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ENERGY PRICING DEVELOPMENTS IN COMMUNITY POLICY 1981-82

(Communication by the Commission to the Council)

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INTRODUCTION

This is a progress report on energy pricing - developments in the market, pricing policy, and transparency - for the period October 1981 to October 1982. In it the Commission

- summarises recent developments in Community policy on the pricing of energy for users within the Community;
- reports on the progress of the Commission's work on pricing in each energy sector, and on prospects for the further development of that work.

The preliminary issue of the Commission's new Energy Price Bulletin (see para. 3 below) which contains information on energy prices in the Community up to January 1982, and a commentary on price trends, should be read in conjunction with this report.

COMMUNITY POLICY ON ENERGY PRICING

"Consumer prices should reflect representative conditions on the world market, taking account of longer term trends."

Council Resolution of June 1980

2.1 Community policy on energy pricing is based on the principle that consumer prices should reflect costs and market conditions, and provide for fair competition within and between member states.

2.2 These principles have been embodied in Community law for many years; rules governing the alignment of prices for Community coal with coal from competing sources, and providing a legal framework for financial assistance to the Community coal industry are contained in the ECSC Treaty and in ECSC Regulations.

Community rules on energy pricing were extended by a number of Council decisions in the period 1974-78, which gave the Commission the task of monitoring price developments in markets for crude oil and oil products.

2.3 But it is only since the second oil crisis in 1979 that realistic pricing of energy has come to be seen as an indispensable element of policies to promote structural change in energy supply and demand. In its Communication to the Council last year on the Development of an Energy Strategy for the Community (COM(81)549) the Commission identified pricing as one of five priority areas for development in Community policy.

2.4 The Council has accordingly considered energy pricing at each of the last three meetings of Energy Ministers, and reached a number of important decisions.

- At its meeting on 27 October 1981 it approved a Recommendation on Electricity Tariff Structures (81/924/EEC - OJ L 337/12) and gave a first reading to a Communication from the Commission on "Energy Pricing - Policy and Transparency" (COM(81)539). Following this discussion at Ministerial level, the Council, at its meeting on 9 December 1981, approved Conclusions on energy pricing reaffirming and extending those agreed in 1980.

- The Council returned to the subject at the meeting of Energy Ministers of 16 March 1982, and invited the Commission to proceed to the implementation of the agreed principles by way of studies of energy pricing practice in each of the four energy sectors.

- At its meeting on 17 July 1982, the Council approved a Recommendation on Investment in the Rational Use of Energy (which was adopted formally on 28 July 1982) which included important references to energy pricing.

2.5 The Council now has before it a new draft Recommendation prepared by the Commission on principles of natural gas pricing, which follows lines similar to those already adopted for electricity.

2.6 The principles embodied in these decisions have already been the subject of very detailed examination and discussion, which does not need to be reopened. This report focusses instead on the steps the Commission has taken towards practical action, the difficulties that have been encountered, and work which remains to be done. It may however be helpful, by way of introduction, to recall the main elements of the decisions taken so far.

2.7 The need for realistic pricing

"Consumer prices must permit an adequate level of investment in energy supply and encourage energy efficiency; to this end they must not be kept at artificially low levels and thereby prevented from providing reliable signals ... Government policies which contribute to the formation of energy prices must take account of the need for a realistic reflection of market trends."

Council Conclusions of 9 December 1981

"Electricity supply undertakings should... cover their costs on the basis of the most objective allocation possible of such costs among the various categories of user Electricity tariff structures should... reflect the costs in supplying the various categories of user... Tariffs should not be kept artificially low."

Council Recommendation of 27 October 1981

In short, realistic pricing means that the consumer must bear in full the cost of supplying him with energy, including the full long-run cost of production and distribution or of acquisition on world markets. It also means that costs must be allocated fairly between different categories

of consumer. Government intervention in the form of financial support to energy suppliers or consumers is to be discouraged, except where such policies are agreed at Community level to be in accordance with Community energy policy, and with other rules of the common market.

2.8 The need for unity of the common market

"Differences in pre-tax energy prices within the Community may arise from the existence of a genuine competitive advantage (arising for example from favourable location, prudent investment, superior productivity or specific market conditions) or alternatively from the existence of priorities consistent with the Community's... energy objectives... Any differences which do not correspond to these guidelines must be clearly identified, and, to the extent that they arise from differences in public policy, progressively reduced."

Council Conclusions of 9 December 1981

"The Council recommends that the Member States... apply energy pricing policies which unite the pursuit of energy objectives with efforts to ensure that prices truly correspond to market conditions and costs. Where it is the responsibility of the public authorities, the calculation of the constituent elements of energy prices should also take such objectives into account."

Council Recommendation of 28 July 1982

In other words, Ministers have agreed to work progressively towards the elimination of differences in policies and practices which give rise to differences in energy prices within the common market. It is important to note however that this does not mean that consumer prices should be identical throughout the Community. On the contrary, the aim of Community policy is to ensure that differences in investment and productivity in energy transformation (refining, transport, distribution and electricity generation) between Member States are reflected in energy prices, so as to encourage rational decisions by both producers and consumers, and to promote a political and economic climate favourable to prudent energy investment policies.

TRANSPARENCY

3.1 A third element in the recent decisions of the Council is the need for transparency of energy prices, and, where appropriate, of costs.

"Transparency is a necessary and urgent condition for the implementation of the principles... This means that consumers should have adequate access to information on energy prices and on the methods by which both prices and tariffs are determined."

Council Conclusions of 9 December 1981

"The Council encourages the Commission's efforts to achieve the necessary improvement in price transparency and asks the Commission to report the results of these efforts."

Council Conclusions of 16 March 1982

The aim of the Commission's work in this field has been to ensure that consumers have sufficient information on prices and costs to enable them to take sensible decisions on fuel use, investment in energy saving and fuel substitution, and, in the case of industry, on location. A further aim is to provide adequate information to satisfy informed public opinion and responsible authorities that the principles described in paragraph 2 are respected in practice. It does not imply that prices for individual consumers need be made public, but it does imply the availability of up to date, accurate, and comparable data in an aggregated form.

3.2 In its Communication to the Council on Energy Pricing, Policy and Transparency (COM(81)539) of October 1981, and especially in the technical annex thereto^{1/}, the Commission described in some detail the various sources of information on energy prices to which it has access, arrangements for publication and dissemination of this information, and drew attention to certain shortcomings and inconsistencies in this data. The main conclusions were that transparency of oil and electricity prices is generally good, but that there is room for improvement in the coal and gas sectors. Paras. 4-7

^{1/} SEC(81)1632 "The Price and Cost Structure of Energy Markets in the Community".

refer to the contacts the Commission has had with experts in national administrations and the energy supply industries with a view to improving transparency.

3.3 The methods used to promote public understanding of conditions on energy markets need to be adapted to satisfy the different needs of the various types of consumer. The requirements of the large industrial purchaser who is evaluating alternatives for investments in industrial processes are quite different from those of the small domestic consumer who seeks advice on cutting his fuel costs. Transparency of prices to large industrial consumers presents particular problems. At this level of consumption prices are set in individual contracts, often of long duration, and are heavily influenced by the conditions of supply specific to each individual contract. In many cases the terms of such contracts are protected by commercial secrecy; where information about such contracts is collected on a confidential basis, that confidence must of course be respected. Any publication of aggregated data derived from confidential material must be organised so as to avoid revealing, even inadvertently, the contents of individual contracts.

3.4 Effective transparency of energy markets depends in the end on the willingness of individual energy suppliers throughout the Community to make their terms of business known to each individual category of consumer in the most effective manner possible. The collection and publication of energy price data by national and international authorities has a contribution to make to this process, but statistical exercises are not in themselves sufficient to create adequate transparency.

3.5 Nevertheless the Commission believes that its work on energy price information is a useful contribution to transparency. It therefore intends in future to publish, at regular intervals, a summary of up-to-date price information concerning all four energy sectors. A preliminary trial issue, No -1, of this projected "Bulletin of Energy Prices", containing information up to January 1982 is being circulated at the same time as this Communication. The Commission's aim is to publish a further issue, containing information

correct to January 1983 in May of next year, and to start regular publication at six-monthly intervals in November 1983. Achievement of this timetable will however depend on the progress of discussions with correspondents in the energy industries.

3.6 The trial issue of the price bulletin contains an introductory commentary on recent price trends in the Community. For the purposes of this progress report the most significant points to note are:

- (a) Since 1978 there has been a sharp divergence in trends in prices for oil and gas on the one hand and of coal for the other. Whereas up to 1978 oil appeared to act as "price leader", which determined prices for competing fuels, there is now mounting evidence that coal prices are determined by the cost of supply of imported coal, and that coal has gained a lasting price advantage.
- (b) There has also been since 1973 a marked divergence between trends in electricity prices and those for oil and gas. The average rise in the real price of industrial electricity since 1973 was about 60% while real prices of residual fuel oil have nearly tripled. This trend is however far from uniform within the Community, and electricity price increases have been much steeper in those countries (especially Greece, Ireland, Italy and the Netherlands) who depend heavily on oil and gas for electricity generation. In these countries there is strong political pressure to control electricity prices at levels comparable with those prevailing elsewhere in the Community.
- (c) Natural gas prices have risen particularly steeply in 1981 and 1982 and are now in many cases comparable to those for competing oil products. There is however a tendency, especially in the gas producing countries, to control prices for domestic gas at levels sharply below those for domestic heating oil.

OIL

4.1 Transparency. In COM(81)539 the Commission reported that there has been substantial progress towards transparency of oil markets in recent years. In June 1982 the Commission's Weekly Oil Bulletin entered its fourth year of publication. This bulletin reports at weekly intervals on prices for five main oil products (premium and regular gasoline, automotive diesel, gasoil and heavy fuel oil) and, at less regular intervals, on the cif price of crude oil and of imported oil products.

4.2 The Weekly Oil Bulletin is now an established aid to transparency. Its usefulness can be judged from the fact that there is a continuing increase in its circulation and from the fact that some national administrations make use of it within national systems for price regulation. This does not however imply that the information contained in it is of a statistically rigorous character. On the contrary, the introductory note with which it is prefaced, and the methodological notes which are published once every three months emphasise that some elements in the Bulletin must be treated with caution, since they are intended to serve mainly as indicators. The Commission is giving continuing attention to the improvement of the Bulletin.

4.3 National Price Regimes. The structure of the oil market within the Community is such as to encourage realistic pricing in the absence of government intervention to control prices. With the help of the Group of Oil Price Experts which meets regularly under Commission chairmanship, and which includes both the officials responsible for oil pricing matters within national administrations and specialists from the oil industry, the Commission is working on a study of the extent to which existing systems for the regulation of oil product prices, such as exist in most member states, are compatible with the principles agreed by the Council. An independent consultant has been engaged to advise on the consistency of technical aspects of oil price regimes.

4.4 The oil price group has reached agreement on a working document on oil price regimes. This paper notes that there is clear evidence from throughout the Community that pre-tax prices are increasingly determined by market forces.

Examples of this tendency have been seen in 1982 in France and Italy where the former systems of administered pricing have been loosened or abolished, and in the Netherlands, where since August 1982 price controls have been suspended except during periods of sharp divergence between spot and contract prices. The only important exception to the general trend towards deregulation arises in Greece, where maximum prices, controlled by the Government, appear to be determined more by a theoretical calculation of costs than by market forces. The Commission considers that the guidelines suggested in this paper form a useful basis for future work aimed at ensuring a consistent approach to oil pricing within the Community during periods of tension when there are abrupt and significant movements in price.

4.5 The Commission has also been paying close attention to the widespread practice of subsidising the use of oil in agriculture, horticulture and fisheries. So far as horticulture is concerned, the Commission has issued guidelines permitting on a temporary basis a limited degree of subsidy. These guidelines are linked to the programme that has now been agreed (see paragraph 6.5) for the removal of the preferential gas tariff enjoyed by the Dutch horticulture sector. From April 1983 no further authority will be given by the Commission for fuel price subsidies, though the Commission will continue to examine sympathetically those aids which are genuinely linked to investment in energy efficiency. The procedures defined in Article 92-93 of the EEC Treaty for action by the Commission to prohibit state aids not compatible with the Treaty is currently being followed in relation to oil price subsidies paid to the agriculture, horticulture and fisheries sectors in Belgium, Italy and France.

4.6 Taxation. The most important source of variation in oil product prices within the Community is taxation, and in this field progress has been disappointing. The Commission's communication on "Taxation of Oil Products" (COM(81)511) was submitted to the Council in September 1981. This Communication leaves on one side the controversial issue of whether there is a need, on macroeconomic policy grounds, for a general increase in oil taxation; the Commission concentrated instead on the desirability of reducing progressively the marked disparity in the levels of taxation imposed on oil products. This could be achieved by an agreement on "target zones" for the total tax rate (excise plus VAT) to be applied to each product. Member States would undertake to revalue their excise duties at regular intervals so as to remain within the target zones, and to prevent the progressive erosion of tax rates through inflation. The Communication also drew attention to the need to ensure that the coverage of oil taxation properly reflects energy policy priorities, and in particular to remove tax exemptions that are no longer justified. COREPER subsequently agreed on a questionnaire to all Member States to serve as a basis for examining this latter issue. Replies to that questionnaire have been considerably delayed, and many are incomplete in various respects.

4.7 In discussion of the Commission's communication in the Council Member States have expressed serious reservations about the Commission's proposals. They have emphasised that taxation policy has to be considered in a global context, and that macroeconomic policy, transport policy and budgetary considerations in particular have to be taken into account in addition to the requirements of energy policy. The Commission fully accepts that energy policy is only one element in the determination of tax policy, and urges only that taxes on energy should at least not work in contradiction to energy policy objectives. At present this requirement is not satisfied since :

- taxation on oil is still subject to progressive erosion by inflation;
- a number of important exemptions from oil taxation cannot be justified by reference to energy priorities;

- the very wide divergence of tax rates within the Community is inconsistent with the declarations of Ministers on energy pricing principles.

4.3 The Commission therefore proposes to introduce new arrangements to improve official and public understanding of the present structure of oil taxation in the Community. It will continue with its work on tax exemptions. And it wishes to remind the Council of its long-standing proposal for a draft directive on the harmonisation of oil excise duties (OJ No C92-30.10.73). This last proposal does not raise the sensitive political issues involved in the more ambitious recent proposals on convergence in tax rates, but is limited to the definition of common rules on scope, liability, coverage, deferment periods and exempted uses. Although some details of this proposal require reconsideration in the light of changes in energy priorities, it remains a useful basis for progress on oil taxation policy.

COAL

5.1 Pricing policy for coal within the Community presents rather different problems from those for other forms of energy. The cost of coal produced within the Community is in general higher than the price of coal imported from third countries; the ECSC treaty, together with legislation deriving from it, provides a framework for the downward alignment of prices for community coal against the price of imports, and so to regulate the degree of support given to the coal industry, so as to ensure fair competition within the Community.

5.2 The energy strategy of the Community places particular emphasis on the need to encourage coal consumption, especially in the electricity and industry sectors. As noted in paragraph 3.5 and in the preliminary issue of the Energy Price Bulletin, coal prices have risen much less sharply than those for oil since 1979, and it is widely believed that coal has now secured a lasting price advantage over oil especially in the heat market (industrial and district heating).

5.3 The Commission therefore attaches particular importance to the improvement of transparency of coal prices. As described in COM(81)539 the Commission already has access, by virtue of its responsibilities under the ECSC treaty, to very detailed information on prices and costs of coal either imported or indigenous. However there is no published information which provides a consistent and reliable indication of coal prices actually prevailing in the market. For example official pithead prices, which are published by the Commission at regular intervals in the Official Journal and in a "Carnet de prix charbon" do not provide a reliable guide since they are in many cases based on pithead costs, before alignment, and because they give no indication of transport costs at the point of consumption.

5.4 The Commission has therefore put to representatives of the coal industry, working within the framework of the Comité d'Etudes des Producteurs de Charbon de l'Europe Occidentale (CEPCEO), a suggestion for the publication of aggregated data derived from information provided under Commission Decision No 72/443/ECSC on alignment of coal prices. Producers have expressed some anxiety that such a procedure might have the effect of inhibiting their freedom of commercial action. The Commission has however emphasised that any such publication would be ex post; it would serve only to provide a simple guide to price conditions actually prevailing in the market, and it would not have any effect on existing rules on alignment. The Commission has also put to national administrations a proposal to amend Council Decision 77/707/ECSC so as to enlarge the scope of information provided by member states on imports of coal for use in power stations or in combined heat and power plants, and to provide for the publication of aggregated data.

GAS

6.1 In COM(81)539 the Commission noted that the principle of realistic pricing is more difficult to define in relation to natural gas than for other forms of energy. Until recently, nearly all gas consumed in the Community was produced within the Community at very low cost. Its price was in consequence set not by reference to its cost of production, but at levels settled in relation to competing fuels, mainly oil, in such a way

as to permit its rapid but orderly penetration of the energy market. The gas market within the Community has however now arrived at a turning point since further penetration cannot be envisaged without involving serious risks in relation to resource depletion and of external dependence. The aim of gas pricing policy should therefore be to encourage the progressive reallocation of gas to premium uses so as to ensure that limited and valuable resources are exploited as efficiently as possible.

6.2 Transparency. The Commission has discussed with national administrations, with individual gas undertakings and with the Comité d'Etudes de l'Industrie de Gaz (COMETEC - GAZ) the need for improvement in transparency. Because of the historic practice of pricing gas in relation to competing fuels, the gas industry has some reservations about transparency, and the difficulties in relation to large industrial users referred to in paragraph 3.3 are particularly acute. However, useful progress has been made towards improvements in the SOEC's annual survey of gas prices, both for tariff customers and for the smaller categories of industrial user not subject to tariffs. For larger industrial users the Commission is considering with the gas industry a system for communicating average prices for representative groups of consumer.

6.3 Gas tariffs. The Commission has also consulted the gas industry about the harmonisation of gas tariff structures, and reached a broad measure of agreement on the proposals that it has now sent to the Council in the form of a draft Council Recommendation. These proposals apply to the particular circumstances of the gas industry the principles already adopted for electricity and for energy in general. Gas pricing should be such as to optimise valuable gas resources; prices should be set at realistic levels in relation to competing fuels; they should discourage waste, while at the same time encourage flexibility in the use of gas, for example by promoting interruptibility of gas supplies.

6.4 The passage of this recommendation through the Council will be the first priority of Commission activity on gas pricing in coming months. The Commission will in addition be seeking information from member states on the level of gas prices relative to those for competing forces of energy. It also proposes to give particular attention to areas where there is evidence that gas is not priced in such a way as to encourage its use as a premium fuel - especially the continued use of natural gas in power stations contrary to the spirit of Council Directive No 75/404/EEC of 13 February 1975, and the supply of natural gas feedstock to the chemical industry.

6.5 Early in 1982 agreement was reached between the Commission and the Netherlands Government for arrangements to bring to an end the preferential natural gas tariff enjoyed by the Dutch horticulture industry. Under these arrangements large growers will, from April 1983, pay the same price as industrial users.

ELECTRICITY

7.1 In COM(81)539 the Commission noted that good progress had already been made towards creating a framework for the collection and publication of electricity price statistics, and in defining the principles now incorporated in the Council Recommendation of 27 October 1981 on electricity tariff structures. The industry, through the Union Internationale des Producteurs et Distributeurs de l'Electricité (UNIPÉDE) has also worked closely with the Commission on projects to determine the weight of taxation in the cost of electricity supply in individual member states, and to estimate the cost of electricity from new oil, coal and nuclear power stations currently planned or under construction within the Community. Important progress has therefore already been made towards Community aims on electricity pricing.

7.2 The cost of electricity generation varies widely within the Community for many reasons, of which the most important are differences in the price of primary fuels, differences in the fuel mix, differences in the capital cost of new power stations, and differences in the structure of demand and the generating stock available to meet it. However, differences in electricity prices within the Community, which are greater than for any other form of energy, do not necessarily arise from a realistic reflection of the cost differences. In some cases price differentials appear wider than can be explained by cost differences alone; in others, and particularly in countries where the electricity industry is at a cost disadvantage relative to those in other countries, there is some evidence that financial assistance may be being provided to permit the alignment of electricity prices with those of lower cost producers.

7.3 In Italy a law provides for a state financial aid to the steel industry, specifically linked to increases in electricity prices, and the Commission has set in motion the procedures provided by Decision 2320/ECSC for the regulation of state aids in the steel sector. Other cases of pricing arrangements which result in preferential prices for particular categories of consumer are also being examined by the Commission, and action under the Treaties will be taken in any case where there appears prima facie to

be a breach of competition rules. More generally the present difficult economic climate has given rise to losses for many electricity undertakings; but in some cases these losses are exceptional and cannot be recovered on existing pricing policies. During the coming year the Commission will be giving particularly close attention to the effect of Government policies on electricity prices, and on the implications of price control for the financial health of the electricity industry.

7.4 There is however a third category of reasons why electricity prices differ between member states, arising neither from disparities in cost, nor from artificial or uneconomic pricing. Since a major share of the cost of electricity supply is that of amortising and maintaining the stock of generating, transport and distribution equipment, differences between member states in the financial structure of the electricity industry, and the accounting conventions it uses are important to the definition of costs. A further issue is the way in which electricity tariffs are constructed so as to apportion the cost of overheads between individual consumer types. The Council Recommendation calls on member states to ensure that this should be done as objectively as possible, but approaches to this complex issue vary widely within the Community. In some countries there are clearly defined rules designed to ensure that each customer pays the long-run marginal cost of supply to him. In others a more pragmatic approach is adopted, and in some cases large industrial consumers receive electricity at prices based not on the cost of the electricity system as a whole, but on that of supply from individual power stations. The latter approach makes it possible to provide large industrial consumers with electricity at prices very much lower than in the former.

7.5 The Commission believes that a common approach to this problem within the Community will be necessary to create an economic climate favourable to rational investment in the electricity system, and to continued substitution of electricity for other forms of energy. Further work will however be required to determine which approaches correspond best with the principles already agreed, and with the Community's broader

energy priorities. It has already embarked on discussion of these issues with representatives of the industry, and is now seeking to define with UNIPEDE a programme of work to identify the issues more precisely, and if possible to develop proposals for a common approach.

CONCLUSIONS

8.1 During the last year, work on energy pricing has focussed on improvement in transparency and the definition of principles, first in the Council, and then at a more detailed level in discussions between the Commission, experts in national administrations, and organisations representing each of the four energy industries. This process will continue in coming months. The projected publication of a six-monthly bulletin of energy prices will mark an important stage in progress towards the required improvement in transparency.

8.2 Since the process of defining principles is now nearing completion, the Commission considers that its work should now move onto a more practical level. It therefore intends in the coming year to examine energy pricing practice within each Member State, with a view to ensuring that the principles adopted by the Council are generally respected. For this purpose the Commission plans to give particular attention to pricing issues in the Review of Member States Energy Policy and Programmes which it will present to the Council in 1983. As the first step in this process the Commission is addressing to each Member State individually, and in confidence, a letter of enquiry seeking information on issues that give rise to concern in the context of energy pricing principles. This process will of course be additional to action outstanding and pending in relation to pricing practices which may be incompatible with Community rules on competition.