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OPINION

of the Committee on Economic and Monetary Affairs

on trade relations between the European Economic Community and the Gulf States

Draftsman: Miss FORSTER

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nglish Edition

At its meeting of 18-19 March 1981, the Committee on Economic and Monetary Affairs appointed Miss Forster as draftsman of an opinion for the Committee on External Economic Relations.

The draft opinion was adopted at the committee's meeting on 14 September 1981 by 17 votes to 13.

There were present: Mr J. Moreau, Chairman; Mr Albers (deputizing for Mr Wagner), Mrs Baduel-Glorioso (deputizing for Mr Leonardi), Mr Barbagli (deputizing for Mr Collomb), Mr Beazley, Mr von Bismarck, Mr Bonaccini, Mr Caborn, Mr Damseaux (deputizing for Mr Combe), Mr Diana (deputizing for Mr Macario), Mr Fernandez, Mrs Forster, Mr Franz, Mr Ghergo (deputizing for Mr Giavazzi), Mr Herman, Mr Hume (deputizing for Mr Walter), Mr Marshall (deputizing for Mr De Ferranti), Mr Mihr, Mr Müller-Hermann (deputizing for Mr I. Friedrich), Mr d'Ormesson (deputizing for Mr Schnitker), Mr Pruvot (deputizing for Mr Delorozoy), Mr Purvis, Mr Rogers, Mr Ruffolo, Mr Schinzel, Mr Seal (deputizing for Mr Schwartzenberg) Mr Turner (deputizing for Mr Hopper), Mr Wedekind (deputizing for Mr Beumer), Mrs Wieczorek-Zeul (deputizing for Mr Wagner), Mr von Wagau.

1. The Committee on Economic and Monetary Affairs strongly endorses the central premise of the report by the Committee on External Economic Relations (Doc. 1-866/80), namely that the Community has a great interest in successfully developing cooperation with the Gulf States. The Community countries have the necessary goods and skills but are undergoing a recession, which is being reinforced by unpredictable leaps in oil prices, to which they are highly vulnerable because of their oil import dependence. The Gulf States on the other hand have great energy resources and unabsorbed financial surpluses which have again grown greatly in the last couple of years, yet lack a diversified industrial and agricultural base and also many of the needed skills. Mechanisms whereby both sets of countries could be reinforced by matching the complementary strengths of each, would make a great contribution to them, and to the world economy in general.

2. The report also cites a possible partnership between the EEC and the Gulf States in helping to spur economic growth in the resource-poor developing countries which have suffered the most from the oil crisis. This too could be a powerful benefit of such cooperation.

3. Nevertheless, the constraints on the successful achievement of such cooperation agreements are also very great, including the often overriding political factors involved (such as the Palestinian question and East-West rivalry in the Gulf), the very great differences in circumstances between the various Gulf States cited in the report, the potential overlaps with other groups and negotiating fora (the new Gulf Cooperation Grouping, OAPEC, the Arab League, the Islamic Conference, OPEC and the Group of 77), and many other factors.

4. It is not for the Committee on Economic and Monetary Affairs to comment in detail on the political aspects of the report, and in fact we would suggest that political questions falling within the Euro-Arab dialogue should be kept separate from the financial, economic and trade measures proposed in the report. The successful development of the latter might even assist progress towards settlement of some of the supremely important political problems, whereas linking all the different aspects together could lead to failure on all fronts. The EEC itself began with joint action for coal and steel, followed by more general economic coordination, and questions of political cooperation are still being discussed and developed twenty years later.

5. In crude economic terms what can the Community offer and what can the Gulf States deliver? The main premise of the report is that these two could be matched in some form of "energy pact" whereby the Gulf States might "undertake to supply specific quantities of crude oil at uniform prices with a binding

formula to determine price changes". (paragraph 10 - indent 1 of the resolution). In exchange the EEC would offer the Gulf States a guaranteed suitable rate of interest for investment of their surpluses. (paragraph 10 - indent 2 of the resolution).

6. The Gulf States should undertake to supply specific quantitites of crude oil at uniform prices with a binding formula to determine price changes. Can the Gulf States do this? What mechanism would be used? Is it in the best interests of the EEC that such a deal should exist?

(a) <u>Can the Gulf States do this</u>?

It is clearly going to be difficult for the Gulf States to deliver on the oil supply side without, to cite one reason alone, undermining wider OAPEC and OPEC commitments and flexibility. In addition the possibility of conflict or changed circumstances in one or more of the Gulf States could undermine the whole basis of any contract and a "force majeure" situation could arise. Setting aside these difficulties, if a contract were negotiated, the long erm effect (how many years is long term in this context?) would be that the Gulf States would be supplying stated amounts oil to the EEC at a price calculated according to a formula. At the same time each of the Gulf States would be selling oil outside the contract at OPEC prices. If the OPEC price were higher the Gulf States would only wish to continue the contract if the return offered by the EEC on their invested surplus were high enough to compensate for the revenue lost on sales. If the OPEC price were to fall lower than the contract price the Gulf States would be delighted, but the EEC would suffer severe disadvantage. Should the contract therefore contain "a most favoured nation clause", and if it did wouldn't this mean that eventually the contract and OPEC prices would become the same, and that much of the value of the contract to either side would disappear?

(b) <u>What mechanism would be used</u>?

The report proposes a Community oil procurement and prospecting company. (Paragraph 8 of the resolution and details in the explanatory statement). This company is to operate in competition or collaboration with existing privately owned and nationalised oil companies. Individual members of the Economic and Monetary Affairs Committee have varying views on whether or not Community funds should be used to finance an EEC oil company, but would question how such a Company could operate if it were buying oil from the Gulf States at a different price from all other companies. If the price were lower than the OPEC level would it charge OPEC prices to subsequent customers and pass the profit to the Community Budget? If the price were higher than

OPEC, would funds be available from the Community Budget to subsidise sales to customers? Assuming the contract was for 1 mbd, and a lower figure would not be worthwhile at the EEC level, at a price of approximately 35 EUA's a barrel (i.e. about 35$), there would be a turnover of some 10,000 million EUA's a year. The EEC budget is currently about 20,000 million EUA's, and so an oil price variation of 10-20% could have serious consequences for the budget.

We feel that the practical difficulties in the way of the successful operation of an EEC oil company would be immense and that the REX Committee should give further thought to how their suggested scheme would work out in practice. For example, the individual Member States have different levels of oil imports and one arrangement might be that the shareholdings in the EEC oil company would be held by National Governments pro rata to their level of imports and that oil supplied under the contract would be allocated in the same ratio. This could mean, for example, that consumers in Germany would have a much greater amount of oil available to them at the contract price than those in the U.K. Whether the contract price were higher or lower than the OPEC price, a significant difference between the two prices would be bound to have a distorting effect on the competitive position of the consumers in the different Member States.

(c) <u>Is it in the best interests of the EEC that such a deal should exist</u>?

At first sight the suggestion that the EEC should have a guaranteed supply of oil from the Gulf States at a fixed price appears attractive. However as stated under (a) the guarantees could become meaningless if there were conflict in one or more Gulf States or any other "force majeure" situation which would be just the moment when continuity of supply would be important. There is also the possibility that further sources of oil will be found or developed faster than in the Gulf States (in Russia, China, or South America, for example, or within the territory of the EEC itself) which would mean the world price of oil might fall or at least not rise as fast in real terms as the oil from the Gulf States. Price is always a matter of supply and demand and if increased supplies of oil from new sources are coupled with efforts by users to economise on the use of oil and to develop alternative sources of energy the EEC might be beterr advised to steer clear of a long term buying contract and to remain free to buy what oil it needs on the world market at the best price it can negotiate. This view is suppotted by the fact that the IEA estimates that by the end of the century the OECD total oil imports from OPEC will be in the range 13 - 20 million barrels per day compared with the 24 mbd current import level.

7. OPEC, and in particular the Gulf States, wish to develop their economies so that they are less dependent on oil but such radical structural changes are bound to be slow. It is, therefore, in the interests of OPEC that the OECD should not move too rapidly to other sources of energy. Hence although since 1973 the West has been faced with fiercely escalating oil prices, it may be that in the 1980's oil prices may level out or even fall (as they have done over the last 18 months) as the OPEC seeks to maintain oil supply and hence revenues as long as possible. There is no doubt that further vicious prices rises would cause users in the EEC to intensify their efforts to conserve energy and to speed up the change to non OPEC oil sources and to alternative sources of energy. The pattern for the 1980's may therefore be very different from the 1970's and would lead to the Gulf States probably wanting a long term supply contract. We suggest that the EEC should either use this to negotiate advantageous terms or that the EEC should keep its options open regarding the supply of oil, and that it should take some other steps to encourage the Gulf States to come to an arrangement with the EEC to recirculate their petrodollar surplus.

8. What else do the Gulf States require?

They need to diversify their economics away from oil, and the safest direction for them to move would be towards the xploitation of alternative energy sources or towards industries which are high energy users. The Gulf States have relatively small populations, with insufficient numbers of scientists, engineers and technicians and a limited infrastructure. A good use for their petrodollars would be for capital intensive energy projects in other parts of the world, or to finance R & D programmes in the alternative energy field for subsequent licensing onwards to the sophisticated developed countries or at the other end of the scale to the poorest countries which can no longer afford to buy oil and need simple systems which can be used locally on the basis of wind, water or solar power or on some other indigenous energy source. In the Middle East and North Africa areas possibly the most potentially rewarding use of energy would be in the distillation and recovery of potable water from brackish and salt water and in pumping and irrigation systems so that horticulture and agriculture can be developed. Other high energy uses (such as steel and aluminium production) would be open to competition from other low cost energy countries and some of these might not have such high transit costs to areas of high population where the customers for these industries mainly reside.

9. Recycling problems

Besides industrial cooperation the major theme of the draft motion is the need for cooperation in seeking solutions to recycling problems. This issue is wider than that of relations with the Gulf States although they do include most of the countries with really major financial surpluses. The

Committee on Economic and Monetary Affairs agrees with the motion's assessment, that cooperation between the Community and the Gulf States in this sphere is of crucial importance. It also agrees that promotion of the development of the oil-importing developing countries should be a key objective of such cooperation. The Economic and Monetary Committee suggests that any deal the EEC negotiates with the Gulf States to promote the recycling of petrodollar surpluses should relate to one or more of the items discussed under (8) above and that the REX Committee should come forward with some concrete proposals in its final report. The specific issues raised, however, are of great complexity and will be handled in more detail in a forthcoming report from this Committee. It should, however, be underlined in this context that the idea of a guarantee fund whereby the EEC states would offer the Gulf States a guaranteed suitable rate of interest for their investment of surpluses requires much more detailed study than the REX Committee have so far given it.

10. Conclusions

To summarize then, the Committee on Economic and Monetary Affairs agrees on the value of seeking cooperation agreements between the Community as a whole and the Gulf States. Among the general possibilities listed in the draft motion it strongly supports higher joint financing of development projects in countries of the Third World, and also the general concept of seeking solutions to recycling problems although the specifics need to be more carefully examined. The EEC should help the Gulf States in the diversification of their economies away from undue dependence on oil. Firstly, we suggest this should be in the field of alternative energy sources either by joint EEC/Gulf State investment in capital intensive energy projects in the EEC and in other parts of the world or by joint financing of R & D programmes in this field which would lead to revenues from subsequent world wide licensing of patents or know how. Secondly, the EEC should assist the Gulf States in the development of projects which are high energy users. The most rewarding of these especially in the Middle East and North Africa could be the recovery of potable water from brackish or salt water and in pumping and irrigation systems so that horticulture and agriculture can be developed. Other high energy uses (such as steel and aluminium production) could also be developed within the Gulf States. Further consideration should be given to how far the EEC could go in supporting these so that damage to the Communities own industries within the EEC and in third country markets is kept to a minimum.

If agreement on the lines of the proposals made in the draft motion is to be reached it will have to be on the basis of a very simple package deal. At present there are simply too many variables in the proposals to stand any real chance of success, and if we are to succeed the political problems must be excluded as far as possible from the agreement.

11. In addition to the suggestions made above the Economic and Monetary Affairs Committee suggests the following changes in the Motion for a Resolution:

(a) Omit paragraph 6. For the reasons already stated we want to keep the deal as simple as possible to enhance the changes of success and to try for the inclusion of the largest possible number of sectors is fundamentally wrong. Also, we feel that apart from the major projects of the type discussed under (8) above and possibly also cooperation in the field of training which are best done at the Community or Member State level, all such items as transfers of technology and joint ventures should remain within the province of private enterprise and they should not be subject to interference from the Community. The exclusion of Community or State financial interest would also help in keeping the arrangements separate from political manoeuvring.

(b) In paragraph 8 and in the Explanatory Statement more detail should be given on how the EEC oil company should operate.

(c) In paragraph 9 all reference to petrochemical products and basic chemical products should be excluded in order to avoid damage to the EEC's own industries (c.f. the problems caused by U.S exports to the EEC and third countries of these types of product based on very low naphtha and gas prices in the USA).
