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THE DEVELOPMENT OF AN ENERGY STRATEGY FOR THE COMMUNITY

Communication from the Commission to the Council

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for the Community

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Introduction

1. In the course of recent years the European Council has repeatedly declared the need for the Community to face up to the energy challenge.

This has led to two Council Resolutions — in 1974 and in 1980¹ — setting Community energy objectives whose main features are a reduction in oil dependence through the more rational use of energy and a broader diversification of energy supply.

But it has not led to the implementation of an overall strategy comprising action by the Community, Member States and producers and consumers. The inadequacy and inconsistency of the action taken in the wake of these expressions of political will can only be deplored.

Relatively slack demand between 1975 and 1980, combined with weak pricing and taxation policies, reversed the upward movement in real oil prices, leading to a certain complacency and slackening of efforts to use energy more efficiently and to replace oil. The events in Iran, which caused price tensions on the world market, gave rise to a new interest on the part of governments. The consequent vigilance displayed at a Community and an international level has helped to prevent any new pressures on the oil market in the short term. But the longer-term problems still await satisfactory solutions. It is inevitable in these circumstances that the scope for a sustained upturn in economic growth will be constrained once again by undue dependence on oil.

In stressing this situation the Commission does not intend to belittle the importance of the political commitments which have been made or that of the measures already adopted at national and at Community level. Its objective is to present — in the context of the follow-up work to its Report on the mandate of 30 May² — a framework for action allowing the Community to respond more effectively and without harmful delay to the serious challenges which the energy question raises now and for the future.

¹ OJ C 153, 9.7.1975; OJ C 149, 18.6.1980.

² Supplement 1/81 — Bull. EC.

The challenges to the Community

2. Despite the success of efforts to reduce energy and oil demand since 1973 the Community is still the single largest oil importer in the world (8.7 mbd in 1980).

More than half of these imports come from three countries (Saudi Arabia, Libya and Nigeria).

The broader international picture is also far from comforting. It would be risky to count on a fall or even a stabilizing in demand for energy.

As far as the less developed countries (LDCs) are concerned a marked increase is a real possibility. At the same time world market supplies for oil will be derived from a diminishing number of oil exporters, with Saudi Arabia playing a more and more dominant role.

3. The Community economy has been badly hit by the effects of the doubling of oil prices in 1979. The challenge is to shield it from the risk of further pressure, both by reducing as rapidly as possible the Community's dependence on oil and also by taking effective measures to limit possible causes of increase in the price of its supplies.

To these ends measures need to be taken both on the energy demand side (energy saving and rational use of energy) and on the supply side (diversification). In the latter field efforts must be stepped up, particularly by increasing coal consumption, pursuing vigorous nuclear programmes and by developing renewable energy sources.

4. To bring about the necessary changes will require first and foremost action within the Community itself. But its success will depend heavily on what is done externally. The industrialized countries need to work together if they are to reduce their dependence on oil. Avenues for cooperation with the energy exporting countries to assure stable supplies while respecting their legitimate interests must be explored. Finally, the serious problems faced by a large number of developing countries as a result of their position as oil importers calls for rapid, vigorous and broad action by the world community. The European Community has at its disposal instruments which allow it to give technical and financial help to these countries so as to enable them to develop their resources.

5. But in other ways too the process of change poses new challenges and offers new hopes. The energy transition will have far-reaching consequences for Community industry, offering prospects for the development and application of new technologies to help revitalize the industrial base. This is underlined in the fifth medium-term economic policy programme.¹ The challenge is to maintain the continuity of action required in the face of short-term economic fluctuations. Such continuity is essential both to give confidence and to ensure lasting changes.

Forms of Community action

6. To meet these challenges the first imperative is to ensure more rapid progress towards consistency between energy policies of Member States. All Member States have a common interest in the success or failure of energy policy throughout the Community. Differences of effort and achievement between Member States will not only mean widening divergences in the security of energy supply. They will also adversely affect the level of economic activity in the Community as a whole. Equivalence of effort does not require any substantial centralization of energy policy instruments; nor does it require the pursuit of uniformity in the diversification of supply, which must vary according to national circumstances. But it does call for collective discipline going beyond mere expressions of common agreement. The policies of each Member State must reflect a willingness to pursue common goals.

Every year the Commission presents a report² on the energy policies of Member States in the light of the Community objectives and after consulting national administrations. By drawing attention to progress made and to constraints and weaknesses this report must now become the instrument ensuring consistency. It will be submitted to the Council, together with appropriate proposals and recommendations, after examination by the Medium-term Economic Policy Committee and the Energy Committee.

¹ *European Economy* No 9, July 1981.

² Bull. EC 2-1981, points 1.5.1 to 1.5.7.

7. In the second place specific Community action must be set in train where this is required by the provisions of the Treaty or where it will be more effective than the sum of national measures even when these are properly coordinated. This is true as much for action within the Community as in external relations, where solidarity strengthens collective security of supply.

8. Some action must be supported by financial means, whether from the Community budget or from the Community's lending instruments. Up to now recourse to these means has enabled significant support to be given, but this has been limited in relation to the total financing requirements of the energy sector. The tables annexed to this paper summarize the figures.

The necessary role for Community finance is already recognized in some areas, notably research and development, aid to LDCs and aid to certain kinds of investment. There are other sectors, such as technological demonstration and the encouragement of certain categories of investment, where spending is essential to meet common energy objectives and to improve collective energy security. Community financing measures in these sectors should also command general support.

It is of course true that the success of common action cannot be measured in terms of the amount of budgetary finance involved. Many of the objectives described above can and should be pursued through, for example, better coordination of national policies supported by a system of agreed analysis and recommendation. But the financial means available to the Community must be equal to the requirements for action determined by its strategic objectives. The amounts assigned to energy in the Community budget must therefore grow more quickly than in the past, reflecting the strategic priorities.

9. These principles of action will be applied to every sector of energy supply and demand.

It is generally accepted that coal should have a more important role to play in Community energy supply. The scope for possible reconversion to coal is considerable, especially in industry. Large expenditure is needed throughout the Community in this area and in coal transport, import and storage. The basis therefore exists

for a re-examination of Community coal strategy and for common action to ensure greater consistency between the coal policies of Member States, and to bypass the sterile arguments between coal-producing and coal-importing countries in the Community. In its absence the prospects for coal within the Community will remain uncertain, damaging the morale of the coal industry and adding further uncertainties to the development of new technologies in the coal sector.

The development of nuclear energy is vital to ensure security of energy supply and one of the main ways of reducing dependence on oil. The pursuit of vigorous nuclear programmes is an essential element in an economic policy for Europe aimed at overcoming structural problems in the energy sector.

The Community can help to ensure the best possible progress in the nuclear sector not only by exercising its specific responsibilities in the field but also by setting the development of nuclear power within the framework of an overall energy strategy.

Natural gas has become over the past fifteen years an important element in the energy balance of Member States, making a useful contribution to diversification of supply. Maintenance of this trend, however, poses a number of problems as regards security of deliveries, coordination of investments and coherence in pricing policy.

New energy sources have a great potential for growth, but there are problems of cost and of timing. A smooth entry onto the markets of all Member States will not be assured without action ahead of time (in research and technological development). Such action will not bear all its fruit — in the energy and industrial fields — without a Community approach taking account of the different possibilities in each Member State.

Oil is bound to remain a major element in the Community's energy balance, and the bulk of oil supplies will come from outside. There must be Community solidarity in measures to guarantee security of these supplies. The pricing of oil products must reflect both the need to reduce oil dependence and the objectives of economic policy.

On the demand side, structural change is already under way. This must be continued so

that consumers can adapt in the best possible economic conditions to the shift from oil to other energy sources.

Agriculture is a special case both on the supply and the demand side.¹

It consumes directly and indirectly large amounts of energy. It has therefore an urgent need for new technologies and additional investment to reduce its energy consumption. But while increases in oil product prices set new constraints on agriculture, they also offer the possibility of new outlets for products of agricultural origin for use as raw material for energy production. The Community has every interest in promoting progress in both these directions and in using its financial instruments to that end.

Between now and the end of March 1982, the Commission will set out its views in each of these areas in more detail, together with proposals.

Operational priorities

10. There are five main priorities for Community action:

- ensuring an adequate level of investment both in alternatives to oil and in the more rational use of energy;
- the development of a common approach to energy pricing and taxation;
- the establishment of measures of Community solidarity to avoid instability on the markets;
- the reinforcement of common policies in the fields of research, development and technological demonstration;
- the further development of common approaches and initiatives in external energy relations.

Investment

11. Diversifying the sources of energy supply and the more rational use of energy (including energy saving) will require a major investment effort.

¹ Supplement 6/80 — Bull. EC.

12. At the present time energy investment is stagnating at around 1.6% of GDP. The most optimistic forecasts of Member States point to a possible rise to an average of 2.2% of GDP over the decade. Over the same period the United States expects energy investment to amount to above 4% of GDP and Japan to between 3 and 3.5%. The particular circumstances of these countries are not a sufficient explanation of this difference in order of magnitude. If the Community does not take the necessary decisions its overall level of investment could be too low, adversely affecting its ability to adapt to high energy costs and thereby its competitiveness.

13. There is, moreover, a real risk that the forecasts themselves will not be realized. Action must therefore be taken in relation to every factor liable to influence the level of investment:

- Many decisions are held up by the uncertainty of investors and consumers about future trends in oil import prices and about the energy pricing and taxation policies of public authorities. The action proposed by the Commission on energy pricing and taxation (see page 13) will have an essential role to play in this respect.

- There are risks inherent in the industrial application of new processes such as coal gasification and liquefaction or in the large-scale exploitation of solar energy and other renewable energy sources. The action proposed by the Commission in the field of technological demonstration (see page 14) is intended to help overcome the constraints on the behaviour of investors in this field.

- Public concern is another factor delaying certain projects. It is felt most clearly about the health and safety risks in nuclear programmes. More recently it has also been expressed in relation to the ecological impact of increased coal consumption.

The Community has a direct role to play both in presenting balanced information on the advantages and disadvantages of different ways of meeting energy needs and in developing common action to resolve specific problems. Community action in the fields of research on radioactive waste disposal, improving security of supply and safeguarding nuclear materials must be strengthened. The Commission will present proposals very shortly.

- The recession and the risk that it may persist also raise doubts about the profitability of certain investments.

This factor weighs particularly heavily on the development of investments in the more rational use of energy: in new energy-efficient equipment, the conversion of oil-fired heating and motive power to coal, and the application of new energy technologies in industry. These investments offer the best prospects for the regeneration of Community industry and for the direct and indirect creation of employment, and they have the most direct effects in reducing oil imports and helping the balance of payments.

14. Two studies completed for the Commission have examined, respectively, the technical feasibility of rapid advances in the more rational use of energy¹ and its investment and employment implications,² concluding that the scope for and benefits of accelerated investment on the demand side are considerable. The upper limit of cost-effective investment of this kind amounts perhaps to as much as 250 000 million ECU over this decade. These investments are delayed, however, because they involve a large number of decision-makers — households and companies — many of whom are affected in the present economic climate by problems of short-term profitability and access to external finance on acceptable terms.

15. There is already an active debate on how to accelerate these investments, and the Commission is conducting — with the aid of Member States — a detailed survey of the perspectives and problems associated with investment in the more rational use of energy. This survey will enable it to define the most effective ways of stimulating these investments and will serve as a basis for proposals in this area that will follow shortly from the Commission.

In the meantime the Commission will propose that the New Community Instrument should be used more in support of investment in the more rational use of energy with a specific tranche set aside for that purpose. The Commission will also use interest-rate subsidies financed from the ECSC budget to support the same kind of investment in the coal and steel sectors.

¹ In favour of an energy-efficient society.

² Investment and employment in an energy-efficient society.

Investment in energy saving and in substitution for oil must be encouraged both as a means of reducing the share of oil in total energy consumption and because of its favourable effects on the level of economic activity and employment. The responsibility of the Community in this field is linked to that in the field of medium-term economic policy.

Prices and taxation

16. Through its impact both on energy demand and in the long term on energy investment, energy pricing has a fundamental role to play in the pursuit of energy policy objectives. But pricing policy also has wider implications, affecting industrial competitiveness and trade between Member States and with the rest of the world. A common approach to energy pricing is therefore a critical determinant of the coherence of the energy policies of Member States, supporting investment policy and enabling proper judgments to be made about the effectiveness of energy saving measures and the economics of alternatives to oil. Moreover, it is essential to the avoidance of distortions in intra-Community competition and in the encouragement of greater consistency between the pursuit of general macroeconomic or budgetary objectives, on the one hand, and energy policy objectives, on the other. Finally, it is important to the credibility of the Community in its encouragement of sensible pricing practices in the countries with which it trades and competes.

17. The Commission has already underlined these points in a communication on energy and economic policy,¹ and has developed some of them in its paper on oil taxation.² The Council has also been invited to adopt a recommendation on electricity tariff structures.³

In a separate communication the Commission has further developed the principles of energy pricing adopted by the Council in a Resolution of 9 June 1980.⁴ These principles emphasize the need for consumer prices to reflect in full the cost of development of alternative energy

resources and so to encourage investment, even when in the short run world prices for oil are stable or falling.

Within the Community there should be a common market in primary energy. Differences in the prices at which coal, crude oil and gas are made available to the energy industries should be limited to those arising from differences in transport costs. This does not, however, mean that consumer prices can or should be identical throughout the Community. On the contrary, it is right that prudent investment in energy transformation (refining, transport, distribution and — especially — electricity generation) within individual Member States should be reflected in advantageous consumer prices. However, consumer prices are determined not only by comparative costs, but also by important differences in policy, notably as regards taxation, price control and the financing of public utilities.

Consistency in energy pricing and taxation policies, in accordance with energy supply and demand objectives, requires first of all an improvement in transparency of energy prices and tariffs and a common effort to adapt oil taxation to the aims of energy and economic policy.

A mechanism to avoid instability on the markets

18. The objectives of security and stability of supply apply to all forms of energy, and their pursuit is a key feature of Community strategy. They are of particular importance as far as oil is concerned given the dominant role played by oil prices and the less flexible nature of the oil market compared with the past.

19. The lesson of 1979 was that even very limited shortfalls in oil supply over a brief period — and even the risk itself of such a development — can have serious and disproportionate effects on oil price movements. A repeat of those events would have damaging consequences. The relative slackness of the market in recent months could mean that this danger will be underestimated even though the rise in the dollar has increased considerably the cost of the Community's imported oil.

The Community would be failing in its task if it did not manifest solidarity in the face of such

¹ Bull. EC 10-1980, points 1.2.2 to 1.2.4.

² Bull. EC 9-1981, points 1.1.6 to 1.1.8.

³ OJ C 214, 21.8.1980.

⁴ OJ C 149, 18.6.1980.

difficulties. This solidarity would be more difficult to achieve if it were not established beforehand in a period of calm. A mechanism already exists to deal with serious supply difficulties. But it is vital that the Community should arm itself ahead of time with procedures and means to soften the impact of any future oil supply shortfalls, especially on prices.

20. The Commission has accordingly proposed a procedure to handle situations of limited shortfalls on the oil market, together with a series of measures from which the Council could choose the most appropriate in the light of circumstances.

To be effective the set of actions proposed would have to be closely coordinated in a wider framework involving the USA and Japan. But as the preparation of Western Economic Summits has shown — and especially those in Tokyo in 1979 and Venice in 1980 — the Community can helpfully give a lead to the other major oil consumers by virtue of its position as collectively the single largest buyer on world markets.

The Community is more vulnerable than other consuming groups as far as external oil supplies are concerned. It must therefore protect itself against the risk of fortuitous tension on the world oil market. Even if measures to that end are taken only on a contingency basis, agreement on the conditions and procedures under which they would be applied, without prejudice to the precise decisions required by particular circumstances, would be proof of the credibility of the Community strategy.

Research and development; technological demonstration

Research and development

21. The logic of action at Community level on energy research and development is self-evident. It enables the Community to support large-scale activities beyond the financial reach of individual Member States (e.g. the development of controlled thermonuclear fusion); it avoids costly multiplication of effort; and it works as a catalyst in promoting the cross-fertilization of ideas and the more rapid diffusion of

results. In each of these ways, it helps the Community to make up for the natural benefits enjoyed by the USA and Japan.

22. The Community has been involved in support for energy R&D since its inception, first in coal under the ECSC Treaty, then in nuclear fission and fusion under the Euratom Treaty, finally in energy conservation and new energy sources under the stimulus of the first 'oil crisis' of 1973-74.

The result is that energy already absorbs some 70% of total funds in the Community's R&D budget. The annexed tables show how much has been committed under the various heads. The Community budget provides thereby the equivalent of some 10% of total public support (Member States and Community) for the financing of R&D in the energy and related fields, and the overall effort coordinated within the Community framework is still greater.

23. An increased research effort is needed to help reduce more rapidly the Community's dependence on oil (energy saving and substitutes) and to make it easier for Community industry to adapt to changes in the energy market. This will mean a need for increased financial resources. Community intervention will enable expenditure to produce the maximum possible benefit, to avoid waste of resources and to ensure the widest dissemination of research results.

Against this background the Commission has begun to reorganize its services involved in research and is examining the different programmes. It will make proposals to intensify research on the more rational use of energy and renewable energy sources, not only in its own interests but so as to meet the needs of the LDCs.

It will do the same in the field of coal research to reflect the growing importance of coal.

Technological demonstration

24. The involvement of the Community in coordinating and financing support for projects to demonstrate the industrial and commercial viability of new methods and technologies is more modest than that in R&D and now requires renewed attention. The demonstration phase provides the essential bridge to the full-

scale commercialization of new techniques, thereby supporting industrial as well as energy policy in encouraging the launching of new industries, processes and products.

It has been clear for some time that the Community's multiannual programmes of support for such projects in energy saving and in alternative energy sources which began in 1979 would be insufficient to meet demand. In 1980 therefore the Commission made precise proposals to the Council involving a doubling of the financial ceilings.¹ The Commission's reports on the existing programmes underline the positive experience of the operation of the existing Regulations to date. The Commission will take all the steps necessary to ensure effective dissemination of the results of the programmes so as to maximize the benefits throughout Community industry.

25. As a further element in the encouragement of innovation in and through the energy sector, the Commission intends also to help ensure that those involved in the development and exploitation of new energy technologies are able to secure the full benefits of the common market, and in particular that markets for high-performance but relatively high-cost equipment can be fully developed. Particular attention will be paid to the development of common standards so as to avoid the creation of non-tariff barriers to trade.

Innovation is a necessary part of energy strategy. Financial action and coordination at the level of the Community are vital to the achievement of the most effective results in research and development and in technological demonstration. The potential in this field must be better exploited and exploited to the full.

External relations

26. Community energy strategy must inevitably be pursued within a wider international framework involving the other main consuming nations, the energy-exporting (and especially the oil-exporting) countries, and the oil-importing developing countries. The Community alone offers a credible basis for the expression of the interests of Member States *vis-à-vis* each of these groups, developing relations with each

as far as possible in a balanced way and making use of a variety of methods and frameworks for action.

The benefits of Community coordination have already been amply demonstrated in the preparation of Western Economic Summits, meetings of the International Energy Agency (IEA) and most recently in the UN Conference on New and Renewable Sources of Energy. The Community must build on this experience, both to enhance Community cooperation in the fields of hydrocarbon supplies, the international coal trade and supplies of nuclear fuels, and, most importantly, cooperation with the developing world.

27. Cooperation among Member States in securing supplies of natural gas from outside has been less than satisfactory in the past. It can and should be enhanced. The negotiation and conclusion of new contracts should be pursued within the framework of a common approach to Community requirements and objectives, and the Commission has put forward to the Council specific proposals to this end.¹

28. In the fields of coal and nuclear fuels the aim of the Community must be to develop a framework of relations with the exporting countries which can likewise ensure stable and secure supplies. This cannot be achieved satisfactorily by individual Member States acting alone. The essential need for Community action in securing supplies of nuclear fuels is already well established and has led to the satisfactory conclusion of cooperation agreements with the main suppliers, notably Australia, Canada and the United States. This position must be maintained and developed so that new negotiations of renegotiations that may prove necessary in the light of changing circumstances can follow a similar course.

29. The Community and its Member States have already made a substantial contribution to the development of energy resources in the developing world, with total aid (grants and loans) amounting to over 700 million ECU in 1980 alone. Of this total nearly one third (over 200 million ECU) was accounted for by loans from the European Investment Bank, which is one of the main sources after the World Bank

¹ OJ C 280, 30.10.1980.

¹ Bull. EC 9-1981, point 2.1.122.

