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ENERGY POLICY

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Introduction

The underlying problem of energy supply in our society has been stated many times in the last seven years; but our failure so far to cope with it makes it worth stating again.

2. The economies of the industrial world were built on the availability of cheap energy derived principally from coal in the 19th century, and from gas and above all oil in the 20th. Coal reserves are still substantial. But oil is already a scarce resource, as the successive rises in its price since 1973 well demonstrate. It will become scarcer still over the next thirty years and beyond. But even if supply will soon flatten out and decline, the momentum of demand, unless corrected, will continue to increase. If our economies are to continue in their present form, let alone resume their growth, they will require major reorganization whereby dependence on oil is drastically reduced, other sources of energy are developed to take an increasing place, and the price of energy in its various forms finds its level between supply and demand.

3. The Member States of the European Community are particularly vulnerable. At present oil provides 55% of their energy requirements: 85% of oil consumed comes from abroad; and 90% of imported oil comes from the OPEC countries, which control 70% of world reserves and 50% of production outside the Soviet Union and Eastern Europe. Since 1973 the OPEC countries have learnt that they can cut production while maintaining or increasing revenues. In addition interruption of supply for political or other reasons is a continuous hazard. Obviously this has a major and direct effect on the ability of governments to promote growth, control inflation, and reduce unemployment. The energy price increases of the last six months will involve an extra payment of around US \$ 50 billion in foreign exchange by the Community in 1980.

4. The impending crisis passed virtually unobserved until 1973. Since then the policies followed by the Member States individually and by the Community as a whole have been fragmentary in effect, reflecting the different situation of each country within the Community. The price of energy still varies widely and sometimes inexplicably both as between fuels and between Member States. In spite of large nominal price increases since 1973, the real price to the consumer has not kept up, and in some cases has actually fallen.

5. The case for establishing common Community policies is strong. When the Coal and Steel Community, and later the European Economic Community and Euratom, were set up, the need for an energy policy as such was not foreseen. At that time coal occupied a more important place than it now does, and nuclear energy seemed the main energy source of the future. Thus although powers in respect of coal and nuclear energy were attributed to the Community, no specific power was attributed in respect of energy as a whole. Nevertheless achievement of the political, economic and social objectives of the Community as defined in the Treaties are increasingly conditioned by the supply of energy, and there could scarcely be a true common market without common policies in the field of energy. The Commission has prepared a more detailed note for the Council about the general economic implications.

6. Since 1973 there has been some advance in this direction. In 1978 consumption was about the same as in 1973 in spite of economic growth of 10.7% in real terms. The degree of energy saving is hard to assess with precision, but the measures taken within the Community, including price increases, may well have reduced energy consumption by between 7% and 10% between 1974 and 1979. For oil alone consumption was 50 million tons less in 1978 than in 1973. Community energy dependence on imported oil fell from 60% in 1973 to 47% in 1979, and the proportion of energy requirements met by oil fell during the same period from 60% to 55%.

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7. So far co-ordinated action at the level of the Community has taken five main forms. First efforts have been made to set Community targets for energy saving, reduction of dependence on oil, and development of alternative sources. Only some of these are likely to be met. For example only about 70 gigawatts of nuclear capacity will be installed by 1985 compared with the objective of 160 gigawatts agreed in 1974, and both consumption and production of coal have actually fallen. The target for the reduction of oil consumption in 1979 was not met, and there may be difficulty in meeting the oil import target set for 1985. Next the Community has helped in the financing of new coal and nuclear generating plant and in energy projects generally. It has promoted harmonisation of standards throughout the Community to help in energy saving. It has set up crisis management mechanisms. It has extended its research and development programmes into alternative sources, and given financial aid to demonstration schemes for energy saving techniques and exploitation of new sources. Finally it has taken steps to improve its knowledge of the oil market with a view to improving stability, above all in spot transactions.

8. But the gap between what has been done and what needs to be done to establish an effective Community energy policy remains wide. Even if Member States were to fulfil their existing energy programmes for the next 10 years and even if the rate of economic growth were as low as we fear it may be, additional imports of oil of between 50 million and 100 million tons might still be necessary to satisfy increasing demands by 1990.

9. 1980 may offer the Community a breathing space in which to look in realistic fashion at the problems of energy supply and to agree on policies to deal with them. These problems are only in part financial. They cover the general conditions under which energy resources are developed and exploited, including varying national standards,

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rules, and procedures, in particular with regard to the environment. This has special application to nuclear energy. Progress has recently been made following acceptance of the Commission's proposals on reprocessing of nuclear materials, nuclear waste disposal, and fast breeder technology, but more work is necessary to establish consistent environmental and security standards for nuclear power stations within the Community.

10. There are two broad areas in which new Commission action might now be envisaged: energy price and tax policy; and increased energy investment.

Price and Tax Policy

11. In spite of the increase in crude oil prices in 1973 and since, the price of oil products to the consumer does not fully reflect the Community's paramount need to become less dependent on external supplies of oil and thus less vulnerable to any future shortfall of supplies or greatly increased prices. There is a certain price to be paid for reduced dependence on oil imports and the resulting longer-term stability of our economies. At present the different fiscal policies followed by member governments scarcely promote the greater independence the Community needs. Indeed part of recent oil price increases have in effect been carried on national budgets. This may have helped to reduce inflation in the short term, but it has had a number of unhappy consequences, including reduction of the incentive to save energy and develop new sources, and negation of efforts to reduce oil consumption. More recently member governments have agreed on the need to pass on price increases directly to the consumer, and most have registered some success in doing so. This is an essential requirement for a Community energy policy.

12. The different ways in which prices are fixed in each Member State, the different systems of taxation, the

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different weighting given to energy in such devices as cost-of-living indices, and the different relationship between the various forms of energy used have created trade distortions between Member States and distortions of consumption within them. Progressive harmonisation of energy prices and taxes within the Community is therefore essential. This will be a long term, at times cumbersome but indispensable process. It should greatly contribute to our general objectives of economic convergence within the Community. It would also make it easier to measure and control the effects of energy prices on inflation and unemployment, and to pursue consistent policies to reduce dependence on imported oil. Instead of being vulnerable to every wind that may blow from outside, and reacting in dispersed and inconsistent fashion, the Community would be equipped with instruments of macro-economic management which would help it to cope with challenges from inside and out.

13. Progressive harmonisation of energy prices and taxes would have wide consequences. Indeed given the different economic circumstances and energy requirements of Member States, harmonisation might eventually create some distortions of its own. It would involve a shift in the structure of revenue and expenditure in each Member State and within the Community, and would thus have important redistributive effects. If it were not to aggravate inflation and depress economic activity, it might require compensatory reductions in other forms of taxation. The Commission has prepared a separate note for the Council on the implications of energy price and tax harmonisation in the Community.

Energy Investment

14. Among Member States investment in the various forms of energy, as a proportion of total capital investment, differs greatly according to circumstances. During the
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period 1980 to 1990 Member States plan to spend in total over 400 billion ECU on energy or up to 2% of Community GDP. On present planning the contribution to this investment from Community funds is likely to be small. Although about 40% of all Community financing goes into the energy sector (through the EIB, Euratom, ECSC etc), this amounts to only about 4% of all energy finance. Furthermore only 2 to 3% of the Community budget goes into energy investment.

15. Although there may at present be relatively little difficulty in raising funds for some forms of energy investment in the short term, we believe that the total volume now envisaged is markedly insufficient in the long term, and is not geared to meet the specific needs of the future. If the present rate of energy saving falls short, and if the switch to energy sources other than oil is further delayed, then the Community could find itself with a substantial energy gap which it would be tempted to fill at rising cost by increasing imports of oil.

16. The bulk of the increased investment required must come from national sources. But because the ability of Member States to undertake such investment varies markedly in terms of financial, technical and other resources, and the different character of their national programmes, there is an obvious danger that economic and social differences within the Community could thereby accentuated, our efforts to promote convergence frustrated, and the objectives of the Treaties made still further from attainment. These difficulties could be met through an expanded Community programme of investment support designed to underpin a Community energy policy inside and outside the Community.

17. Its purposes would be subordinate to the general requirement to promote energy saving, the substitution of oil by energy from such sources as coal and above all nuclear power (whose exploitation is vital to meet our future /needs),

needs), and the development of synthetic fuels and other renewable resources. Its particular role would be to help remove the obstacles which now prevent investments from being undertaken (for example insufficient funds or high technology risk) or which delay investments (for example doubts about competitiveness with oil in the short term, high initial cost, and long payback times). In so doing it should serve to increase investment in proven technologies and encourage it in more advanced technologies. To allow maximum scope for the exercise of national judgment and control of projects, the programme would work in such a fashion as to fit in with and supplement national programmes with different degrees of Community participation in specific projects. All Member States should qualify to benefit from it, especially those most dependent on oil as an energy source.

18. It is not now possible to estimate reliably the total financial requirements. The additional investment required in the 1980s to hold oil imports down to their present level could be in the order of 50 to 100 billion ECUs, or between one quarter and a half per cent of Community GDP. Most of this extra expenditure would need to be committed early in the 1980s to yield results by 1990, and a continuing effort would be needed thereafter to ensure a sufficient growth of energy production in the following decade.

19. In general terms the energy industry is capable of financing itself. But with the growing importance of advanced technology and the need for increased research and development, as well as the long lead times and long payback periods associated with energy saving techniques and new forms of energy, there is a substantial need for additional financial support to underwrite the financial and technical risks involved.

20. Such support could take a number of forms. As it would be primarily designed to supplement national programmes, a mixture of grants for projects and subsidies for loans

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would be appropriate. Some of the support might be provided by lending on the basis of Community loans (guaranteed by the Community budget). But the very nature of the action envisaged would require direct and significant support from the Community budget itself.

Financing

21. The sums required for a major Community effort are too large to come out of the existing Community budget. Hence new means of Community financing would be needed. Its main purposes would be:

- to supplement the harmonisation of energy prices and taxes in the Community;
- to supply more funds for investment in the Community in saving energy, exploiting existing resources and developing new sources;
- to help in promoting the switch from oil to other sources of energy, and to reduce the dependence of the Community on supplies from overseas; and
- to provide underpinning for a Community energy policy, thus completing and bringing up to date the original provisions and objectives of the Treaties.

22. Until we have a clearer idea of the amount required, it would be premature to draw any conclusions about methods of financing. There are a number of possibilities, from raising Community loans for the purpose, to increasing revenue under the Community's existing system of own resources, to introducing a specific Community energy tax designed to contribute to the objectives of energy policy as a whole. If the choice were to be some form of Community energy tax, it would be desirable

- to adopt a system which is administratively simple and easy to operate, raises least political and constitutional difficulties, and can be rapidly introduced;

- to minimise complications with third countries, in particular oil suppliers and those with whom we have preferential agreements;
- to ensure that the tax was an own resource of the Community with its yield going directly into the Community budget.

23. The main possibilities - not mutually exclusive - for taxation would be to impose a tax on the consumption of energy, either in all its forms or on oil or specific oil products; a tax on production of energy in general or oil in particular; a duty or levy on imports either of energy in general or of oil or specific oil products. The Commission is sending the Council a detailed examination of possible fiscal instruments for raising Community revenue from energy. Each form of taxation has its advantages and disadvantages. Various combinations of taxes might also be considered.

24. More generally the impact on the industrial competitiveness of the Community of any method of financing would naturally depend on its size and character. Side effects would be limited and action more effective if a Community initiative were carried out on an agreed international basis. It would therefore be essential to consult our major industrial and trading partners with a view to their taking comparable action. The Community and its Members will anyway have to define their attitudes to the decision of the United States Government to impose a petrol conservation charge on imported oil and to work for an internationally agreed demand restraint programme. It should be made clear that a Community initiative would be designed to help further the policies already publicly advocated by the OPEC countries to reduce consumption of oil and extend the life of the world's oil reserves; and also to help poor non-oil-producing countries in developing the energy resources of the third world.

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Conclusions

25. In this paper we have sought to establish the reasons, need and basis for a new Community initiative as part of a Community strategy for energy. At present the anomalies and differences which have arisen between Member States in their pricing and taxation of energy have had seriously distorting effects, and hindered efforts to reduce dependence on imported oil and achieve greater independence. Energy accounts for so important an element in our economies that there could scarcely be a true common market consistent with the objectives of the Treaties without common policies in the field of energy. Thus we propose progressive harmonisation of energy prices and taxes to reduce these distortions and give the Community the instruments of macro-economic management it needs.

26. We believe that planned investment in energy for the next decade and beyond falls short of our requirements. In our judgment we need a Community programme to support the efforts of Member States to promote energy saving, to substitute oil by energy from other sources and reduce our dependence on foreign suppliers, and to develop other renewable sources. Such a programme would need financing. In our paper we have considered some of the possibilities for doing so. We shall later be making proposals in the sense indicated in this paper. In the meantime the European Council is invited

- to support the idea of a new Community initiative as part of a Community strategy for energy; and
- to take note of the approach towards it suggested in this paper.