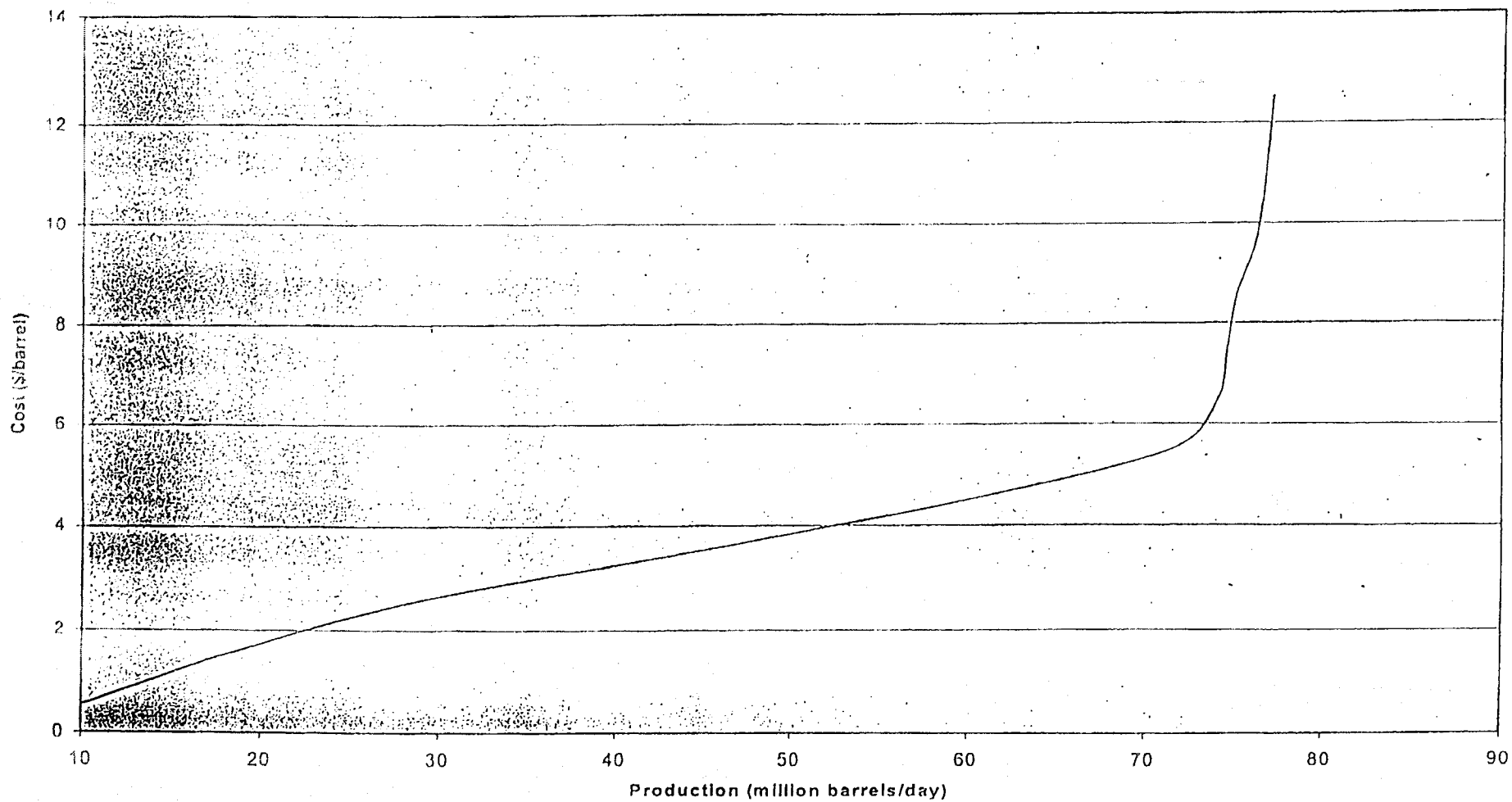


Monthly trends in oil stocks (crude oil + oil products)
Eur 16 = Eur 15 + Norway

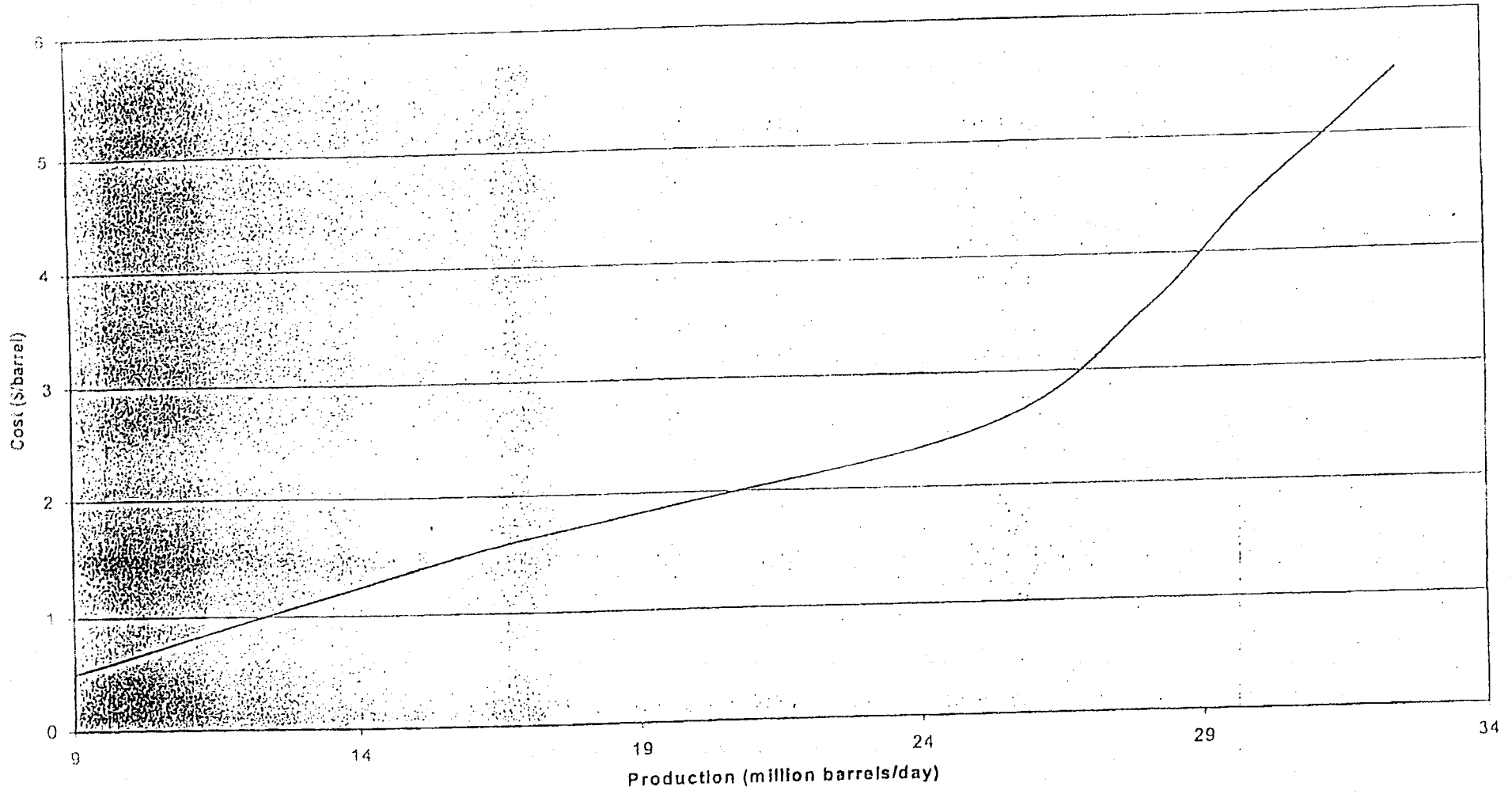


End of month position

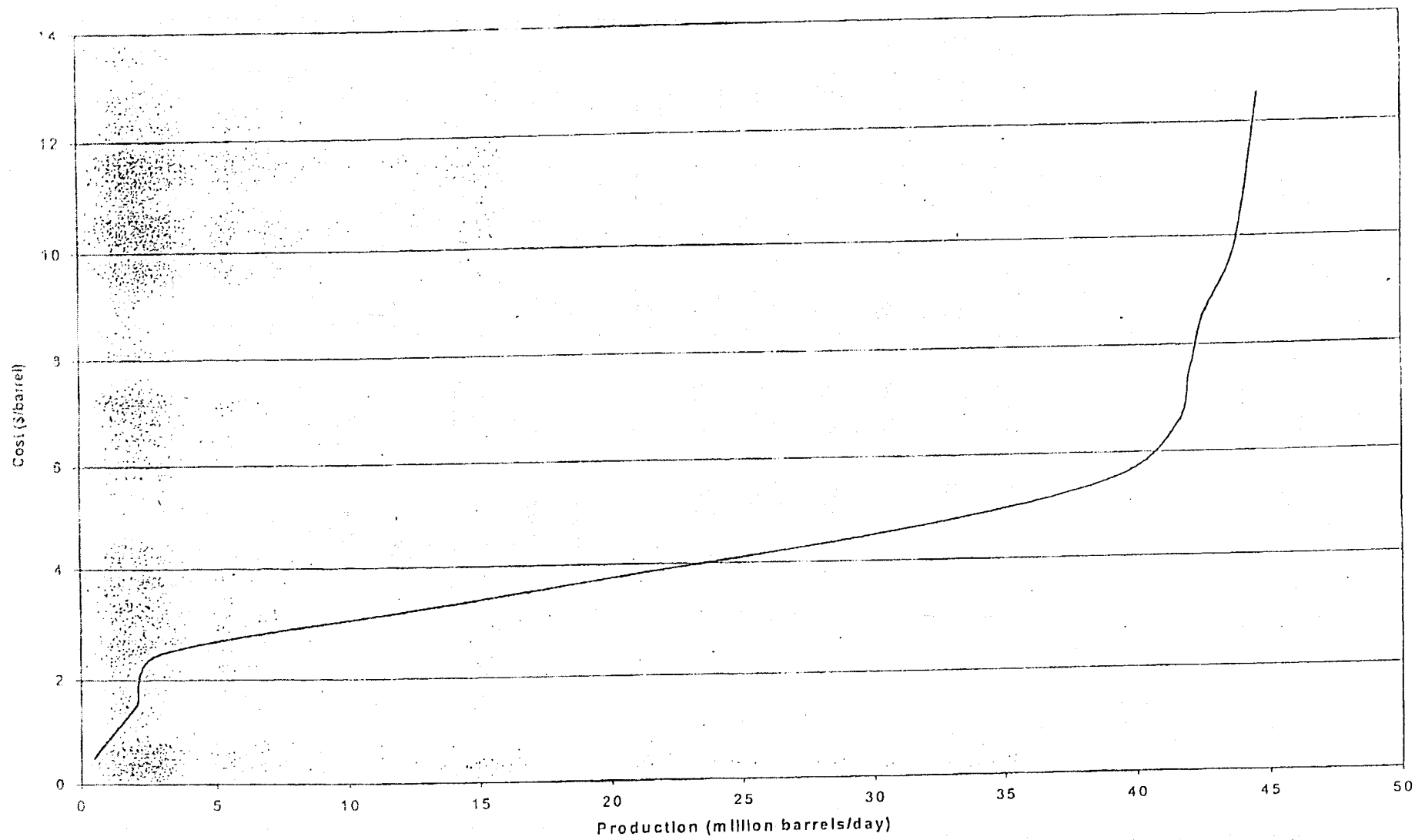
Cost of production of world supply in oil



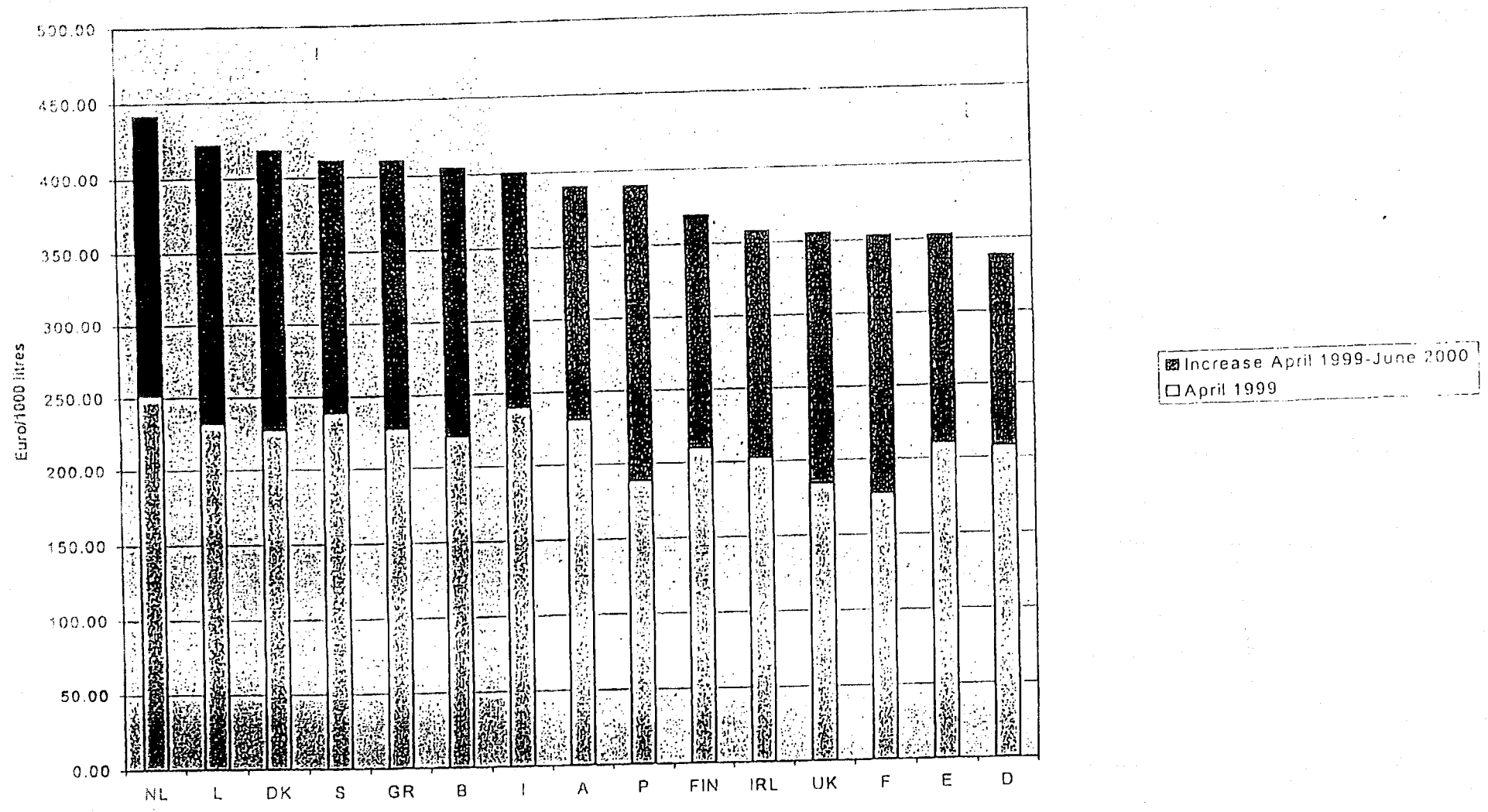
Cost of OPEC oil production



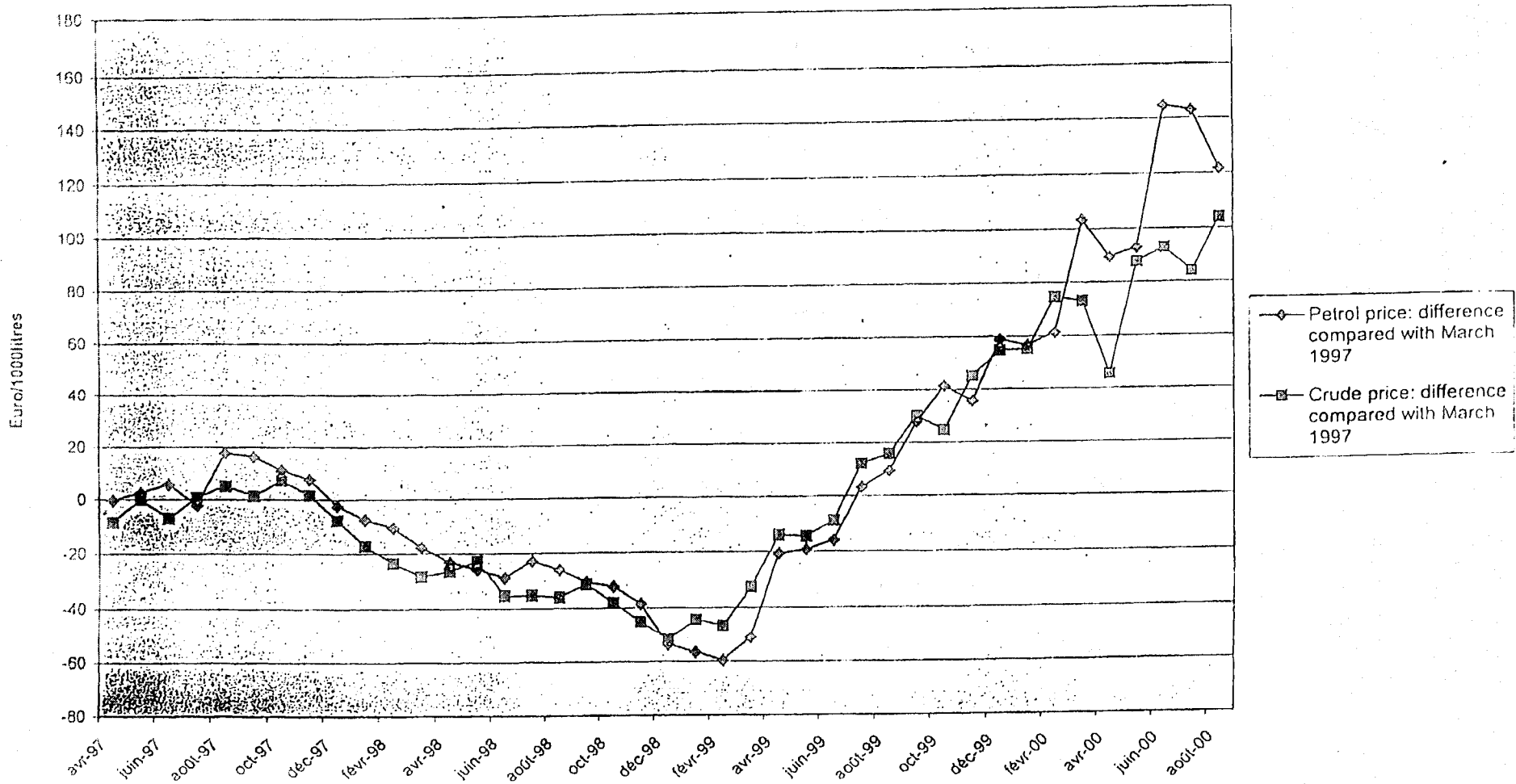
Cost of non-OPEC oil production



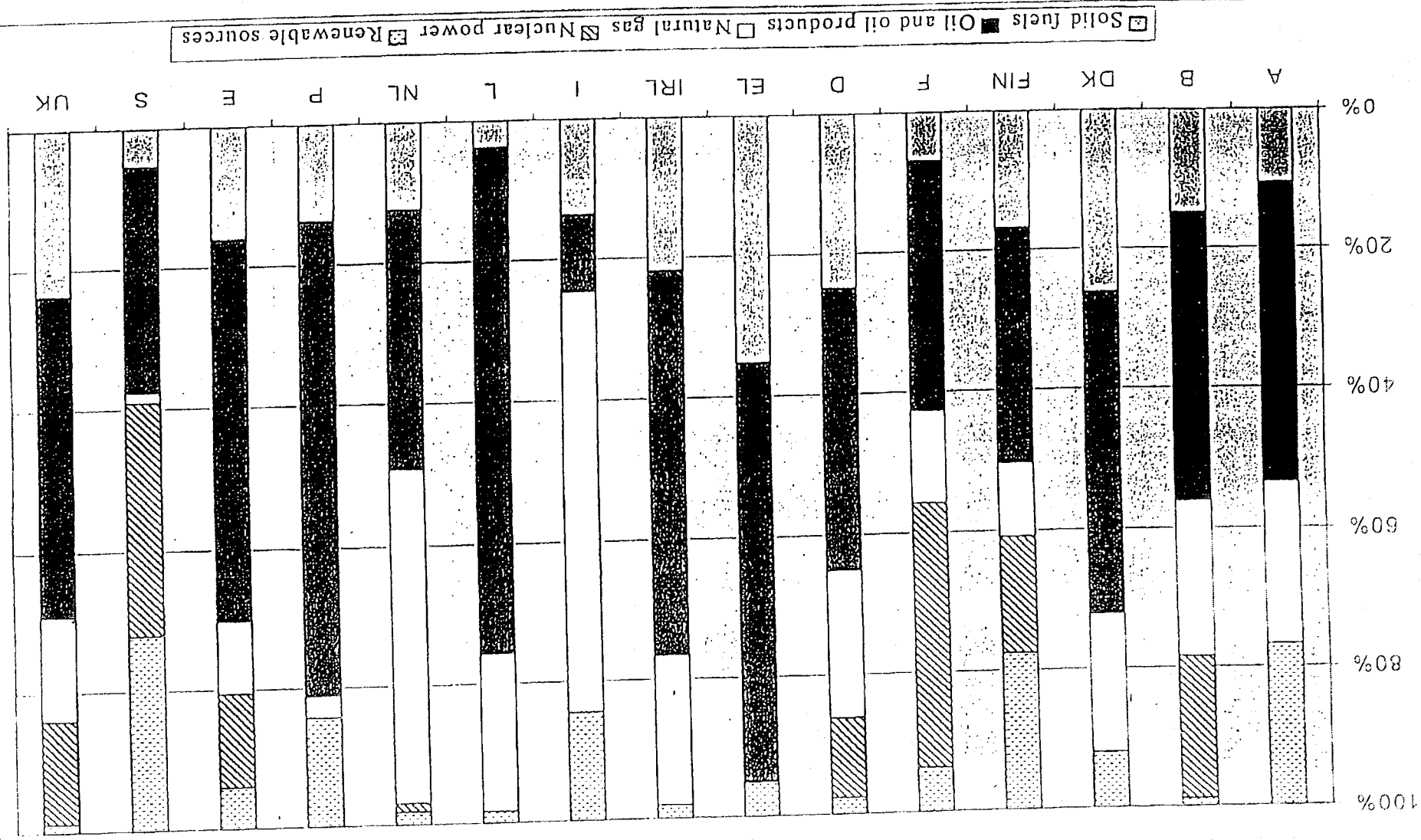
Comparison of prices, excluding taxes, Eurosuper 95 (June 2000)



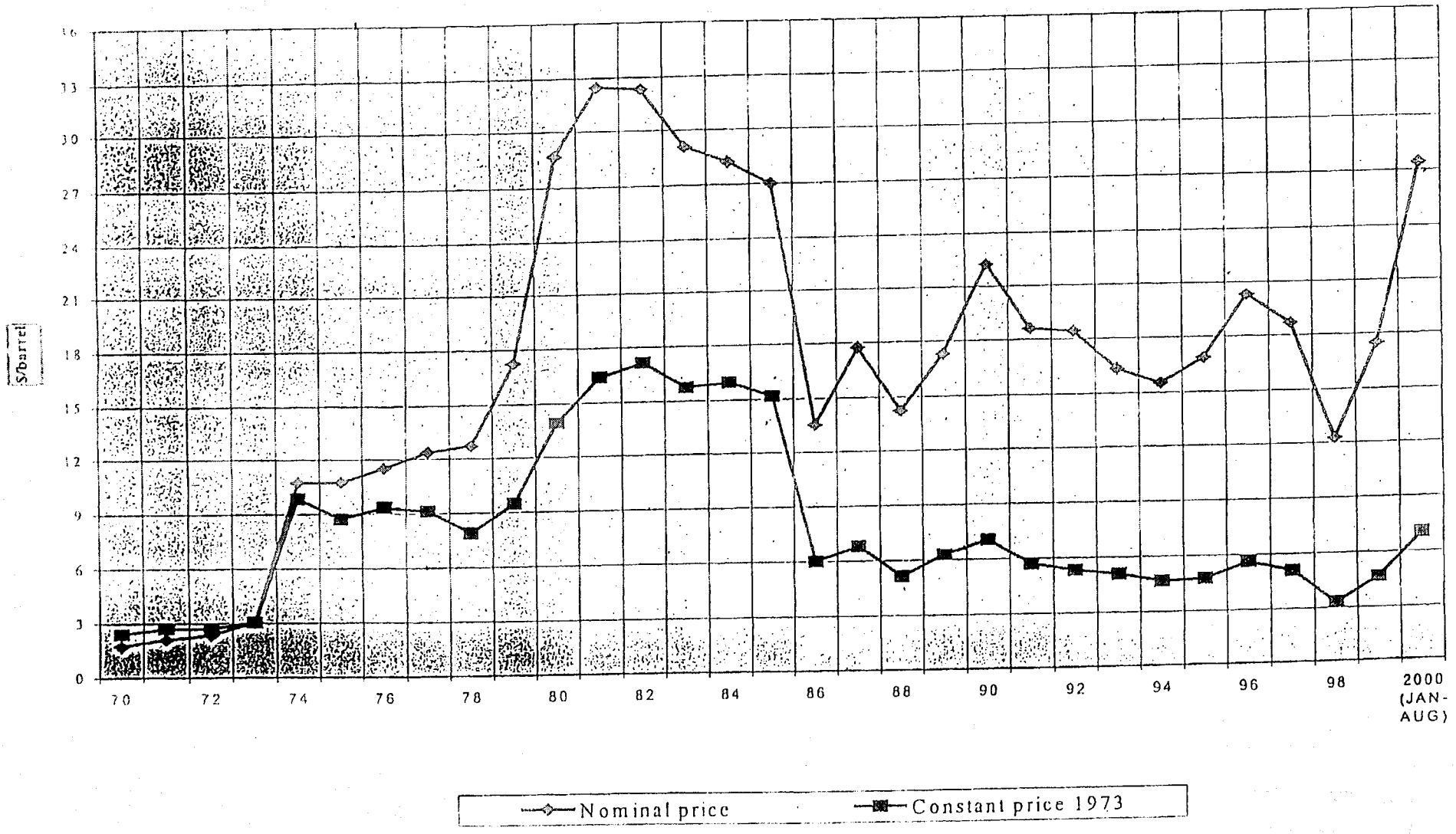
Comparison of trends in the price of Eurosuper 95 in the EU and the price of crude oil (dated Brent)



Structure of energy consumption in the EU (1998)



Price of crude oil (OPEC Basket Price)
1970 - 2000 (JAN-AUG)



Erstatning for engelsk
kopi, der var ulæselig.

Niveau des stocks pétroliers dans l'Union européenne

DERNIERE INFORMATION MENSUELLE DISPONIBLE - LAST AVAILABLE MONTHLY DATA

Sur base de la
consommation de
1999
On the basis of
1999consumption

au/at:22/09/2000

	CATEGORIE/CATEGORY I		CATEGORIE/CATEGORY II		CATEGORIE/CATEGORY III		TOTAL	
	Days of consump.	1000 t	Days of consump.	1000 t	Days of consump.	1000 t	Days of consump.	1000 t
	Jours consommat. (1)		Jours consommat. (1)		Jours consommat. (1)		Jours consommat.	
B - 30/6/2000	94	614	77	2499	222	929	93	4042
DK - 30/6/2000	157	649	141	1393	503	576	172	2618
D - 30/6/2000	115	9284	118	20623	222	2959	122	32866
EL - 31/3/2000	78	690	70	1291	133	1090	87	3071
E - 31/5/2000	105	2579	91	7063	142	2871	102	12513
F - 30/4/2000	109	4238	97	12992	179	2163	105	19393
IRL - 30/6/2000	65	253	81	899	112	634	87	1786
IT - 31/5/2000	97	4327	88	6085	126	6820	102	17232
L - 31/5/2000	150	232	147	598	214	3	148	833
NL - 30/6/2000	154	1587	103	2788	5505	1167	148	5542
P - 30/4/2000	124	704	88	1202	90	961	96	2867
UK - 30/4/2000	96	4241	92	6649	338	1518	102	12408
A - 31/5/2000	144	719	94	1417	213	851	124	2987
S - 30/6/2000	106	1176	105	1862	353	1633	140	4671
FIN - 30/6/2000	95	483	120	1544	142	632	119	2659
EUR-15	108	31776	100	68905	168	24807	111	125488

(1) Obligation de 90 jours pour les trois catégories de produits / 90-day obligation for the 3 product categories

CATEGORIE/CATEGORY I - Essences auto et carburant pour avion de type essence/Motor spirit and aviation fuel of gasoline type.

CATEGORIE/CATEGORY II - Gasoil, diesel, pétrole lampant et carburacteur de type kérosène/Gasoil, diesel oil, kerosene and jet-fuel.

CATEGORIE/CATEGORY III - Fuel oils.

Excise duty and VAT rates on motor fuels			
	Excise duty gazoline <i>Euros/1000 litres</i>	Excise duty diesel <i>Euros/1000 litres</i>	VAT rates motor fuels
Minimum Directives EU	287	245	15 %
Belgium	507	290	21 %
Denmark	518	344	25 %
Germany	562	378	16 %
Greece	291	246	18 %
Spain	371	269	16 %
France	589	391	19,6 %
Ireland	378	330	21 %
Italy	520	381	20 %
Luxemburg	372	252	15 % (gazoline 12 %)
Netherlands	596	351	17,5 %
Austria	414	289	20 %
Portugal	289	245	17 %
Finland	559	304	22 %
Sweden	529	345	25 %
United Kingdom	777	777	17,5 %

