

Facing oil challenges

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PURPOSE: to face the challenge of higher oil prices.

BACKGROUND: in recent months, oil prices have experienced a sharp and abrupt increase, reaching their highest level, in real terms, since the end of the seventies. Consumer fuel prices have been increasing sharply in the EU following the crude oil price trend. The current surge in oil prices is largely the result of a major structural shift of oil supply and demand in the global economy: oil consumption in OECD countries is declining; demand growth in the rest of the world is led by emerging economies, in particular China and India; demand in many countries is underpinned by existing subsidies for fuels; oil production in the short term is unlikely to keep pace with sustained strong demand; the number and size of new oilfields is shrinking; the largest potential for further oil production expansion is concentrated in the Middle East and OPEC countries, where state-run companies dominate extraction and production; refinery bottlenecks and capacity constraints have also negatively influenced level of supply. The weakening of the dollar has also contributed to pressure on oil prices.

Estimates indicate that the **current high oil prices will have long-term impacts, reducing growth and increasing inflation in the EU economy.** Through higher input and transport costs, high fuel prices increase food prices. These high price levels are squeezing the purchasing power of all EU citizens, with the most severe impact on the lowest income families, and putting a strain on business. Energy intensive sectors, as well as transport and agriculture, and in particular fisheries, are most affected and face a difficult adjustment process. Globally, higher oil prices imply a sizeable income transfer from oil-consuming to oil-producing countries, and this from the EU to a small number of third countries.

CONTENT: according to the Commission, the response of the EU to recent increases in oil prices should be **based on the assumption that prices are likely to remain high in the medium to long term.** This implies the need for structural adjustment, which needs to be accelerated to produce its positive effects as soon as possible. At the same time, the **short term effects on some vulnerable groups should be mitigated,** helping them to adjust to the new market situation. Great care should be exercised over proposals to offset oil price increases by tax cuts. The most likely effect would be to transfer revenue from consumers to the oil supplying countries, aggravating global imbalances. This could be followed by further price increases and would distort the functioning of the single market, undermining EU efforts to improve energy efficiency.

The major policy response must be to make the **EU more efficient in the use of energy, and less dependent on fossil fuels.** Increased oil prices should spur the EU to implement its **integrated energy and climate change policies.** Despite near term difficulties being experienced by certain sectors of the EU population in meeting rising energy bills, solutions can only come from completing shifts in energy demand and encouraging energy efficiency throughout the economy. Short-term palliative measures that Member States may take should be well targeted and should not lead to distorting effects on the internal market.

Against this background, the Commission recommends to the European Council to:

- confirm its determination to **adopt legally binding measures** to give effect to its 2020 targets for renewables, biofuels and greenhouse gas reductions by the end of 2008, which are essential to improve substantially energy efficiency and the diversification to the EU energy supply;
- step up the drive for **energy efficiency in business and in private households** so that quicker and greater savings can be achieved in line with agreed objectives;
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- note that the forthcoming strategic energy review on security of supply and external energy policy, will also report on the functioning of the oil and petroleum markets. In addition to a proposal to **improve the transparency of emergency oil stocks** the Commission will also report on the feasibility of requiring greater transparency on commercial oil stocks;
- note that the Commission is examining options for revising the energy taxation directive and will shortly propose to **amend the Eurovignette Directive** as part of the wider drive to support greater energy efficiency;
- note the Commission's intention to report on the possible use of tax incentives, including reduced VAT rates to encourage energy savings;
- support the organisation of a **high level meeting on oil markets** between main oil producing and consuming countries and strengthen existing regional and bilateral dialogues in order to achieve better market access and transparency;
- agree that Member States could provide targeted support when justified to **vulnerable households**;
- agree that Member States could make available targeted **financial support for the most affected entities** provided this aid is used to support industrial redeployment, retraining or restructuring measures.. Furthermore, any measures taken to alleviate the immediate impact of high oil prices must be proportionate and accelerate longer term adjustment to a low carbon economy;
- agree on the need to **restructure the fisheries sector** while taking care of the economic and social repercussions. The Commission will shortly make proposals for urgent measures to help ensure the survival of those segments of the European fleet that are most vulnerable;
- agree to **assist net oil importing developing countries** to mitigate the short term impact of high oil prices, to improve their energy efficiency and to develop alternatives to fossil fuels, as part of the EU's and Member States' overall development policy and assistance programmes.