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COMMUNICATION OF THE COMMISSION TO THE COUNCIL

on the problems connected with the profitability of the
refining industry in the Community and in ways of resolving them

COM (78) 1

Communication from the Commission to the Council on problems connected with the profitability of the refining industry in the Community and on ways of resolving them.

I. Introduction

In March 1977 the Commission forwarded a communication to the Council⁽¹⁾ on refining problems, which was discussed in the Councils of 29/3, 14/6, 25/10 and 13/12/1977.

At the Council meeting on 13th December 1977 a compromise proposal was submitted by the Presidency to the Council (see annex) on the procedures to be put into practice regarding refining. The Commission proposes that the Council should adopt this text.

This communication, which complements that of March 1977⁽¹⁾, describes the initiatives which the Commission intends to take in the refining sector.

These new initiatives have as their purpose not only to bring about a structural adjustment, but also to reduce the effect of cyclical developments. The situation in the refining sector remains very worrying and is characterised particularly by inadequate, and often even negative, profitability.

The causes of this situation are manifold : structural factors (surplus distillation capacity, poor adaptation to the structure of demand, import of finished products); cyclical factors (demand stagnating as a result of economic difficulties, the current abundance of crude oil, high level of stocks, different price systems in Member States, etc.).

The guiding principle of the previous communication of March 1977⁽¹⁾ was to seek solutions at Community level and to bring about convergence between the indispensable and balanced efforts of the industry and those of the public authorities. This principle remains valid, but the present situation requires more specific initiatives on the part of the Community, even though the difficulties are not as dramatic as those in the steel or textile industries.

The initiatives under consideration leave a major responsibility to the industry, but if its response is not adequate, binding measures will have to be considered. In any event, the Commission will develop close consultation with all the companies concerned and with the European Federation of Trade Unions.

(1) Communication by the Commission to the Council of 17 March 1977 : "Community approach to the refining problems of the Community" (COM (77) 71 final).

II. Distillation Capacity

4. Approximately two-thirds⁽¹⁾ of the 140 million tons of surplus distillation capacity mentioned in the communication of March 1977 have been taken out of service in less than a year although what has been achieved differs significantly from country to country and from one company to another. This response is still insufficient, however, since the surplus of capacity continues to have a depressing effect upon prices. As much more progress is not to be expected in closing down capacity, other means must be considered, particularly for resolving the short-term problem of the refining industry.
5. The most appropriate way in the short-term of adapting the level of processing in refineries to changes in demand, is for the individual companies themselves voluntarily to apply a flexible limitation to the level of refining activity, so far as concerns production destined for the Community market (this restraint would parallel that envisaged for imports of products).

The aim is that each company should adapt its production to the normal development of the Community market.

To achieve this result, the Commission intends to :

- a) draw up each year a Community oil balance for the year to come based on information obtained under existing Community legislation (2) and from appropriate consultation with the industry and with the authorities of the Member States.
 - b) recommend on this basis for the year under consideration an average indicative percentage in relation to the preceding year for the change in the quantity of crude to be processed in refineries for the Community as a whole. This figure, which may be altered in the course of the year as circumstances require, will be made public,
 - c) at the same time, every refiner operating in the Community will be invited to inform the Commission, on a voluntary basis, of the estimated quantities to be processed in each of its refineries and of the corresponding actual figures for the preceding year. These data - treated as confidential - and any revisions made during the year, will be discussed between the individual companies and the Commission so as to clarify if need be the reasons for differences from the indicative percentage on a global basis by company.
6. For practical reasons the operation will have to be simplified for the year 1978. Based on an enquiry made of the principal suppliers to the EEC, and on its own estimates of oil consumption, the Commission thinks that, as a first provisional estimate, the indicative percentage growth in refinery processing should be about 2% above 1977.
 7. The Commission will report to the Council on the results of these consultations. Should the procedure described above prove to be insufficient the Commission would take appropriate initiatives.

(1) 25 million tons of capacity have been finally withdrawn from service; 57 million tons have been shut down temporarily.

(2) In particular Regulation EEC No. 1729/76 regarding the communication of information on the supply situation.

8. In the medium term the objective of adjusting supply to demand by shutting down distillation units must be pursued.

82 million tons of distillation capacity have been closed so far. Approximately another 60 million tons per year of distillation capacity still have to be shut down, in accordance with the objective of closing 140 million tons per year of capacity mentioned in the communication of March 1977, to restore overall equilibrium between supply and demand in the Community.

To achieve this result the Commission has the intention of organising consultations with the companies by the Commission aimed at rationalisation through the closure of distillation units. In this regard, the Commission considers that priority should be given to examining possibilities of shutting down the oldest distillation units which are largely amortised, situated in areas where there is a high concentration of refineries, and whose operating conditions do not entirely meet the accepted standards for environmental protection.

If need be, national aids could be considered for initiatives to create alternative jobs for surplus personnel, with the grant of appropriate Community aids for eligible projects.

III. Construction of new distillation units

9. Although, because of the present surplus, the problem is of only marginal importance until 1980/82 at least, the possibility that new plants will be built cannot be entirely excluded. The Commission's view is that no new distillation units should be constructed, so long as there is no improvement in the refining situation, although justified exceptions cannot be ruled out.

In order to ensure compliance with this policy, the Commission proposes that the Council should adopt the consultation procedure foreseen in the compromise of the Presidency (point 2), that is to say that the Member States should inform the Commission of each new project in accordance with regulation no. 1056/72 and that the Commission should arrange consultation in the Energy Committee.

Until there is a significant improvement in the situation the Commission, however, may :

- a) consult the Member State concerned on any new project notified to it under Council regulation no. 1056/72 (information on investments in refining).
- b) withhold authorisation from direct Community aid (Regional Fund) for the construction or extension of distillation units.
- c) suggest to the European Investment Bank that it should grant no more loans for the construction or extension of distillation units.

Moreover the Commission, by virtue of the powers conferred upon it by Articles 92 and 93 of the Treaty, will examine whether it is necessary to discourage any national aids tending to increase distillation capacity in the refining sector.

IV. Construction of conversion units

11. There has been significant progress in constructing additional capacity to prevent a deficit arising in the output of light products as a result of changes in demand.

It should, however, be noted that in certain countries, and for some companies difficulties are being experienced over conversion investments because of the high debt ratio of companies, of the inadequate level of prices, and of uncertainty over the future difference between the prices of light and heavy products.

12. The Commission intends to monitor developments closely, taking account particularly of the results of the consultation procedures with non-Member countries foreseen in Arts. 15 and 16, but considers that financing problems should diminish as soon as industry again becomes sufficiently profitable.

However, to the extent that the situation of the beneficiary companies warrants it, and it does not run counter to the objective of reducing capacity, some encouragement could be given to the construction of conversion units, particularly by :

- European Investment Bank loans,
- Loans granted under the new financial facility proposed by the Commission
- Community or specific national aids serving the general interests.

V. Imports of petroleum products from non-Community countries

13. Since 1975 the Community has been a net importer of petroleum products. In 1977 these imports (of which about 50% come from East European countries) represented around 6% of the consumption of petroleum products in the Community. Although this is a fairly modest percentage, these imports can influence the level of consumer prices and thus reduce the profitability of the refining sector to an insufficient level.

14. Community policy has to strike a reasonable balance between the interests of the Community industry and those of exporting countries and must take account of the liberal policy and the Community towards non-member countries. Nevertheless the application of commercial policy measures, in accordance with the GATT rules, cannot be excluded should need for them arise.

15. The Commission accordingly proposes that the Council should adopt the procedure envisaged in the compromise of the Presidency (point 3).

The procedure foresees the establishment of indicative medium term forecasts for the importers of refined products, consultation with non-member countries, the comparison of companies' annual forecasts with the trends apparent in the indicative forecasts, consultation with companies representative of industry and commerce, and study by the Commission of the possible application of existing commercial policy measures.

The Commission intends forthwith to improve the system of collecting information upon imports through the application of regulation 3254/73.

As regards 1978, the Commission considers that, bearing in mind the slight growth in consumption foreseen (+2%), the level of imports of petroleum products should not differ significantly from that of 1977.

16. As soon as the refining situation in the Community has improved - probably by to about 1980-82 - as a result of a real effort, fairly shared, towards adaptation, a substantial part of the annual increase in the Community demand for petroleum products should be covered by an increase in imports from oil producing countries, particularly those made at preferential rates of duty in return for guarantees of crude oil supplies, without prejudice to existing preferential arrangements. Such a trend in imports should ensure for the producing countries a reasonable share of the EEC market on preferential terms, without these imports constituting a serious danger to the Community refining industry, (which would in any event justify the use of safeguard measures.) Such a policy would depend upon broad consultation with the interested countries so as to ensure its smooth implementation. Consultation would have to be arranged rapidly so that investments by the oil producing countries could be planned accordingly.
17. In the event that measures of protection should prove necessary, they will be discussed and implemented with due regard for the essential requirements of the Community commercial policy and in accordance with its rules. The Commission will at once set up an ad hoc group with representatives of the Member States. This group, consultative in character, will be given the task of studying in greater detail the different measures mentioned below without at this stage considering the advisability of applying them :
 - a) stabilising in principle the overall ceiling for duty-free imports of petroleum products under the system of generalised preferences, and reimposing normal duties each time that a beneficiary country reaches the cut off level (i.e. 20% of the ceiling for each category of product).
 - b) maintaining at their present level (unless there is a specific arrangement to the contrary) the ceilings for duty-free imports granted to non-member countries under association and cooperation agreements and reimposing more or less automatically the applicable duties when the ceilings have been reached,
 - c) limiting the tariff preference to products obtained from crude oil produced in the country concerned, when applying EEC agreements or conventions granting duty-free entry without a ceiling,
 - d) raising the duties on petroleum products to their nominal level by cancelling existing arrangements for suspension (except in cases where duties have been totally suspended),

- e) examining, in accordance with normal procedures, the autonomous commercial arrangements between Member States and state-trading countries with a view to holding imports at their present level (Council Decision 75/210),
- f) examining the possibilities of implementing the safeguard clauses and anti-dumping measures (for example by establishing a reference price list).

VI. Consumer prices of petroleum products

18. It is unhealthy for an important sector of the oil and gas industry, namely oil refining and distribution, to earn persistently inadequate profits in the Community market even though overall (by virtue for example of oil and/or gas production, petrochemical operations, or of activities outside the Common Market) some profits are available to finance investments. There is a danger that some companies may contemplate, or be forced to, withdraw from the markets concerned, that this will reduce competition, and some necessary investments (e.g. in conversion plant) will not be made because of cash flow difficulties, too high a debt ratio, and uncertainty as to eventual profitability.

Although the improvement of this situation depends greatly upon the achievement of an overall balance between supply and demand, specific action is nevertheless essential to improve price transparency and realism.

19. Concerning price transparency, the Commission :

- will continue to publish regularly its report on the price situation in accordance with directive 76/491,
- will undertake from 1st March 1978 a six months "check run" to verify the Rotterdam market quotations,
- will continue the detailed examination of a system for publishing price schedules, including prices applicable to term contracts. In this connection the advantages of establishing price indicators (excluding duty and taxes, for main products, and by Member State) will be considered.

With regard to price realism, and in particular on the basis of the data provided under Directive 76/491, the Commission recommends that :

- the governments concerned will introduce the necessary fiscal measures to ensure that profits arising at the stage of oil and gas production do not cause deterioration of the market and abnormal competition, for example by being re-applied in the exploration sector,
- where national pricing systems exist, the price levels established allow adequate profitability for the industry's operations.

Furthermore, the Commission will consider establishing, with the aid of experts from the Member States, periodic indicators of the economic and financial situation of refining in the countries of the Community.

DRAFT COUNCIL DECISION ON PROCEDURES
FOR THE IMPLEMENTATION OF THE PROPOSALS MADE BY
THE COMMISSION IN ITS COMMUNICATION
[R/684/77 (ENER 25)]

COMPROMISE PROPOSAL FROM THE CHAIR

1. Application of Regulation No 1056/72 to the refining situation
in the Community

In order to establish general monitoring of developments in the refining sector, with particular reference to the reduction of surplus capacity and the adaptation of structures, the Council agrees that Regulation No 1056/72 be applied to this sector in accordance with the following procedure:

- The Commission would be informed of developments in the refining sector (particularly as regards temporary or permanent withdrawals from service and the construction of new conversion capacity), on the basis of the information communicated (before 15 February each year) by the Governments (Regulation No 1056/72).
- On the basis of this information the Commission would each year prepare a report on the refining situation in the Community and arrange consultation within the Energy Committee.
- If necessary the Commission would present a communication to the Council, possibly including proposals.

This last provision in no way anticipates the action the Council may take on the proposals.

The French delegation may, if it sees fit, confirm its wish that refiners be encouraged to conclude rationalization agreements and that greater price transparency be sought.

2. Procedure for consultation on the construction of new primary distillation capacity (up to 1980 only)

The Council agrees that the general monitoring referred to in paragraph 1 above should be supplemented by a flexible consultation procedure which would apply to new primary distillation capacity but have no binding force:

- Member States would inform the Commission of each new project in the context of the information to be furnished annually under Regulation No 1056/72. (Each Member State is at liberty to inform the Commission of any new project before the deadline for its annual obligations under this Regulation).
- The Commission would organize consultations in the Energy Committee.

It would be for the Commission to decide following these consultations whether it intended to express its opinion to the Council on the advisability of any such project and of Community aid for its realization.

3. Procedure for import of refined products from third countries

The Council agrees that the Community should implement a policy with the emphasis on exchange of information and co-operation between all the parties concerned, allowing economic operators within and outside the Community to act with better knowledge of what the situation was likely to be in future, based on the following procedure:

- After consulting the Energy Committee, the Commission would draw up indicative medium-term estimates for imports of refined products; these estimates would take special account of firms' import estimates.

- After consulting the Member States within the appropriate bodies, the Commission would consult third countries under existing agreements or through other channels.
- The Commission would compare the annual estimates for refined product imports (which it possessed by virtue of Regulation (EEC) No 3254/74) with the trends apparent from the indicative estimates. If there were substantial discrepancies, the Commission would consult industrial or commercial firms and the Energy Committee.
- The Commission would study and, if necessary, propose to the Council the application of one or other of the existing commercial policy measures in the field of petroleum products.

The Council will stress the need for extreme caution in this field, both as regards consultations with third countries and as regards possible recourse to commercial policy measures.
