COMMISSION OF THE EUROPEAN COMMUNITIES

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OIL SUPPLY

(Communication by the Commission to the Council)

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At their meeting on 13 May 1980, the Council invited the Commission to examine and report on actions to be taken if oil supply problems arose which, while not warranting full emergency sharing arrangements, nevertheless demanded a coordinated response by Community governments.

2) Meanwhile, the outbreak of hostilities between Iran and Iraq have reduced world exports of oil by nearly four million barrels per day. With the present high level of stocks in the Community (around 130 days of present consumption), demand approximately 9% lower than last year, and the announcement of production increases by certain producer States, there is no reason to foresee an early oil shortage and markets have remained reasonably calm.

3) Nevertheless, individual countries and companies are being differently affected, and the supply interruption may be prolonged. There is therefore need for governments to work together in assessing the situation and in taking action to forestall tension in oil markets.

4) Governments have already agreed that abnormal purchases of oil on the spot market should be discouraged, and that arrangements should be made for any necessary stock draw-down required to balance supply and demand between now and the end of the year; they have also agreed to reinforce oil saving and fuel substitution measures, and to continue in close consultation, so as to deal with situations of particular difficulty for individual countries.

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5) This communication by the Commission is to provide the basis for consideration by the Council of the continuing action needed at Community and national level. The purpose is to preserve a flexible approach to deal with any situation which may develop in coming months, within the framework established in Council Directive 73/238 of July 1973. That Directive, inter alia, required Member States to take powers to draw on stocks, to impose restrictions on consumption and to regulate prices. It also created a coordination group under the chairmanship of the Commission (now the Oil Supply Group) to coordinate action in the event of supply difficulties.

6) The range of possible actions is set out at Annex. The Commission regards it as particularly important that :

(i) all member countries should undertake measures to reduce pressure in oil markets. These measures may differ from country to country according to special national circumstances, but they should be coordinated at Community level and lead to comparable effects.

(ii) the possible measures should include :-

(a) demand reduction efforts, which could be strengthened at the appropriate time by guidance to companies to hold oil deliveries to consumers down to specified levels;

(b) guidance to companies to avoid abnormal oil purchases, and in any case to consult the government before oil is purchased at premium prices on the spot market or elsewhere;

(c) improved and faster collection of information on oil stock levels;

(d) closer consultation with industry about stocks, leading if necessary to government guidance on future stock levels;

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(e) informal arrangements at Community level to deal with special problems;

(f) consultation, followed by the necessary action at national level, when internal prices of specific oil products vary by more than an agreed percentage from the Community average

(g) continuing close consultation and coordination of action by the Oil Supplies Group, meeting at the level of senior officials as often as is necessary;

(h) coordination of action with other consuming States, through the appropriate institutions.

7) Following consideration by the Council, the Commission will work out detailed proposals further as necessary, in consultation with the Oil Supply Group.

ANNEX

Areas of opportunity for action

At times of artificial disruption of the supply/demand balance, it is necessary to supplement traditional market forces by additional measures, especially to avoid increases in marginal supply prices to unnecessarily high levels. These measures may not necessarily be the same in the different countries but should lead to comparable effects.

This could take the following alternative but complementary forms:

- Action on prices through discouraging the purchase of high-price oil by the oil companies. This action can be reinforced by consumer price and taxation policies;
- Action on supply/demand through specific measures of demand reduction and/or stock policy;
- Increases in indigenous production.

Whichever course or combination of courses is adopted, it must be co-ordinated not only at Community level but with other countries, notably the USA and Japan.

a) Discouraging oil companies from making purchases at excessive prices

i) Governments should agree that specific and sumultaneous action will be taken to discourage oil companies from making crude oil and product purchases at excessive prices and/or accepting deals that include ancillary elements (discounted sales of goods or services, etc.) which effectively increase the real price paid for the oil. Governments themselves should also adopt the same level of self-discipline in the context of any state-to-state deals.

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ii) The form of this action would depend upon individual national circumstances, but could include:

- advice or guidance to companies, supported by a specific request to consult the Government before high-priced oil is purchased;
- voluntary price discipline or price controls for the main oil products, ex-refinery and/or at consumer level, to ensure that companies will not be able to recoup the cost of high-price purchases;
- administration of taxation law, where possible, to penalize high-price purchases and sales.

In any event, governments must avoid pressing oil companies to maintain supply regardless of cost.

b) <u>Demand reduction</u>

Governments should react in a flexible manner to reduce demand according to the severity of the supply disruption. Such a flexible reaction could be operated in three phases:

i) coverage of a small isolated deficit without the need for general consumption reduction;

ii) coverage of a quantitatively larger deficit necessitating consumption reductions which need not be the same in all Member States but which would reflect the degree of reduction needed in each Member State;

iii) a more serious situation justifying identical consumption reduction in all Member states without necessarily identical measures.

In this context, companies may be advised to reduce deliveries by a specific percentage to all except priority customers. It has been argued in the past that this would create unnecessary public alarm. This need not be so, if the action is explained to the public as a way of ensuring fair shares and of avoiding ruinous increases in oil prices.

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This method of reducing demand would be quick, should not require complex government controls, and could be reinforced if governments wished by specific governmental measures (e.g. ban on Sunday driving, lower heating temperatures, etc.).

When seeking to persuade companies to follow a particular course of action to reduce market tension, it must be recognised that certain actions by companies could leave them open to legal action by their customers. Consequently, government guidance must be in a sufficiently official form to allow companies to plead appropriate exemption clauses where necessary.

Governments will wish to consider measures to help companies who are left short of crude oil or products by, for example, giving permission to these companies to run down stocks temporarily or encouraging inter-company exchanges. Here again any government action must be taken in a way that will provide legal clearance for the companies.

c) Stock policy

The building of oil stocks in anticipation of shortages and/or price rises has been one of the causes of market tension in 1979 and 1980. Community stocks are now much higher than in other years. A flexible stock policy is one opportunity for action. Community countries should continue to consult with the industry and between themselves about stock levels and future company stock policies and be prepared to give guidance to companies (on a basis agreed informally) not to increase, or even to run down, stock for a limited period (or of course the reverse, depending on circumstances).

A reduction of 10 days' stocks would in fact allow full demand to be met for 6 months with a 5% supply deficit.

The significance of stocks is such that a faster and more frequent ad-hoc stock reporting system should be set up in a permanent way to improve transparency on stock levels. Details are being worked out in consultation with the industry, and the Commission will shortly bring forward a proposed scheme for implementation.

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d) Measures to increase Community production

Increasing Community production is mainly a longer term prospect through the encouragement of further investment in oil and gas exploration and production. Reports by the main producing countries (UK and Netherlands) which have been circulated at official level, show little scope for quick increases in an emergency.

e) Oil sharing at Community level

There are wide differences between national situations, and it might be necessary to find supply arrangements to correct imbalances between companies and countries. Any informal arrangement should rely on the voluntary co-operation of the oil industry on an international basis.

Thus companies could be asked to direct limited supplies of oil to specific destinations, and possibilities of increasing intra-Community exchanges of oil, gas and coal could be exploited - all in advance of the introduction of full emergency sharing arrangements.

f) Price policies

Price policies can be an instrument to reinforce the "dissuasion" at a) above, but it should also be taken into account that oil product prices, before and after tax, vary widely in the Community. Some differences will always exist because of different structures of distribution costs, etc., but too-wide differences should be avoided in order to limit the risk of limited supplies being channeled away from areas of low return. The information now circulated by the Commission allows reasonably up-to-date comparisons to be made. When individual governments find that the price for a specific product varies by more than an agreed percentage from the average, then after having checked the comparability of the statistic they should seek an explanation by an examination of their own internal pricing procedures and/or by discussion with oil companies, and subsequently decide whether action is necessary.