

COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

COMMUNITY APPROACH TO THE REFINING PROBLEMS OF THE
COMMUNITY

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EXPLANATORY MEMORANDUM

1. During its meeting of 21st December 1976, the Council gave its agreement to the Community Working Programme for 1977 in the field of energy policy and invited the Commission to submit as soon as possible the relevant proposals and communications.
2. This Working Programme includes, under point 6., "Oil Refining Policy", the following problems :
 - problems of excess refining capacity and of the adaptation of capacities to demand structure, and the
 - problem of refineries' protection in face of product imports from third countries.
3. In the attached communication the Commission examines these problems and submits to the Council proposals for their solution.

COMMUNICATION

BY THE COMMISSION TO THE COUNCIL

COMMUNITY APPROACH TO THE REFINING PROBLEMS OF THE COMMUNITY

S U M M A R Y

1. The refining industry of the Community presently faces, or will face in the near future, problems affecting its profitability in such a way that initiatives at Community level are necessary.

This communication suggests the general lines along which solutions may be found. If the Council accepts this general framework the Commission will take the necessary initiatives for its implementation.

2. The problems of the refining industry are partly of an internal nature (surplus of distillation capacity, adaptation of refining structure to market requirements) and partly of an external nature (imports of products from third countries). These problems are closely interrelated.
3. In order to solve the problem of the Community's distillation capacity surplus, some 140 M.t/y of distillation plant (i.e. about 16.5% of total existing capacity) needs to be withdrawn from service. This objective should be attained by a standstill on new construction and exceptions should only be made after consultation at Community level. Furthermore marginal and/or less efficient plants should be temporarily and in some cases finally, taken out of service.

Solving this problem is primarily a task for the industry. Appropriate measures by national Governments should aim at creating the best possible social, fiscal and administrative environment for the industry's actions. On the basis of Regulation 1056/72 the Commission can monitor developments in this sector and check whether the industry's corrective actions are meeting the Community's objective. Each year the Commission will inform the Energy Committee in order to discuss the situation and to decide on what attitude the Community should adopt. If necessary, the Commission will present a report to the Council.

4. In order to solve the second problem i.e. the imbalance between the refining structure and the demand structure, the construction of additional conversion capacity, ranging between 8 and 12 M.t/y of gasoline output, will be necessary, at an estimated investment cost of about 2 to 3 billion US dollars (1976). This matter should be a subject for consultation and cooperation with producer countries.

This problem is also in the first place a task for the industry. The solution of the problem requires primarily a better profitability of refining operations.

Through Regulation 1056/72 the Commission can monitor the evolution in this field and on that basis consult the Energy Committee, on the attitude the Community should adopt. If necessary, the Commission will present a communication to the Council.

5. The third problem, the growing competition from the many export refineries planned in third countries, particularly those of the Middle East and Mediterranean, will put new strains on the profitability of the Community's refineries.

In order to maintain a balance between the need for a profitable Community refining industry, on the one hand, and the need for an outward-looking policy on the other, the Community should develop a policy with the emphasis on information and co-operation between all parties concerned, along the following lines :

- (a) establishing indicative medium-term forecasts of imports,
- (b) setting up a system for information and consultation within the Community,
- (c) organising consultations with the non-member countries concerned on the problems relating to the trade in refined products. In the case of non-member countries covered by Community agreements these consultations should take place within the framework of the institutional apparatus laid down in these agreements;
- (d) if necessary, by applying commercial policy measures.

6. When the above measures are implemented, the activities of the oil companies must not contravene the rules of competition contained in the Treaty and, in particular, Articles 85 and 86 thereof.

INTRODUCTION

This document focuses on solutions to the three following problems which must be faced by the refineries of the Community :

- reduction of distillation capacity surplus,
- adaptation of refining structure to market requirements,
- rising imports of petroleum products from non-Community countries.

These problems are closely inter-connected.

A. Reduction of distillation capacity surplus

1. One of the main problems for the Community's refining industry is a marked surplus of distillation capacity which seems likely to persist into the 1980's. The surplus places a heavy burden on the profitability of the refineries in the Community, and could lead to the withdrawal of certain refiners from Community markets. In order to rectify this situation with the least delay, the substantial reduction of existing over-capacity is a matter of urgency.

Proposed actions

A reasonable objective would be so to reduce capacity that a utilisation ratio of 80% is achieved at the earliest date instead of the 60-70% ratio to be expected over the period 1976-80 if no corrective action is taken. This would entail the withdrawal from service of 140 m.t/y of distillation plant (see Annex I). Such a reduction in refining capacity would still leave a margin of flexibility sufficient to ensure the protection of consumers against the risk of unjustified price increases (until 1973 the rate of utilisation of refineries was of the order of 85%).

To achieve this objective, the following action would be required :

- (a) to ensure that no new projects are started,
- (b) temporarily, or in some cases, finally, to take out of service marginal and/or less efficient plants.

In order to make sure that no new projects are started, the Council should agree on a stand-still for a transition period lasting in the first phase until 1980. Only in exceptional cases would construction of new plants be envisaged. Member States will inform the Commission about each new plant planned. The Commission will arrange, as soon as possible, consultation within the framework of the Energy Committee and, if necessary, make known its opinion.

4. In the view of the Commission, the distillation capacity surplus is primarily an industry problem which should be solved by the companies themselves within their own responsibility. However, the Member States should ensure that this process of rationalisation can take place in the best conditions and, to this end, should try to create a social, fiscal and administrative environment favourable to its execution. They must also ensure that there are no serious repercussions upon employment. (1)

The Commission will see to it that the implementation of the process aimed at does not lead to illegal concerted practices between oil companies nor to abuses of a dominant position to the detriment of smaller and non-integrated refining or distribution companies.

5. The Commission has available Regulation 1056/72 as an instrument for monitoring developments in the refining sector and for checking whether corrective action taken by the industry meets the objectives for the Community, i.e. to reduce capacity by 140 M.t/y. In order to complete the information given by the annual returns required by Regulation 1056/72, governments should ask companies to provide additionally, from 1977 onwards, details of their plans for the temporary closure of plant. On the basis of this information, the Commission will consult the Energy Committee each year about developments in the refining sector and the attitude which the Community should adopt. If necessary, the Commission will present a communication to the Council, possibly including proposals.

B. Adaptation of refining structure to market requirements

6. Over the period 1975-85, the Community will also face the problem of a growing imbalance between the product structure of refinery production and of market demand, as a result of a shift in the demand structure towards light products, which could amount to 24 M.t/y of gasoline and naphtha (petrochemical feedstock) by 1985.

7. Proposed actions

These problems can be solved in the following ways :

- (a) an increase in the proportion of light crude oils processed
- (b) additional imports of gasoline and/or exports of fuel oil,
- (c) a further expansion of conversion capacity beyond that already planned.

(1) Which at the moment would appear unlikely in view of the structure of the refining industry, of the very limited number of personnel in relation to capital invested, and of the fact that since 1974 the industry has had to adapt itself to a reduced level of activity.

8. Since the contribution to be expected from the lightening of the crude oil stream, and from additional imports of gasoline and exports of fuel oil may not be sufficient, additional conversion plants will be needed in order to correct the forecast deficit of light products. Total additional conversion capacity probably required by 1985 will range between 8 and 12 M.t/y of gasoline output, which corresponds to an estimated investment of about 2 to 3 billion US Dollars (1976). This matter should also be a subject for consultation with third countries within the context of discussions on cooperation.
9. The necessary level of investment by the industry in the Community will only be achieved provided the underlying profitability of main products trading is satisfactory. Most companies seem to have no fundamental difficulties with regard to financing new investments in conversion capacity because project economics are favourable. Therefore, one may expect that the industry will make the necessary investments in order to reach a better balance between production and demand structure.
10. The Commission has the necessary instrument (Regulation 1056/72) to monitor developments in this sector. In liaison with the Member States, and in consultation with the industry, the Commission will ensure the coordination of all the action taken in this field. On the basis of the information thus collected, the Commission will, each year, consult the Energy Committee on the evolution in this sector and the attitude the Community should adopt. If necessary, the Commission will present a communication to the Council.

C. Imports of petroleum products from non-Community countries

In the years to come, the Community market will also be affected by the many export refineries planned in third, and in particular the producing countries, especially those in the Middle East and the Mediterranean. Present capacity in these two regions is about 160 M.t/y. As for the future, estimates from 260 to 373 M.t/y have been put forward by the producing states; current estimates, although more moderate, are still considerable. Up to now, imports of oil products by the Community have not exceeded 30 M.t/y, or about 6% of crude oil imports, of which some 5 M.t/y were imported from the two regions mentioned above. These imports did not cause serious problems to Community refineries. Although the domestic requirements of the producer countries are growing and imports by the USA, Japan and other regions may rise, there can be little doubt that increasing quantities of product exports will be directed towards the Community market.

12. In the medium term the Community's oil industry will thus have to cope with intense competition from producer countries. The Community has traditionally been a net exporter of petroleum products. This situation started to turn in 1976 when the Community first became a net importer by some six million tonnes, or around 1% of its internal requirements.

It appears reasonable to expect this trend to continue in future. But when making their decisions on investment, the producer countries must take account of the real possibilities offered to them by the Community market. The Community for its part must be aware of the fact that it depends on imports of crude oil from these countries.

13. The present system for importing petroleum products into the Community can be summarised as follows :

a) Tariff situation

following the GATT negotiations, the normal common customs tariff (CCT) rates now vary from zero per cent for feedstocks to 3.5% for heavy oils and 6% for light oils. These rates protect around 50% of the added value. This rule currently applies to some 75 - 80% of products imported into the Community.

The remaining 20-25% of imports are subject to tariff concessions under the cooperation agreements, free trade agreements and preferential agreements signed by the Community and as part of the generalised preferences scheme. Depending on the particular arrangements, petroleum products can be imported duty-free or at reduced rates within the limit of the individual quotas or global ceilings established. The ceilings laid down in some of these arrangements must be abolished by 1 January 1980.

b) Quantitative restrictions

In the absence of a Council Decision, oil has not yet been submitted to a common import régime (1). The situation differs among the Member States. Only one Member State maintains quantitative restrictions for imports from GATT countries and countries accorded like treatment, while several Member States still retain quotas for imports from Eastern countries. There are normally no quantitative restrictions in respect of non-member countries with which the Community has concluded free trade, preferential or association agreements.

(1) The Council has not yet taken a decision on the proposal of the Commission to include petroleum products in Regulation (EEC) No. 1439/74 of the Council of 4 June 1974 on common rules for imports (OJ No L 159 of 15.6.1974) and in Regulation (EEC) No 109/70 establishing common rules for imports from state trading countries (OJ No L 19 of 21.1.1970), nor on the definition of the concept of origin (Proposal for a Regulation (EEC) of the Council on the common definition of the concept of origin of petroleum products (COM(73) 2247 final of 2 July 1974).

14. Point 13 shows that the Community's external freedom of action in commercial policy is limited by international commitments on customs duties, and on the lifting of quantitative restriction, which it cannot go back upon except through the application of safeguard clauses, a process which is subject to strict international rules. Furthermore, account must be taken of existing or future Community agreements with non-member countries which provide for - or could provide for - co-operation in energy matters, possibly involving commitments to import certain refined products from these countries.

Proposed actions

15. It is the Community's responsibility to attain a satisfactory balance between its imports of crude oil and refined products. This balance must take account firstly of the Community's wish to pursue an outward-looking policy and secondly, of the need to provide sufficient work for the Community's refining industry after its adaptation (see points A and B) in line with market trends.

The Community policy concerning the supply of petroleum products should try to attain this objective by :

- a) setting indicative medium-term forecasts for imports;
- b) establishing a system of information and consultation within the Community;
- c) organising consultations with the non-member countries concerned on the problems related to the trade in refined products. In the case of non-member countries covered by Community agreements these consultations should take place within the framework of the institutional apparatus laid down in these agreements;
- d) if necessary, by applying commercial policy measures

16. The indicative medium-term forecasts should :

- permit those involved in economic activities in and outside the Community to act with better knowledge of the probable future situation
- provide a basis for the consultations with non-member countries;
- provide a basis for assessing future import possibilities under the general preferences scheme or under future Community agreements with outside countries;
- indicate the critical points at which Community intervention might become necessary.

17. As part of the information and consultation machinery within the Community, the indicative medium-term forecasts should be compared with companies' annual estimates of product imports; the Commission has this information at its disposal under Regulation (EEC) No 3254/74. If necessary,

individual companies could be consulted regarding major differences between Community and company forecasts. Companies should also notify major changes in their forecasts during the year.

This comparison would enable the Commission, after consultation with the Energy Committee, to pass on information and obtain opinions on the probable trend of imports and demand for products.

18. Suitable methods of consultation with non-member countries should be developed in order to identify common interests and to find solutions acceptable to both sides. In seeking these solutions, the Community should take account of special situations in regard to security of supply (joint ventures, long-term contracts). In cases where the Community is linked by agreements with the producer countries solutions must be sought jointly by the two parties.

19. For protecting its oil industry against serious disturbance as a result of excessive imports of refined products from third countries, the Community disposes, in case of need, of the following instruments (see details in Annex II):

(a) Anti-dumping measures

EEC Regulation 459/68 of 5 April 1968 enables the Community to apply anti-dumping taxes to imported oil products, if these products cause considerable damage to the Community oil industry because they are sold at dumping prices.

(b) Safeguard measures

If imports were made in quantities so increased, and on such conditions as seriously to affect, or threaten to affect, the refining industry, the Community could take safeguard measures, such as quantitative restrictions or additional import duties, subject to the international obligations of the Community.

As regards third countries with which agreements have been concluded, the safeguard clauses included therein could be applied, taking account of all aspects of the Community's co-operation with these countries.

For the third countries measures can be taken on the basis of Article 113 of the Treaty by a Council decision on a proposal from the Commission.

Recourse to temporary measures of this type would obviously be an extreme step which should be taken only after exhausting all the possibilities for a solution under the consultation and cooperation procedures referred to in point 15 (c).

ANNEX IExisting and forecast refining capacity surplus in the EEC assuming
no intervention

On the eve of the oil crisis of October 1973, there was available in the Community nominal refining capacity of 770 M.t/y, permitting a sustained input of some 655 M.t/y at a utilisation ratio of 85% (the 1963-73 average). This compared with 610 M.t of crude oil run in 1973, leaving a margin of spare capacity of about 45 M.t/y. At that time the industry, expecting consumption to continue to grow at more than 5% per annum, was committed to the construction of 80 M.t/y of additional plant (10%) mostly to enter service over the period 1974-5. In the event crude oil throughput fell between 1973 and 1975 by 110 M.t/y (15%) and spare capacity rose to over 200 M.t/y by mid 1975.

Over the period 1973-85 estimates of total demand for finished products (including net exports) compare with capacity as follows :

	M.t/y				Estimate
	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1980</u>	
Inland Consumption	516	480	442	516	
Bunkers	38	32	31	37	
Exports	53	47	33	..	
Imports	30	35	39	..	
Net exports*	23	12	- 6	-	
Refinery own-use/loss	33	32	32	39	
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Crude oil requirement	610	556	499	592	
Nominal capacity (mid year)	770	815	850	880	
Utilisation ratio of nominal capacity	80%	70%	60%	67%	
Spare capacity at max. utilisation 85% (average 63/73)	45	135	221	160	

* Because of large margin of uncertainty, it is impossible to produce reasonable forecasts for exports and imports of finished products for 1980 and the assumption has been made that they will be in balance.

ANNEX II

Possible Community action on the basis of external trade regulations

A. Anti-dumping regulation

EEC Regulation 459/68 of 5 April 1968 (O.J. L 93 of 17.4.68) contains the basic principles regarding anti-dumping measures.

It stipulates that before such measures can be taken,

- a) dumping should be proved
- b) this dumping should cause considerable damage to a production of the Community

Dumping exists, if the export price of a certain product is :

- lower than the selling price of the same product in the country of origin,
- or lower than, either its export price to other third countries, or than its tax paid cost in the country of origin.

Applied to oil products, this means that dumping for example occurs if it is proved that a producing country sells its product to different importing countries at different prices according to the particular conditions of these importing countries, or that the product is sold at a price level lower than the cost price of crude oil plus a normal margin for transformation, i.e. at a price lower than the production cost (1).

The assessment of a certain damage presupposes an investigation of all factors influencing the situation of the industry in question i.e. the evolution of the producing of the importing country, the evolution of the market share of the imports, the evolution of prices, benefits and losses of the companies established in the importing country.

It should be stressed that quantities imported at dumping prices could complicate the already precarious situation of the Community's oil refining industry.

B. Safeguard measures

A distinction should be made between the general safeguard clauses of Article 113 and the specific safeguard clauses contained in the preferential or association agreements.

(1) To demonstrate the existence of dumping practices on the international oil market is undoubtedly difficult and the application of protection measures in this respect could not be contemplated except in extreme cases.

- a) Article 113 of the EEC Treaty makes it possible for the Community to take safeguard measures against all third countries, including state trading countries, in the framework of the common trade policy. On the basis of Article 113 a common import régime has been established for products imported from third countries. But crude oil and oil products have not been included in this common régime until now.

However, this fact does not reduce the possibility for action on a Community level, given the general applicability of Article 113, and the Commission intends, if needed, to submit to the Council the necessary proposals for taking safeguard measures in accordance with the situation of the market for petroleum products and the international obligations of the Community.

- b) Apart from the general safeguard clauses based on Article 113, mention should be made of the specific clauses contained in the preferential or association agreements which the Community has signed with third countries. These safeguard clauses are intended to deal with serious disturbance to a sector of the economic activity or with difficulties which may result in the deterioration of a regional economic situation.

As to the nature of these measures, they can be quantitative restrictions as well as additional import duties.