COUNCIL OF THE EUROPEAN UNION

Brussels, 9 October 2008

13266/2/08 REV 2

ECOFIN 348
UEM 169
ENER 269

NOTE

from:	The Presidency
to:	The European Council
Subject:	Report by the Presidency, in cooperation with the Commission, on the situation on oil markets, and short- to medium-term measures in response to the surge in oil prices

Delegations will find attached **a revised version** of the report by the Presidency, in cooperation with the Commission, on the situation on oil markets, and short- to medium-term measures in response to the surge in oil prices. This report was prepared following discussions in the Economic and Financial Committee and revised following discussions in the Permanent Representatives Committee and in the Ecofin Council.

Encl.:

Report by the Presidency, in cooperation with the Commission, on the situation on oil markets, and short- to medium-term measures in response to the surge in oil prices

The European Council of 19 and 20 June 2008 expressed concern with regard to the continued surge in oil and gas prices and their social and economic consequences. It agreed on further work to be done and on actions to be undertaken and invited the French Presidency, in cooperation with the Commission, to report before the October European Council on this issue.

Against this background, the Presidency established a roadmap for the Ecofin Council on oil-related issues, with three main items falling under the core competence of Finance Ministers:

- the functioning of the markets;
- the role of financial instruments to improve energy efficiency, to promote the use of renewable energy sources and to foster a more environmentally-friendly use of fossil fuels;
- and the feasibility and the impact of measures likely to relieve the effects of the surge in oil prices.

This report builds on the work already undertaken within the ECOFIN Council and complements the work undertaken in other Council formations, notably as it relates to the energy and climate change strategy of the European Union (Energy Council, Environment Council, GAERC, etc…).

It concentrates on measures which are applicable in the current context and can be applied without delay. Other measures have been proposed in the field of taxation (VAT, tax on speculation…), notably to smooth the effects of a rapid surge in prices. Such initiatives would in any case require further studies.

1. **High oil prices are set to prevail in the medium and long term in the face of continued strong demand from emerging economies and supply constraints**

Oil prices show strong volatility. Oil prices reached an all-time high in early July, before falling back to around $100 per barrel by the end September.

High oil prices are to a large extent the result of a structural shift in oil supply and demand, rather than a temporary phenomenon. More specifically, oil supply capacity has had difficulties to keep pace with sustained strong demand growth, driven particularly by the emerging economies. **Financial markets are, however, likely to have played a role** in amplifying recent oil price movements and in increasing their volatility, as recently seen again on September 22–23.

In this context, **while the recent fall in prices is welcome** as it will relieve some of the pressure on consumers, who will regain purchasing power, and on companies, shifts in oil prices can be quite unpredictable.

At current levels, oil prices still remain high but it would be unwise to base policy on the assumption that prices will return to much lower levels. Therefore there is an **urgent need to focus on policy measures aiming at ensuring long term energy security for Europe**.

In this context, finalising the work on the Commission's proposals on renewable energy and climate change submitted in January 2008 is of paramount importance. These proposals, for which Member States committed to reaching an agreement in the Council before the end of 2008, will promote a diversification of our energy supply away from fossil fuels, including oil, create strong incentives for a less-intensive use of carbon-based energy sources and will thus reduce our consumption and dependence on oil in the longer term.

On the demand side, further energy efficiency improvements and behavioural adjustments are necessary. Thus, it is essential to continue to pursue an active policy to improve energy efficiency both at EU and Member State level. The Commission has already proposed or is about to propose a series of measures aiming at shifting current patterns of energy use at Community level, a policy which should be pursued with continuous ambition. Against this background, achieving the 20% energy saving target requires first, rapid decisions by the Council and the Parliament and second, vigorous action by Member States, to ensure the full implementation of the measures adopted.

The dialogues with key oil producing countries need to be strengthened. The objective is to improve the investment climate and to make these markets more transparent. Similarly, energy dialogues with major oil consuming countries need to be intensified. In particular, they should draw the attention to the fact that fuel subsidies distort incentives to move towards greater energy efficiency.

It is also crucial in the short to medium run to aim at reducing price volatility and to address the concerns of the more vulnerable parts of the population, while preserving the long term goal of moving towards a low carbon economy.

2. **To help reduce volatility on the markets, the EU is committed to make them more transparent by increasing the information given to the markets**

Efforts to enhance the availability and quality of oil market data are critical to enhance market transparency and could help reduce price volatility. At the global level, the Commission (Eurostat) has been actively involved in efforts to create *a common global database (JODI*). The objective is to improve "participation, timeliness, completeness, quality and accessibility of data". The database was released by the end of 2005, but remains work in progress. It should be vigorously pursued.

Also, following the agreement reached in July by the Ecofin Council, the European Council could welcome the Commission's commitment to rapidly make a concrete proposal for a weekly reporting of commercial oil stocks in the EU. The European Council could welcome too the intention of the Commission to make a regulatory proposal in the framework of the forthcoming directive on emergency stocks by mid-November. In order to implement this proposal, the Commission will undertake its usual cost benefit analysis and will endeavour to ensure reliability of data. In addition, before the implementation of a regulated system, the European Council could invite the Commission to formally ask before the end of the year the oil companies to voluntary introduce a weekly publication of commercial oil stocks.

3. **Short term and targeted measures to smooth the effects of rising oil prices on the most vulnerable have been taken at national level**

High oil prices reduce the global purchasing power and especially of the most vulnerable persons.

While policy interventions that blunt the price signal, and hence prevent the necessary adjustments should be avoided, short-term targeted action by Member States to alleviate the impact of high oil prices on the most vulnerable households can be taken to help them face the extra burden on their budgets. In particular, measures providing low-income people with a lump sum amount to compensate for the rising costs of their heating bills ("domestic fuel fund", "aide à la cuve", …), or increasing social transfers so as to compensate for the rising energy costs – are being implemented or considered and can be warranted.

4. EIB financial instruments can contribute to the comprehensive action of the Union especially on energy efficiency

4a. Commission-EIB joint actions to support investments in energy efficiency, renewable energy sources and more environmentally-friendly use of fossil fuels

The European Council could consider three possible courses of action by the European Commission the EIB Group and the EBRD, where appropriate, in order to support investment specifically in the fields of (i) energy efficiency, (ii) use of renewable energy sources, and (iii) more environmentally-friendly use of fossil fuels:

- (i) The Commission in cooperation with the EIB could determine the appropriate financial instruments in order to improve energy efficiency and renewable energy project identification and implementation. This action could notably be targeted towards municipalities and SMEs.

- (ii) In order to accelerate the development and deployment of cost-effective low carbon technologies, the Commission could step up the implementation of the European Strategic Energy Technology Plan (SET-Plan). It could analyse the deficiencies, identify gaps in the current range of instruments financing low carbon technologies and propose new measures to overcome them.

- (iii) As requested at the Nice informal meeting, the EIB and the Commission have set up a working group, also with European institutional investors. The Council could request proposals to be worked out by the December Ecofin to pool together the investment capacity of EU long term institutional investors around the EIB for a European initiative to support energy, climate change and infrastructure projects through equity, quasi-equity and similar financial products to complement, on a large scale, their existing lending capacity, and without recourse to national budgets.

The primary focus of these actions is on the EU 27 Member States, candidate countries and potential candidate countries. However, an extension to other regions could be considered, in particular focusing on Neighbourhood countries.

4b. EIB financial instruments can contribute to the comprehensive action of the Union especially with increasing focus on energy efficiency

The European Council could ask the EIB to enhance its involvement in developing sustainable, competitive and secure energy supplies for Europe and develop a new strategy and new instruments in favour of energy efficiency.

The development of sustainable, competitive and secure energy supplies is already one of EIB's priority lending objectives. In particular, progress seemed strong in recent years as the initial EIB's lending target for 2007 for energy was exceeded to reach €6.8 billion of loans.

The European Council could also ask EIB to take further steps:

- **increasing its lending targets in energy, with a minimum floor for low carbon energy projects.** The European Council could invite the EIB to propose further increasing its energy targets in view of its next Corporate Operational Plan for 2009 to 2011 and invite the EIB to set a **minimum floor that at least 20% of energy projects in the EU should cover renewable energy projects**. In addition, and, regardless of this target, the Bank should seek to maximise the proportion of its projects associated with low carbon technologies and promote low energy consumption projects.

- **reinforcing its global strategy in favour of energy efficiency, both in favour of households, public authorities and of companies (in particular SMEs).** This includes mainstreaming energy efficiency considerations systematically in all projects, as well as proposing new financial instruments, for example in cooperation with the member states existing programs. This would imply some actions in the EU but also outside the EU to promote energy efficiency and renewable energies in less advanced economies;

- **defining a methodology by end 2008 to quantify the volume of greenhouse gas emissions produced by its projects,** including an assessment of the longer-term consequences of its transport projects. Once the methodology is established, the EIB should start measuring and reporting on the greenhouse gas emissions produced by its projects, wherever feasible;

The European Council could ask the EIB to focus on the following matters of priority:

- **Improving energy efficiency in every day life**. Sectors like building or public lightning have high potential for energy saving. In close cooperation with the financial sector, the Bank could set up a new policy of intervention in those areas and propose expansion of new financial instruments.

- **Investing in Research Development and innovation**. EIB could reinforce its support to the development of low carbon technologies, including large-scale demonstration projects for Carbon Capture and Storage (CCS) and demonstration projects for innovative Renewable Energy technologies. EIB could increase its activity in favour of private innovative industry and participate in strategic EU projects in this field.

- **Developing carbon market**. Ensuring the development of an efficient carbon market, particularly for the post-2012 period is essential. EIB should remain one of the key investors in this field and play a role to enhance the supply side of the carbon market.

- **Security of energy supply and distribution**. EIB should continue its support to the development of energy transmission infrastructure, regional electricity interconnection, gas pipelines, gas storage and LNG terminals as well as to cooperate with financial sector to develop the dedicated financial instruments aimed at supporting such investments, including for external supply.
