

COMMISSION OF THE EUROPEAN COMMUNITIES

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MEASURES TO LIMIT THE EFFECTS OF A LIMITED SHORTFALL IN OIL SUPPLY

(Communication from the Commission to the Council)

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COMMUNICATION TO THE COUNCIL

Measures to limit the effects of a limited shortfall in oil supply

A. Explanatory Introduction

1. A substantial shortage of oil would have serious effects on the economy. This is recognised by governments, and consequently legislative procedures have been established at national, Community and IEA level to allow proper management of the situation. These procedures address the problem of inadequate overall volume by allocation of available oil.
2. Experience over recent years has shown that the economy can be as badly affected by market tension, even when generated by a very small short term shortage or, in extreme cases, by no more than apprehension and lack of information.
3. Between mid-1978 and mid-1981 there has been no substantial shortage that could be called a crisis. There have, however, been periods of severe tension that have led to an increase in the average FOB cost of Community crude oil supply from \$12.75/bbl to \$36.50/bbl. The effects of this price increase on the balance of payments and on the economy in general are all too evident today.
4. Future periods of tension need not have the same effects on prices, provided suitable actions are taken in time, when the first indications of the likelihood of tension can be identified. If measures are inadequate or too long delayed, there can be little doubt that history will repeat itself. This willingness to anticipate difficulties represents the key stone to the Community strategy recommended by the Commission.
5. Member States are well aware of this danger and, in November 1980, adopted a course of action to alleviate tension, based essentially on a political agreement that governments would, on a voluntary basis, undertake or advocate certain measures. The desired results were achieved even when, for a period, the war between Iran and Iraq stopped all exports from these countries; prices in the spot markets for products and crude oil did not go up as violently as on previous occasions.

It is recognised, however, that the stability of prices was also to a large extent due to increased production, declining demand and in particular an overall high stock position. The consequential ability of companies to draw on stocks made it relatively easy for them to abide by government requests to abstain from abnormal purchases. Also, the overall supply situation improved quickly and the agreed international co-operation to correct imbalances between countries did not have to be put into force.

6. Looking to the future, when supply difficulties develop, it cannot be assumed that similar supporting conditions will exist and consequently further preparation is necessary, including - following Council discussions in March and June 1981 - preparing for the possible use of compulsory stocks as a concomitant action if government measures similar to those taken in November 1980 are to be successful. Member States recognised this need and Italy, in particular, made specific suggestions. In this way a true Community solidarity can be built.

B. Objective

7. While the precise nature of any future supply problem cannot be foreseen and consequently the appropriate measures to be taken can only be agreed on when the problems occur, the purpose of this communication is to obtain Member States' agreement in principle to the procedures to be followed after the identification of supply problems in the oil sector likely to lead to pressure on world market prices out of line with longer term perspectives. Such agreement will provide the basis for co-ordination with other industrialised countries.

In this context, consideration is given to the types of possible measures from which a selection may be made in the light of the prevailing circumstances and for which a flexible approach is essential. It is equally necessary to ensure now that governments will have the required flexibility, including any necessary legislative instruments, either in their national plan or by reason of a Council Decision, to take such action as may be considered necessary at the time.

It is necessary to ensure that Member States take all necessary steps to follow appropriate policies for demand, supply and security. Member States' performance will be monitored in a permanent way by the Commission, which will report on a continuing basis to the Council and, if necessary, make recommendations.

C. Procedure within the Community

8. It is therefore proposed that when early indications of supply difficulties become apparent, the Commission should, after consultation with the "Oil Supply Group", on its own initiative or at the request of a Member State, ask for a special Council meeting to start within three days. It should also make any necessary proposals to the Council. If the Commission does not act, a Member State can ask the Council to meet.
9. At this special Council meeting, any Commission proposals will be supported by an explanation of the reasons for which the meeting is considered to be necessary. The Council will review and discuss the situation and decide whether, at the time in question, a situation has arisen in which agreed measures are necessary.
In the affirmative case the Council will, by unanimity and within 5 days, agree on both those measures that can usefully be taken by individual Member States and those that should be adopted by all Member States, whilst ensuring co-ordination at Community level and equivalence of efforts of Member States. After co-ordination with other industrialised countries, such agreement can be formalised where necessary in an act of the Council (in particular where it relates to the use of compulsory stocks).
10. Thereafter, the Council will, by qualified majority, agree on any necessary implementing modalities.
11. The application of any agreed measures should be monitored by the Commission, in consultation with the "Oil Supply Group", which will report to the Council.
12. Should circumstances change, the Commission may, on its own initiative or at the request of a Member State, propose to amend or repeal the measures introduced.

D. Consultations with other industrialised countries

13. It is proposed that consultations should now take place with other industrialised countries, with a view to the establishment, on a wider international basis, of procedures broadly analogous to those envisaged for the Community level. Thereafter, the Commission will transmit a draft Directive to the Council setting out the agreed procedures in detail and requiring that governments dispose of the necessary powers. This Directive will not in itself define the precise course of action to be taken if and when problems occur: this will be decided by the Council in the light of circumstances.

E. Range of possible measures

14. The actions and measures proposed will depend upon and be appropriate to the particular circumstances at the time. However, among measures to be discussed will undoubtedly be those that have been effective in the past, namely:
- a) speed up information systems and in particular introduce the questionnaire on the supply situation (Commission Decision 79/639/EEC) by country and, if necessary, company;
 - b) - take all necessary measures, in conjunction with the oil companies, to prevent import prices varying from normal prices
- or obtain an undertaking from the oil companies that they will refrain from making abnormal purchases;
 - c) encourage adjustment of supplies in such a way as to correct imbalances which pose particular problems for some Member States and encourage the oil companies to remedy specific imbalances which may occur between them;
 - d) encourage the saving of oil by, for example, publicity, other psychological measures or voluntary reduction in deliveries (but not the heavier measures required for full emergencies);
 - e) substitution of oil by other forms of energy in both the public and the private sector in order to reduce consumption;
 - f) support domestic production at a high level;
 - g) encourage the use of commercial stocks in preference to additional purchases and authorise the use of part of compulsory stocks in case commercial stocks were exhausted, in accordance with a specific compulsory stock use programme, including a mutual guarantee that compulsory stocks of individual countries will not fall under 85 days.

Since the use of compulsory stocks is a new element to allow stock use when commercial stocks are not at a high enough level to support the other measures, consideration must be given to how such stocks may be used.

F. Suggested programme for the use of compulsory stocks

a) Basis for implementation

15. If it cannot be confidently foreseen that a run-down of commercial stocks will be sufficient to support other measures adopted by Member States, it is important that the decision to allow the use of some part of compulsory stocks is taken at the outset and that the industry is informed. Only if this is done will expectations in the market be modified to reduce tension, since the assessment of the companies on their supply situation will be changed. It should also be recognised that authorising a reduction in compulsory stocks does not mean that they will be run down in practice unless total stocks decline to the 90-day level.

b) Effects of implementation

16. The effect of such a decision would be that all companies in all markets would have more stock available for use. This would reduce their need to buy. Taking pressure off the market in this way would not mean that market activity would cease. On the contrary, the spot market would maintain its contribution to normal supply, but, since there would be less competition for available oil, it should be possible for normal trade to continue without starting a price spiral.

c) The follow-up situation

17. It seems that 5 days of compulsory stocks would be sufficient to deal with limited supply interruptions, bearing in mind that for instance, 5 days of compulsory stocks would cover a 4% overall supply deficit for 4 to 5 months; moreover, commercial stocks would initially cover the deficit for a considerable time, depending upon their size at the time. It is therefore reasonable to expect that the supply problem would be over and supply returned to normal before an overall 85-day

stock level was reached. If so, prudent rebuilding of stocks could take place, to return firstly to the 90 days of compulsory stocks and later to build up commercial stocks to the level desired by industry.

18. It is, however, also possible that the situation might deteriorate so far that continued compulsory stock draw-down would bring countries under the 85-day level.

It is in case this situation is reached that the compulsory stock use programme must be based, from the outset, on a mutual guarantee that compulsory stocks will not be allowed to fall too far in individual countries. This guarantee would reflect the fact that, in co-operating to reduce market tension, it could be necessary for some countries, for reasons beyond their control, to dig deeper into their compulsory stocks than others.

19. It is proposed that the guarantee should come into operation if the situation develops into a full emergency, so that by transfer of supplies at that stage all countries enter the allocation procedure with comparable levels of compulsory stocks. It should, in any event, come into operation at the request of any country if, in accordance with the provisions of Directive 68/414/EEC, its overall compulsory stocks reach the 80-day level. Allocation inside any Member State would be a matter for the government concerned. Deliveries would be made from oil available to Member States with compulsory stocks in excess of 85 days to bring the other countries' 80-day stock back up to 85, provided that by so doing, the Member States making oil available would not reduce their own stock position to a lower level than that achieved in the receiving Member State(s) after the transfer. The transfer would normally be achieved by the deviation of some incoming supplies to those with the lowest stock position.

A Member State that has not taken all actions possible to assure its own security when it had the opportunity could be excluded from the benefit of this guarantee by Council Decision.

d) Requirements for implementation

20. Considerable reliance must be placed upon the voluntary cooperation of industry. Without such cooperation the deviation of incoming cargoes would, for example, not be possible. However, for the guarantees to be effective, they must be totally credible. Governments must therefore be able to direct the movement of certain quantities of oil if necessary.

Such powers are available to all governments in times of major crisis or war, but only as part of a wide-ranging package of powers. In many cases it would not be legally possible to activate such a package for the modest requirements and objectives under consideration, and in any case such activation would go much further than necessary. What are required are strictly limited powers sufficient for the situation of limited supply disruption. Discretionary powers to direct the use made of 5 of the 90 days of compulsory stock would appear to be sufficient. It is to be hoped that these would not need to be used; but they must be seen to exist, so as to make the guarantees effective and ensure that imbalances could and would be corrected at both national and international levels.

21. If an agreement could be reached between the industrialised countries on such a policy to deal with future limited supply difficulties, the participating countries would need to take the necessary implementation measures. For the Member States of the Community, this should be by Community legislation, for the others by national legislation.

e) Prices for transferred oil

22. In the case of transfer of oil, prices should be negotiated between the companies concerned on the basis of price conditions prevailing for comparable commercial transactions. Nevertheless, argument could arise and, in consultation with the oil industry, a specific arbitration procedure needs to be established to allow rapid settlement based on agreed criteria.

G. Conclusions

23. The Council is asked to approve the attached conclusions.

Draft conclusions of the Council concerning measures to
limit the effects of a limited shortfall in oil supply

1. The Council has considered the Communication of the Commission concerning measures to limit the effects of a limited shortfall in oil supply.
2. The Council endorses the view of the Commission that further preparation in close consultation with the other industrialised countries is necessary with the aim of ensuring that any future limited shortfalls in oil supply do not lead to unrealistic pressure on world prices which would seriously affect the world economy.
3. The Council is of the opinion that, although the precise nature of any future supply problem cannot be foreseen and consequently the appropriate measures to be taken can only be agreed on when the problems occur, it is necessary to agree on the procedures to be followed and to identify a range of measures from which a selection may be made in the light of the prevailing circumstances, in order to ensure Community solidarity.
4. The Council therefore agrees in principle on the following procedure and range of measures, which will be subject to consultations with other industrialised countries with a view to the establishment, on a wider international basis, of procedures broadly analogous to those envisaged for the Community.

Procedure:

If oil supply problems are likely to lead to unrealistic pressures on world market prices:

- The Commission should, after consultation with the "Oil Supply Group", on its own initiative or at the request of a Member State, ask for a special Council meeting to start within three days. It should also make any necessary proposals to the Council.
- If the Commission does not act, Member States can ask the Council to meet;

- In the light of the circumstances, the Council should, by unanimity and within 5 days, agree whether and what course of action is necessary, while ensuring co-ordination with, in particular, other industrialised countries;
- Implementing modalities of the measures adopted will be decided on separately by the Council by qualified majority;
- If circumstances change, the Commission should, on its own initiative or at the request of a Member State, propose to amend or repeal the measures introduced;
- The application of any agreed measures will be monitored by the Commission, in consultation with the "Oil Supply Group", which will report to the Council;
- The Commission will monitor, in a permanent way, Member States' policies concerning demand, supply and security. It will report to the Council and make recommendations if necessary.
- Any Member State may be declared ineligible for the benefit of the solidarity measures decided by the Council if it has not taken all actions necessary to ensure its own security when it had the opportunity.

Range of possible measures

- a) Speed up information systems and in particular introduce the questionnaire on the supply situation (Commission Decision 79/369/EEC) by country and, if necessary, company;
- b) - Take all the necessary measures, in conjunction with the oil companies, to prevent import prices varying from normal prices
- or obtain an undertaking from the oil companies that they will refrain from making abnormal purchases;
- c) Encourage adjustment of supplies in such a way as to correct imbalances which pose particular problems for some Member States and encourage the oil companies to remedy specific imbalances which may occur between them;

- d) Encourage the saving of oil;
- e) Substitution of oil by other forms of energy in both the public and the private sector in order to reduce consumption;
- f) Support domestic production at a high level;
- g) Encourage the use of commercial stocks in preference to additional purchases; and authorise the use of 5 days of compulsory stocks in case commercial stocks were exhausted, including a mutual guarantee that compulsory stocks of individual countries facing supply problems for reasons outside their control will not fall under 85 days.

Physical transfer will take place by decision of the Council if the situation develops into a full emergency or - at the request of the Member State concerned - if the overall level of stocks reaches 80 days.

5. The Council invites the Commission, in the light of the outcome of the consultations with other industrialised countries, to make further proposals.