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Report

drawn up on behalf of the Committee on Economic and Monetary Affairs on
the increase in oil prices

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On Tuesday, 23 October 1979 a motion for a resolution (Doc. 1-417/79) on the increase in oil prices was tabled by three members of the Group of European Progressive Democrats. On 24 October Parliament voted not to adopt urgent procedure on this matter, and it was referred to the Committee on Economic and Monetary Affairs as the Committee responsible. No other committees have been asked for their opinions.

On 27/28 November, Sir Brandon Rhys Williams was named as rapporteur, but was replaced by Mr Balfour at the Committee meeting on 18/19 December.

The Committee considered the proposal at its meetings on 26/27 February and 19/20 March 1980 and adopted the motion for a resolution and the explanatory statement on 27 March 1980 by 10 votes for, 1 against and 1 abstention.

Present: Mr Delors, Chairman, Mr Balfour, rapporteur;
Mr J. Moreau, Mr Ruffolo, Mr Purvis deputizing for Miss Forster,
Mr Hopper, Mr Beazley deputizing for Sir Peter Vanneck, Mr Herman
deputizing for Mr Tindemans, Mr von Wogau, Mr Bonaccini, Mr Fernandez
and Mr von Bismarck.

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Annex: Motion for a Resolution tabled by Mr Debré, Mr Lalor and
Mr Nyberg. (Doc. 1-417/79)

The Committee on Economic and Monetary Affairs hereby submits to the European Parliament the following motion for a resolution, together with explanatory statement:

MOTION FOR A RESOLUTION

on the increase in oil prices

The European Parliament,

- having regard to the draft resolution pursuant to Article 25 of the Rules of Procedure on the increase in oil prices (Doc. 1-417/79);
 - having regard to the report of the Committee on Economic and Monetary Affairs (Doc.1-61/80);
1. notes that in 1979 the prices of petroleum products imported into the Community again rose rapidly;
 2. underlines the adverse effects of this rise in oil prices on the already fragile economies of the Member States, with regard to inflation, unemployment and rates of economic growth;
 3. observes that the rise in the price of petroleum products on the spot market since the beginning of 1979 has been even greater than those in mainstream inland markets;
 4. further observes that spot prices have been consistently more volatile than oil prices in general in both an upward and downward direction, that spot prices before the end of 1978 were **generally lower than in other** oil product mainstream markets and that there are now indications that the gap between spot and mainstream market prices is beginning to close;
 5. points out that the rise in oil prices is due to a number of important factors, including the sudden shortfall of supplies from Iran and subsequent actions taken by producing countries, and that the industrialised countries have failed to adapt sufficiently to earlier price rises;
 6. further points out that the price of petroleum products to the consumer can also be strongly influenced by differing government fiscal policies;
 7. recognises additionally that some link exists between the rise in prices on the spot market for petroleum products, and oil prices prevailing elsewhere;

8. emphasises, however, that the spot market fulfils a number of functions, among which are the balancing of supply and demand at the margin, the furnishing of supplies for independent companies and as a frequently used, if sometimes imperfect, open market reference point for pricing decisions taken by consumer governments and by enterprises;
9. further emphasises that the spot market is especially significant for particular products due to their technical and marketing characteristics, and also for particular Community countries;
10. notes that the Commission has given priority to measures ensuring more complete information on, and better transparency of, the oil market and that it has commenced an analysis of the spot markets of north-western Europe and the Mediterranean area in order to provide a clearer picture of the working of that market.
11. also notes that the Council has adopted two regulations introducing registration for imports of crude oil and petroleum products;
12. strongly supports measures to provide for greater transparency of the spot market, and clearer indications of prices charged and volumes traded;
13. cautions, however, against the possible setting-up of a system of price controls, the regulatory distortions of which would outweigh the possible advantages;
14. points out that the above measures represent only one element in a much wider energy problem which must be tackled if the energy constraints on the Community's economic development are to be lessened;
15. strongly calls for the implementation of common energy policies, among whose central elements should be
 - agreed **target levels of oil imports**
 - an increased commitment to energy conservation
 - the development of alternative energy sources;
16. points out finally that longer term **structural adjustments** will be needed within the Community;
17. instructs its President to forward this resolution and the report of its committee to the Council and Commission.

EXPLANATORY STATEMENTBackground

1. The motion for a resolution in question asks the Council to examine without delay the regulations which are being envisaged to prevent the increase in oil prices on the Rotterdam market, alleging that it is the 'constant' and 'uninhibited' speculation on this market which encourages certain OPEC member states to continue raising their prices. To do justice to this question, however, one must first look at it in its wider context.

Rises in oil prices

2. After the great rise in oil prices in 1973 and 1974, which caused such a shock to the economies of the oil importing countries, prices stabilised and at times even declined in real terms in the period 1975 - 1978.

In late 1978, however, the Iranian crisis helped to spark off a further rapid rise in the price of oil, which culminated in rises involving all OPEC countries by late June. From 31 December 1978 to 1 July 1979, the nominal reference price of crude oil increased by almost 42 per cent, from \$12.70 per barrel to \$18 per barrel. Other categories of crude oil, subject to premiums over and above the price of Arabian light, reached \$23 per barrel. The dollar price (fob) per barrel of imported oil increased almost 60 per cent between 1978 and 1 July 1979. The increase in the cost of imported oil from 1978 to 1979 amounted to 0.5% of Community GDP in 1979.

3. The relationship between crude oil prices and the prices of petroleum products is also dependent on the differing duties and taxation systems in Community countries, and adjustments are lagged over weeks and sometimes months. The effect of duties and taxes can be considerable: in one country, Denmark, duties and taxes represented about 65 per cent of the price of petrol to the consumer in 1979 and 34.7% of the price of domestic fuel.

4. It would certainly be useful to have a clearer idea of the various reasons for the considerable divergences between Member States consumer prices. In this context the Committee on Economic and Monetary Affairs awaits with interest the forthcoming Commission study on the structure of petroleum prices within the Community, and in particular into the ways crude oil prices are transmitted into ultimate consumer prices.

5. The main cause of the latest oil price rises was the situation in Iran, from which oil exports were suspended for two months in early 1979 and which were ultimately resumed at a much lower level than previously. Increased demand in a severe winter accentuated short-term shortages. Subsequently, however, the producing countries have been able to maintain upward movements in prices, in spite of the divisions in OPEC ranks.

A major contributing factor has been the realisation that the industrialised countries, while they have adapted to the previous rise in oil prices, have not adapted sufficiently. Conservation has not gone far enough and alternative sources of energy are still not sufficiently competitive, and the largest economy of all, that of the United States, is more import dependent for oil products than it was prior to 1973. So, insecurity of supply and insufficient fall-off in demand are contributing to a state of shortage which may be of considerable duration.

6. The adverse effects of recent rises in oil prices scarcely need to be listed. A number of these consequences have been spelled out in the previous report of the Committee on Economic and Monetary Affairs on 'the effect of increased energy prices on Member States' productivity and competitiveness' (Doc. 431/75). The most recent price rises have clearly weakened an already weak economic situation in the Member States of the Community.

Recent price increases in the Rotterdam spot market

7. Prices in the so-called 'Rotterdam' or 'spot' market, have, at different times, been both below (1974-78) and above (1979) the level in the inland mainstream markets. In the first eight months of 1979 the fob petroleum price of crude oil imported from outside the Community rose by 57%, and prices on the Rotterdam market for oil products rose by over 95 per cent. Between January 1978 and March 1979 most product prices in European spot markets more than doubled, and in the case of Naphtha, went up 2½ times. The gap between Rotterdam prices and those of petroleum products in inland mainstream markets widened considerably.

The Commission Market Analysis (COMMA), which is currently being carried out, has shown that spot prices for gas oil were 16-51% above consumer prices in November 1979, and 3-43% for premium gasoline, though the study points out that the relationship between spot prices and EEC consumer prices 'showed changes throughout the period and country by country', with consecutive convergences and divergences.

These recent developments have attracted renewed attention to the spot market in oil products and greatly increased calls to establish some form of controls.

It is worth noting, however, that the gap between Rotterdam and other prices has again narrowed considerably in recent months.

Rôle and structure of the Rotterdam market

8. A quick sketch of the role and structure of the Rotterdam spot market is needed to put these criticisms into perspective.

9. The use of the name Rotterdam itself is merely a convenient shorthand to describe trading activities which can take place anywhere in the world. Rotterdam's port and storage facilities and giant refineries has ensured that it has been at the centre of such activities. But no actual Exchange exists as such.

10. Most of the oil needed in Europe goes through the integrated system of the major oil companies or else are sold under long-term contract. A much smaller percentage is traded on the spot or Rotterdam market.

11. According to a recent attempt at definition (in the Petroleum Gazette of September 1979), 'the spot market has had four main functions:

- to take marginal quantities from, or supply them to, the integrated systems;
- to take speculative positions, and to buy for stock, speculating on seasonal price movements;
- to mobilise supplies from outside the major integrated supply systems;
- to act as a source for non-integrated customers, such as independent refineries'.

12. The Rotterdam spot market has been concerned primarily with the buying and selling of petroleum products rather than with crude oil as such.

It is worth pointing out in this context that since crude oil transportation costs are much lower, the crude spot market is more truly world-wide than the spot market for oil products, which is more regionalised for transportation cost reasons.

13. The main products traded are gas oil, which is by some way the most significant in terms of volume traded, fuel oil, Naphtha and mogas. Technical (such as storage requirements) and marketing characteristics (such as the existence of independent distribution systems for the end product) help to determine the importance of spot trade for a particular product. The degree of responsiveness of the market, however, is indicated by its constantly changing structure.

14. A number of western European countries make significant purchases on the spot market, but by far the largest customer is West Germany which relies heavily on imports through independent traders. This is particularly the case for gas oil for heating purposes. Furthermore, in late 1977, the network of independent German petrol stations covered 15-20 per cent of the country's consumption, and of that total Rotterdam petrol covered between one-third and one-half of total requirements.

Sources of supply for the spot market include export refineries in Italy and elsewhere in the Mediterranean, and also in the Caribbean, surpluses from the refineries of the major oil companies and supplies from the centrally planned economies, in particular the Soviet Union.

15. The trading companies themselves have had a very high turnover with new ones being set up by employees of existing companies, and many failing to survive. Very few completely independent traders are still in existence, and many have links with major organisations, including the large oil companies themselves.

16. The actual size of the spot market is both variable and difficult to estimate. The amount of trading activity is characteristically higher than the volumes traded, since many cargoes are traded several times over, especially in periods of particularly unstable marketing conditions.

Only a small percentage of western European demand is met on the spot product market. The exact percentage (and whether this is increasing or decreasing?) is somewhat unclear, but has been estimated as low as three per cent of the western European requirements for oil products. Transactions which are of a purely speculative nature, account for only a small fraction of this percentage.

The recent Commission market analysis seems to indicate that, when comparing this year's results for North-west Europe with those for last year's checkrun, 'the real share of the spot market in meeting overall demand appears to be considerably less than in the past, maybe no more than half of last year's level'. It also indicates that 'reduction in market throughput is to be expected in a tight market since, in order to maintain volumes companies will tend to balance at the margin by exchange rather than spot purchase'.

The spot market for crude, on the other hand, is a world-wide activity, and cannot be identified with any regional spot market for products (like Rotterdam). Consequently there is no reliable statistical base for comparing the volume of spot purchases of crude which flow through the Rotterdam market. The total percentage of crude purchases worldwide, which are made on the spot market, is difficult to quantify, for there is no satisfactory definition of spot sales of crude. However, the total spot market for crude has been estimated as high as 20% of the total in 1979.

Implications of this structure

17. A number of important generalisations can be made:

- the name 'Rotterdam' itself is somewhat misleading in describing the spot market for oil products;
- the market is relatively small: only a small percentage of western European demand is met on the spot market;
- the Rotterdam spot market deals with buying and selling of oil products on the margin. Sharp fluctuations in prices are common, and both upward and downward movements of prices are likely to be more accentuated than mainstream inland prices. For several years there were surpluses. Rotterdam prices were lower than inland prices and were seen as benefitting the consumer. Now there are shortages of uncertain duration. However, there are already indications that the gap between Rotterdam and other prices is beginning to close again;
- trading activity on the Rotterdam spot market has been a risky business, and great losses as well as profits have been made;
- the Rotterdam spot market clearly fulfils a number of very important functions, and the speculative element is but only one facet of the market. A key function has been to furnish supplies for independent companies. The market has also played a crucial role for the major oil companies by providing for balancing of supply and demand within the integrated systems themselves;
- Rotterdam spot market quotations have also been used as price indicators for marginal supplies in the market, for purposes of government price controls, and also for purposes of monitoring of internal company transfer prices. For these purposes it may be flawed, but there are no obvious alternatives.

18. This last point leads naturally to the key question about the extent to which spot prices affect the market for petroleum products as a whole, and what measures, if anything, should be taken to deal with the situation.

Effect of spot prices on the market as a whole

19. The price impact of the spot market for products is inevitably greater than the mere size of the spot market alone would appear to warrant. It has a psychological impact on public opinion in consumer countries. In addition it is also claimed that it influences price expectations among governments of the oil exporting countries, who have recently seen free market prices for products rising at a faster rate than the prices at which they have been selling their crude. It is unclear to what extent a reverse set of circumstances influence the attitude of such governments.

Furthermore, long-term contracts have clearly been influenced by prices prevailing in the spot market: there appears to be a measure of formal and informal linkage between the pricing of bulk supplies and spot prices. Transfer prices within companies may also be linked.

In addition, as mentioned above, government price controls have, in some Community countries, been strongly influenced by spot prices.

All this may have led to some bias in prices in both directions. The precise extent of this bias is highly arguable, and during 1979 prices would clearly have risen sharply in the complete absence of a spot market.

Possible measures

20. Complaints about the workings of the spot market have come not only from some governments but even from some companies (such as the memorandum sent by five oil companies to the Commission in 1977).

21. The proposals put forward have taken two main forms:

(i) a system of formal controls, by providing for price controls, or by giving a monopoly of spot market transactions to an appointed body of brokers;

(ii) measures to provide for greater transparency.

22. The response to the proposals for formal controls has been very varied, and related to the differing philosophies towards controls prevailing in each Member State, as well as to the differing structures of their internal markets. But the opponents of controls have so far prevailed, though the energy ministers have asked the Commission to come up with proposals for the

for the setting up of an international oil Exchange for spot trading of crude and oil products. To this end the Commission has established a working party of experts, the results of whose study will be available later.

23. The whole question of price controls for oil products is a difficult one. On the one hand, the rise in prices, accentuated by trends in the spot market, and which has come in sudden jumps rather than steadily, has been harming the already fragile economies of the Member States.

On the other hand, price controls can have severe distorting effects, and, if prices are kept artificially low, this could discourage the needed adaptations away from the dependence on oil. Indeed, the Committee on Economic and Monetary Affairs has pointed out the advantages for setting up a minimum price for imported crude oil (Burgbacher opinion, PE 44.311/fin). In addition, the St Geours report 'in favour of an energy efficient society' has pointed out some of the problems inherent in price regulation and underlined 'that it would be better to tend towards a system in which energy prices could properly reflect the true replacement costs of the supply industry, and in which the social consequences of higher energy prices were dealt with through the normal means of redistributing wealth', such as through income transfers and specific subsidies.

A further difficulty with price controls on the Rotterdam market is that trading activity similar to that centred in Rotterdam can be carried on outside the Community.

24. The measures to provide further transparency, however, deserve support.

It is clearly vital to get an idea of how prices have been arrived at, such as whether they reflect trends based on a large number of transactions or merely a small number, or else large or small transactions. The marginal nature of the spot market has meant that some product prices rising particularly sharply may be based on very small volumes actually traded. This could lead at least to the possibility of price manipulation.

25. In the past these prices have been reported by private news services (and one in particular) as a result of regular market assessments and these have become 'Rotterdam prices' for particular products, not just for traders but for the world at large.

The Commission, after an initial check run last year, in which it compared prices reported by the private services with its own monitoring of spot price transactions, has now launched a second study of spot prices, (COMMA or Commission Market Analysis) initially of a one year duration, with broader geographical scope (north-western Europe and the Mediterranean) and also covering a greater number of companies and trading firms than before. (58 instead of 33) The participants will make

weekly reports of open market transactions and prices and, very importantly, volumes traded will then be analysed. This study should provide for a greater understanding of the structure of the spot market.

The Commission has also begun to publish weekly reports on consumer prices for the main oil products, exclusive of tax.

26. The Commission has also outlined some other possibilities in its recent communication to the Council on the transparency of the oil market (COM(80)74 fin.).

A 'quick response system' to provide a limited volume of information on an accelerated basis is being considered on a 'switch-on, switch-off' basis in periods of particular market tension.

Finally the Commission recommends that, in the interests of transparency, the possibility of introducing a system of certification of fob prices for crude oil should be studied with a view to subsequent discussions with producer countries.

27. The Committee on Economic and Monetary Affairs strongly supports these various efforts to ensure greater transparency and measures to improve the working of the spot market. On the other hand, while it feels that greater price stability is desirable, it believes that the distorting effects of setting up a system of maximum prices would outweigh the possible advantages and would therefore counsel against such measures.

The wider context of energy policy

28. The rise in oil prices is accentuating an already bad economic situation in the Member States, helping to spur inflation and unemployment and curb economic growth. The problems posed by the Rotterdam spot market represent only one element in a much wider energy problem which can only be mitigated through the formulation of effective energy policies for the whole of the Community. Among the central elements in such a strategy must be:

- a greater Community discipline with regard to the level of oil imports;
- an increased commitment to energy conservation;
- the development of alternative energy sources.

29. These points have been recently underlined by the Commission and have also been emphasised by the Committee in its previous report (Doc. 431/75) on the effect of increased energy prices on Member States' increased productivity and competitiveness, of which paragraphs 17-22 of the motion for a resolution attached particular importance to the securing of energy supplies by way of a common energy policy. That report also dealt in considerable length with the production and structural adjustments which were called for within the Community.

30. In June 1979 a panel of independent experts established by the Commission, and chaired by Mr St. Geours, produced its report 'in favour of an energy efficient society' whose main theme was the 'disassociation' of the hitherto generally close relationship between economic growth and growth in energy consumption.

31. The Commission is also looking at the possibility of some form of energy tax or levy, though the form this might take has not yet been made clear.

It is only by a combination of realistic short-term policies and fundamental and imaginative readjustments in the long-term, that the energy constraints to the achievement of the Community's economic goals can be lessened.

ANNEX

MOTION FOR A RESOLUTION (DOCUMENT 1-417/79)

tabled by

Mr DEBRÉ, Mr LALOR and Mr NYBORG

on behalf of the Group of European Progressive Democrats

with request for urgent debate

pursuant to Rule 14 of the Rules of Procedure

on the increase in oil prices

The European Parliament,

- having regard to the constant rise in oil prices,

1. Invites the Council to examine without delay the regulations which are being envisaged to prevent the increase in oil prices on the Rotterdam market, since it is the constant and uninhibited speculation on this market which encourages several of the member states of OPEC to continue raising their prices;
2. Instructs its President to forward this resolution to the Council.

JUSTIFICATION

The urgency of the motion is self-explanatory.