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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL  
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

**Facing the challenge of higher oil prices**

# COMMUNICATION FROM THE COMMISSION

of 13.6.2008

## TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

### Facing the challenge of higher oil prices

#### 1. INTRODUCTION

The world has enjoyed a long period of growth in the past decade. Globalisation and the development of big emerging economies like China and India have helped lift millions of people out of poverty and onto the road to prosperity. The EU has also benefitted, expanding markets for its goods and services and creating new jobs for Europeans. However, much of this growth has been built on the assumption that the raw materials needed to underpin increased consumption would continue to be easily accessible and in abundance. It is becoming increasingly obvious that many raw materials are not inexhaustible and the pressure of increased demand will drive up prices for those which are in scarce supply. This realisation has been brought vividly home to all of us recently as food and oil prices have escalated. While there is clearly a need for short term action by governments to cushion the impact on the most vulnerable parts of our society, there is also a clear need for a longer term shift to more sustainable ways of producing and consuming. The EU has been at the forefront of delivering this message in its calls for action to combat climate change. There are sound security, economic, social and environmental reasons for promoting greater energy efficiency together with the development of sustainable alternatives to fossil fuels. The purpose of this Communication is to provide a basis for discussion in the European Council and with the EU's partners and stakeholders on how we can adjust to living with higher oil prices in the coming years. There is a clear link between the analysis and recommendations set out in this paper and in the Commission's recent Communication on food prices<sup>1</sup>. Taken together, they offer a framework to help Member States cope with the immediate impact of dramatic price increases and medium/long term ways of adjusting to new resource constraints so as to turn challenges into opportunities.

International oil prices have recently reached an all-time high. 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. For example, the increase in average oil prices this year from

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<sup>1</sup> COM(2008)321.

2007 levels would translate into an increase of some €80 billion in the annual transfer of EU income to oil producing countries.

Although the share of energy costs in its GDP has decreased, the EU economy is more dependent on imported oil today than it was in 1995<sup>2</sup> and is thus more exposed to the impact of price changes. When price spikes occurred in the past, they were mostly the result of temporary factors: this time, high oil prices stem from a structural change in the balance between supply and demand for oil in the global economy so high oil prices are likely to prevail in the medium to long run.

The EU has anticipated this structural shift in its decisions to move towards energy saving, the development of renewables and becoming a low-carbon and highly energy efficient economy, less dependent on imported supplies. Taking decisive action now will enable the EU economy to maintain its competitiveness and flexibility in the globalised market for products, services and commodities. It will also provide opportunities for research, innovation and investment that can be exploited by EU companies.

The policy response to the current high oil price shock should therefore be one that facilitates these adjustments and prepares the EU economies to adapt to the new oil price environment. This process should be accompanied by effective measures to cushion the short term impacts of these adjustments on the most vulnerable in our society. However, we must also learn from the mistakes of the past so such measures should be targeted and avoid creating new distortionary effects. At the same time, the security of the EU's energy supply must be guaranteed in order to reduce vulnerability to possible further price fluctuations on the international market.

## 2. THE OIL PRICE SPIKE

*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.* At the end of May, Brent crude oil was traded at around \$132 per barrel, more than double the levels of a year ago. The average oil price for the first 5 months of 2008 stood at \$105 compared to an average of around \$73 per barrel in 2007, when prices had already tripled compared to the level of 2002 (\$25). Exchange rates movements, and in particular the depreciation of the dollar, have somewhat mitigated the impact of these increases on the EU economy. Nevertheless, by May 2008, prices in euro were 90% higher than at the beginning of 2007.

*Consumer fuel prices have been increasing sharply in the EU following the crude oil price trend.* Although the percentage increase is smaller for consumer prices due to the share of taxation, average consumer prices in EU-27 have increased for petrol (Euro-super 95) by 6 %, for diesel by 14 % and for heating oil by 17 % since the beginning of the year. In certain sectors such as marine fuel and fuel used for air transport, which are untaxed, the percentage increases have been higher.

*Coal and gas prices have followed, rising as fast as or faster than oil prices over the past 12 months.* This means that high oil prices have translated into high energy prices, putting utilities around Europe under pressure to raise their prices.

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<sup>2</sup> In 2007, the EU's energy dependence rate for oil rose to 82.2% compared with 74.4% in 1995. Eurostat, Energy, transport and environment indicators, 2007 edition.

*Current real price levels stand above the peak level reached in the early 1980s.* The evolution of crude oil prices<sup>3</sup> shows that high prices are not rare occurrences. However, in 2001, real prices, having remained at a constant level for more than a decade, began a steady upward movement, with a sharp acceleration in 2007. Analysts predict that prices may remain high or rise further in the coming months.

### **3. WHY HAVE PRICES INCREASED? A COMPLEX INTERPLAY OF DEMAND AND SUPPLY FACTORS**

#### **3.1. The current surge in oil prices is largely the result of a major structural shift of oil supply and demand in the global economy.**

Constant or even slightly contracting oil supply is struggling to keep pace with rising global demand. Previous oil price shocks, such as that of the 1970s, had been induced by supply restrictions imposed by producing countries. This time a complex set of demand and supply factors is interplaying, pushing up prices.

*Oil consumption in OECD countries is declining.* Slower economic growth, higher prices and energy efficiency policies account for the decrease in demand from OECD countries since 2005. The International Energy Agency expects this trend to continue in 2008.

*Demand growth in the rest of the world is led by emerging economies, in particular China and India.* Net oil imports in these two countries combined are projected to increase from 5.4 million barrels/day (mb/d) in 2006 to 19.1 mb/d in 2030 – more than the current combined imports of the United States and Japan<sup>4</sup>. Demand is also rising fast in producing countries in the Middle East and in Asia. Non-OECD demand growth in 2008, stands at 3.7% or 1.4 mb/d. Economic growth and additional revenues from oil exports account for this increase.

*In addition, demand in many countries is underpinned by existing subsidies for fuels,* designed to protect domestic consumers from soaring prices. They have high costs for public finances, diverting resources from longer term development and growth policies. Some countries have signalled their intention to discontinue or reduce price controls or subsidies (Malaysia, India, Indonesia, Taiwan and Thailand). For the time being China is maintaining price caps in order to limit inflation.

*Against this background, oil production in the short term is unlikely to keep pace with sustained strong demand.*

*A wide range of constraints and uncertainties influence the extent and speed at which spare capacity can be put into production.* Many existing oil fields have reached maturity, and have declining output capacity. The IEA estimates that an additional 3 million barrels per day of new supply are needed each year to offset the decline in existing supply.

*The number and size of new oilfields is shrinking.* Stable low prices in the past and uncertainty about the future level of demand have reduced exploration for new oilfields and limited investment in technology. Drilling new oil fields and putting them into production is costly and requires a long lead-time. The cost of developing an oil field today is twice as high

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<sup>3</sup> The OPEC basket, which is very close to the EU 27 crude oil supply cost.

<sup>4</sup> International Energy Agency, World Energy Outlook 2007.

as three years ago. Much of the potential new fields are in "unconventional deposits", in areas difficult to reach, such as tar sands or oil shale. High extraction taxes imposed by some producing countries can also become a disincentive for new upstream investments. In other words, higher prices are today required to support development of new supplies. In addition to cost considerations, exploitation of "unconventional deposits" would have highly negative environmental impacts, including higher green-house gas emissions compared with conventional sources. A further complication is the shortage of equipment and personnel with the necessary technological qualification and engineering skills to work on new explorations.

***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.***

Nationalised companies are less responsive to market forces and less ready to invest in technology advances. OPEC has maintained a very cautious policy with regard to possible expansion of crude oil supply and devoting major investments to increase production capacity.

***Refinery bottlenecks and capacity constraints have also negatively influenced level of supply.*** Global refinery capacity has not increased in recent years, as it was not considered a viable investment when oil prices were low. In addition, the costs of building new plants have surged. Recent refinery problems, following the damage caused by hurricanes Katrina and Rita in the US and in the Gulf of Mexico, have further reduced output capacity. In Europe, while overall capacity is satisfactory, refineries are not equipped to process certain fuel types in sufficient quantities, i.e. diesel, which leaves Europe dependent on the US for the off-take of its surplus gasoline while relying on Russia for supplies to make up the shortfall in European diesel production.

### **3.2. Some other factors of a temporary nature have accentuated the price trend**

***Several factors make full production in some areas of the world difficult*** – these include intermittent sabotage of pipelines or the threat posed by armed conflicts in Nigeria and Iraq, bad weather disruption of extraction capacity in the Gulf of Mexico and security concerns in the wider Persian Gulf area.

***The weakening of the dollar has contributed to pressure on oil prices***, as investing in oil has been seen as a valuable hedge against further depreciation of the currency and resurgent inflation.

***In the same way as in other commodity markets, fresh capital has been injected into global oil markets by investors seeking alternatives at a time of turmoil in financial markets.*** Inflows into commodity markets were estimated at \$70 billion in the first quarter of 2008, implying a surge in a trend that has been evident for several years. However, the level of influence of increased activity from non commercial investors on oil prices is unclear at this stage. There are some indications that linkages between the forward and spot markets have led to recent increased short term price volatility, although there is a need for further analysis of these developments.

### **3.3. In terms of outlook, the rise in oil prices is part of a structural shift, rather than a temporary phenomenon.**

The International Energy Agency's 2007 World Energy Outlook drew attention to increasing demand for energy supplies from non-OECD countries, particularly China and India, and predicted that, under current energy policies, global energy demand could be 50% higher in

2030 than in 2007, with fossil fuels continuing to dominate the fuel mix and accounting for 84% of the overall increase in demand in primary energy between 2005 and 2030. Although world oil resources are expected to meet the demand growth, this assumes adequate investment to deal with under-capacity across the oil value chain and implies a more concentrated share in output from OPEC countries. Spare capacity is expected to remain low.

Unless the policy shift decided by the European Council is implemented, growing EU energy needs will continue to be met by fossil fuels, relying on an even greater share of imports. European Commission baseline scenarios<sup>5</sup> for 2030 foresee that total EU-27 energy requirements would be 11% higher in 2030 than in 2005, despite a moderate improvement in the overall energy intensity of EU economies<sup>6</sup>. Oil would remain the most important fuel, although its consumption in 2030 would exceed current levels only by 6%. The share of fossil fuels in total energy consumption would fall only marginally by 2030, as the net result of a limited decrease in the use of solid and oil fuels and an increase in the use of natural gas, the demand for which is expected to expand considerably up to 2030.

Without implementation of the European Council decisions, the share of renewables in primary energy consumption is projected to reach only 12% in 2030. This would cover nearly 60% of the primary energy consumption increase of some 200 million tonnes of oil equivalent between 2005 and 2030 but would obviously fall short of reaching the target of 20% of final energy consumption set for 2020 unless the agreed additional measures are taken. Without new investment decisions, the share of nuclear in total energy consumption would drop slightly, from 14% in 2005 to only 10% in 2030. Overall, without the impetus of new policy decisions, the share of indigenous and carbon free energy sources would rise marginally, from 21% in 2005 to 22% in 2030. Consequently, import dependence would grow by 14 percentage points, to reach 67% in 2030. Europe would be dependent on imports for 95% of its oil consumption. Likewise, gas imports would rise to 84% from their present level of 58%. Under this scenario of just projecting current trends without factoring in the decisions of the European Council, EU-27 energy related CO<sub>2</sub> emissions would increase significantly, exceeding the 1990 level by 5.1% in 2020 and by 5.4% in 2030. These projections clearly show the need for rapid decision and implementation of the 2020 targets agreed by the European Council.

## **4. IMPACTS ON THE EU ECONOMY**

### **4.1. Inflation**

Increased oil prices create inflation in the EU. Recent increases in inflation have been due in large part to higher energy and food prices, which account on average for about 10% and 20% of household spending, respectively. The contribution of energy inflation to the increase in the Harmonised Index of Consumer Prices (HICP) in the fourth quarter of 2007 averaged 0.8% in the euro area. Similarly, the prices of a number of agricultural products, such as wheat, dairy products and meat, have soared. Within the EU, there are, however, sizeable differences in the contribution of food and energy prices to overall inflation, due to variations in the relative percentages of overall household expenditure on food and energy and the existence in some

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<sup>5</sup> European Commission, European Energy and Transport, Trends to 2030 – update 2007.

<sup>6</sup> This corresponds to a 20.5% increase in final energy consumption, in particular for transport and industry needs. Household energy demand is expected to rise only by 12%, following demographic and lifestyle changes.

countries of administered prices for liquid fuels and electricity. The degree of competition on energy markets can also influence price developments in individual countries. Estimates for the larger euro zone countries show that the direct effect of a €10 increase in oil prices would be an increase in inflation of about 0.6 to 0.8 percentage points during the first year after the increase.

Overall, oil prices are likely to stay high in the long term. Poorer households, for whom energy and food represent a larger share of spending, will be most affected.

#### **4.2. Effects on households**

Energy costs make up a substantial part of household budgets and this trend is expected to increase in the future. This means that Europeans will need to allocate additional funds to pay their energy bills. The rate of increase of prices of liquid fuels for household purposes and for personal transport between April 2007 and April 2008 exceeded by far the overall Harmonised Index of Consumer Prices (HICP) for the same period. At the European level, HICP have risen by 3.6%, the prices of liquid fuel for household purposes by 35.2% and those of fuel for transport equipment by 12.7%. However, fuel price increases affect individual Member States to different degrees. The highest rate was reported for the United Kingdom (69.1%). For a number of Member States (Belgium, Germany, Greece, France, Luxembourg, Finland), the rates of growth exceeded the European average.

The rates of growth of prices for fuels for individual transport purposes were much more convergent, between the highest in Estonia (25.1%) and the lowest in Slovenia (4.8%). In addition, there is a knock-on effect on other significant items in the household budget such as expenditure on transported goods.

#### **4.3. Sector-specific effects of the oil price surge**

In the **fisheries sector**, at current price levels, fuel costs are estimated to be more than €2.4 billion per year, or more than 30% of the value of EU fish landings. Some operators, especially trawlers, are the hardest hit as fuel costs can represent up to 50% of income. In contrast, in recent years, fish prices have stagnated or even decreased. Consequently, at current fuel prices, the trawler industry segments are loss-making or only marginally profitable. For the fishing industry, the increased external economic pressure of fuel price increases adds to existing pressures from fleet overcapacity and an eroded resource base caused by overfishing.

High oil prices may have a significant impact on the profitability and competitiveness of the **agricultural sector**. The impact on family farm income will vary across EU Member States, depending not only on the cost structure, but also on the profitability of the agricultural sector. The share of costs directly influenced by oil prices (fuel, fertilizers and crop protection) in the total farm costs varies considerably according to the type of farming.

Oil continues to dominate the **transport sector**, where it accounts for 97% of energy consumption. Transport costs for industry may range from 1% to 10% of final product value. Households spend 13.6% of their total final consumption on transport. Therefore, a doubling of crude prices would represent an increase of 12% to 15% in the cost of transport, which could amount to almost 1% of final consumption of households. In the aviation sector, the International Air Transport Association (IATA) is forecasting a loss of US\$2.3 billion in 2008, based on an oil price of US\$106.5 per barrel.



It is to be expected that increased oil prices have particular effects in industrial sectors that are more dependent on fuel for their activities. In the base **chemical industry**, oil and gas are the major cost components as oil is the main feedstock and energy source at the same time. The rise of the oil price has direct consequences on the price of most chemical intermediates used for the production of plastics and rubber.

In the **automotive sector**, oil price increases are likely to spur more research and marketing of energy efficient vehicles and encourage fuel efficiency investments. Currently, most effort is being put into reducing the impact of energy consumption on the basis of traditional fuels. With petrol prices at current levels, consumer attention is shifting more towards running costs, therefore giving industry a market argument to improve fuel efficiency and adjust marketing strategies.

High oil prices can also bring opportunities as new techniques and processes are in demand and become competitive. Sectors that could benefit are the **renewable energy sector** and those that specialise in energy efficient technologies. There is an obvious need for increased research in more efficient, less consuming eco technologies – an area in which the EU has an important head start. Current market conditions can be expected to increase demand for energy saving and energy efficient products and systems and non-fossil fuels, with corresponding increases in demand for the relevant energy technologies. Against this background, Member States may also decide to review the place of nuclear power in their energy mix.

## 5. MACROECONOMIC IMPACTS IN DEVELOPING COUNTRIES

Higher food and oil prices contribute cumulatively to strong increases in consumer price **inflation** in most developing countries. If this resulted in a general increase in wages and prices it would make the increase in inflation rates more permanent. As oil prices rise, the practice in some developing countries of subsidising energy prices is becoming increasingly unsustainable in **public finance terms**.

**For net oil importing developing countries**, higher fuel prices add to the stress caused by high food prices, putting pressure on the poorest of the poor. The deterioration in their terms of trade implies a **higher current account deficit** and the need to find additional external financing. Higher oil import bills have a negative effect on the trade balance and – if not offset by other external transactions – the current account balance. The adjustment will have to come from a depreciation of the exchange rate to reduce imports and promote exports – which will further increase the price of oil imports – and/or from higher interest rates, to accompany the reduction of the net foreign reserves or to attract additional external financing. Higher interest rates and lower foreign reserves may slow down growth and increase the financial vulnerability of the economy.

**For net oil exporting developing countries**, the higher oil revenues create substantial inflows in foreign currency, which encourage the real exchange rate to appreciate and reduce the external competitiveness of the non-resource traded goods sector. These absorption problems pose particular challenges for macroeconomic policies, in addition to the often weak governance of oil revenues. Many oil exporting developing countries have established oil revenue funds, which reinvest revenues and can be drawn upon to stabilise the economy in less favourable times in the future.

## 6. POLICY RESPONSES FROM THE EU

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. This is the approach followed in the climate change and renewable energy package, which aims to improve the EU's energy security by reducing our dependence on imported fossil fuels and through diversification of supply, by developing renewable energy as well as through energy efficiency. The EU has had the foresight to set itself the goal of a low carbon future, defining where it wants to be by 2020, enabling governments, companies and households to develop the right mix of investments, incentives and obligations to ensure that it can reach that goal. This approach will also improve the competitiveness of EU industry by making it less vulnerable to changes in oil prices. The agreement to take the key next steps in building a true internal market in energy will also reduce the vulnerability of the EU and its Member States to price fluctuations.

### 6.1. Immediate steps: alleviating impact on consumers

*European households are feeling the impact of the current price spike. Member States have the possibility to mitigate the burden on the most vulnerable segments of the population.*

- Recent price increases are being felt most by those for whom expenditure on energy absorbs a proportionately higher part of their incomes. ***Support for the poorest households can be justified and may be needed – but it should be targeted and promote adjustment to permanently higher oil prices.*** Particular care should be taken to ensure that support does not constitute an artificial compensation that delays necessary structural adjustment or inhibits the necessary reduction in energy demand. Any short term compensatory measures should be disconnected from the energy price itself and focus on income transfers to reduce the loss in real income due to high energy prices. Direct income measures should be preferred to measures such as fuel vouchers that would blunt the signal coming from higher energy prices.
- ***Caution should be exercised with regard to changes in the oil taxation regime, because this might result in even higher prices.*** Lowering taxation could send a wrong signal to oil producers and markets that consumers would be able and willing to absorb further price rises if their governments decide to reduce taxes. Member States should avoid giving the impression that the public purse will offset energy price rises. The recent meeting of the ECOFIN Council reiterated the 2005 Manchester agreement that "distortionary fiscal and other policy interventions should be avoided, as they prevent the necessary adjustment by economic agents. Measure that can be considered to alleviate the impact of high oil prices on the

poorer sections of the population should remain short-term and targeted, and should avoid distortionary effects".

- ***A high-level Summit between oil consuming and producing countries:*** A balanced oil market is in the interest of both oil producers and consumers and can be facilitated by addressing all relevant issues in a dialogue at global level. The EU could promote the organisation of a high-level meeting between oil producers and consumers to discuss a wide range of oil-related topics, including demand forecasts, the need for new investment more coordinated approaches.
- The EU could also mobilize the international community to provide additional resources to oil-importing countries to help them make structural adjustments of their economies by mobilising funds from new sources, including from energy producers, oil solidarity funds and private investors.

## 6.2. Medium-term structural responses

- ***The EU's dialogue with key oil suppliers such as Norway, Russia and OPEC should be strengthened.*** The Commission recalls the importance of the EU and its Member States speaking with one voice in external energy relations and of coordinating their activities. In the framework of these dialogues, work should continue to open new opportunities for investment and production development and to help markets become more efficient and transparent on both supply and demand sides. The Commission will continue to explore the opportunities that these dialogues offer for the strengthening of the EU's energy security.
- ***There is a need to monitor competition in the processing, production and sale of oil and petroleum products.*** It is ever more important at times of high prices to ensure that prices are set under normal conditions of competition. The Commission will continue to monitor developments in the sector and take appropriate action if any distortions of competition are detected.
- At the same time, ***increased transparency and reliability and more frequent publication of data on commercial oil stocks*** could help to reduce price volatility. The Commission will examine the feasibility of following the example of some of its trading partners in ensuring the public availability of relevant information on commercial stocks.
- ***The Commission will focus on security of supply and external energy policy in its second strategic energy review by the end of the year.*** This will include proposals for improving the efficiency of EU's external energy policy with the objective of ensuring EU's collective energy security.
- ***The second strategic energy review will be accompanied by a proposal to revise the existing Community legislation on emergency oil stocks*** in order to create a simple and integrated framework to provide greater transparency. It should cover stocks obligations, compliance options, release coordination, reporting and data availability. Insufficient or inadequate refinery capacity in the EU will also be monitored. The activities of the Commission's market observatory for energy are being further developed in order to provide the necessary market data and appropriate advice.

- ***Taxation measures will be examined to support and facilitate the move towards a low-carbon economy.*** The Commission is examining options for revising the energy taxation directive. This should help to ensure that energy taxes are levied in the most effective and non-distorting way to internalise external costs and support the EU's wider energy policy objectives. Similarly, car taxation could be made more effective in steering consumers towards choosing more energy-efficient cars.
- ***Windfall profits of oil extracting industries should be used for investment. Taxing them is an option*** being considered by some Member States. A number of European countries (Norway, the United Kingdom) collect tax revenues from oil and gas companies through special taxes on profits. However, oil and gas companies use their profits to explore new resources, and many of them also invest in carbon-free technologies, which will ease the pressure on oil prices in the future. Ways need to be found to encourage investments in fossil and non-fossil energy technologies as well as in exploration and distribution. It should in any case be avoided that the longer term consequence of new taxes or other arrangements is a deterioration in investments in exploration, extraction and new technologies.
- ***The EU will intensify its energy dialogues with its neighbouring and developing partners*** to assist them in increasing investment in energy infrastructure, including a higher focus on the promotion of renewable energy solutions and energy efficiency. It will also draw the attention to the fact that fuel subsidies distort incentives to move towards greater fuel efficiency.

### 6.3. Longer term structural responses

- Following their decisions at the Spring European Councils of 2007 and 2008, ***Member States should finalise their work on the Commission's proposals of January 2008 on renewable energy and climate change with a commitment to reaching political agreement on them by the end of the year.*** Giving full legal effect to the proposed targets will provide the necessary guarantees to investors that will generate the required change in the energy mix and turn the current challenge of high oil prices into an opportunity for the EU. The Commission therefore urges Member States and the European Parliament as a matter of priority to concentrate their efforts on the elements of the package that require further discussion.
- ***Further efficiency improvements and demand adjustments are necessary.*** The rising prices of energy products inevitably complement the economic and regulatory instruments that encourage energy efficiency. High prices require a change of behaviour: energy is a scarce resource, to be used responsibly and more efficiently. The EU has the advantage of being more energy efficient than other parts of the world but needs to make more serious progress towards the 20% energy saving objective that was outlined in the 2006 energy efficiency action plan. The Eco-design Directive, now being implemented, sets setting energy efficiency requirements for energy using products to be placed on the market in

the European Union.<sup>7</sup> Evidence shows that households and industry can reap benefits from investing in energy saving devices and habits. For example, the UK's Energy Saving Trust estimates that if every suitable house in the UK installed cavity wall insulation, it would cut CO<sub>2</sub> emissions by around 6 million tonnes and save over £700 million a year. The European Commission will later this year propose to extend the Directive on the Energy Performance of Buildings<sup>8</sup>.

- The Commission's analysis of the Member States' national energy efficiency action plans<sup>9</sup> has shown that ***there is a gap between the political commitment to energy efficiency and the proposals aimed at facing up to the challenges.*** Member States must seriously consider stepping up their energy saving campaigns, including through making grants available to home and building owners to carry out the necessary improvements. Examples such as the energy saving partnerships operated by the city of Berlin for the retrofitting of public and private buildings show how the annual energy efficiencies (26%) can fund the cost of the retrofit.
- ***Energy intensive industries need to become more energy efficient.*** In the medium and longer term, both because of higher energy prices and clear climate change goals, the future prospects of energy-intensive sectors will depend on becoming less energy-intensive, and reducing their CO<sub>2</sub> emissions. The measures that will be taken in favour of these sectors in the context of the EU ETS should be designed with this objective in mind. The revised guidelines for environmental state aid<sup>10</sup> issued by the Commission in January 2008 provide Member States with the possibility of supporting investments in energy efficiency, renewable energies, certain types of biofuels and the greening of production processes. High energy prices only serve to make such investments more profitable.
- ***Structural and technological changes are necessary in the transport sector to make it more energy efficient. External costs of both freight and passenger transport need to be internalised.*** The Commission will propose a review of the Eurovignette Directive to allow Member States to choose this internalisation for heavy goods vehicles. Fighting oil cost rises also requires a shift towards the more energy efficient modes of transport. Some of these, such as shipping, railways and bus or coach transport, are more efficient as they allow collective transport where economies of scale may be gained. Moreover, the Commission is implementing its renewed strategy for reducing CO<sub>2</sub> emissions and improving the fuel efficiency of cars.<sup>11</sup> As part of this, the Commission has recently made a legislative proposal for reducing CO<sub>2</sub> emissions of new cars to an average of 130 g/km by 2012<sup>12</sup> and proposed legislation for improving the CO<sub>2</sub>-performance related to tyres<sup>13</sup>.

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<sup>7</sup> Directive 2005/32/EC

<sup>8</sup> Directive 2002/91

<sup>9</sup> COM(2008)11.

<sup>10</sup> 2008/C 82/01, Official Journal C 82 of 1.4.2008.

<sup>11</sup> COM(2007)19.

<sup>12</sup> COM(2007)856.

<sup>13</sup> COM(2008)316.

- ***The restructuring of the fisheries sector will be accompanied.*** The necessary restructuring of the sector needs to be managed in a way that cushions its economic and social repercussions. The European Fisheries Fund can provide the necessary framework and funding to support the adjustment process, on the basis of restructuring and de-commissioning plans allowing for a reduction of the fleet, for modernisation and energy efficiency, as well as social or reconversion measures. Other measures to support the adjustment of the sector are also under consideration. Such interventions should not be directly linked to fuel prices in order to avoid distortions of competition.
- ***The Commission is also currently examining the possible impact of instruments such as direct tax incentives, direct subsidies or reduced VAT rates as a means of encouraging energy savings in households.*** The Commission will report on the results in the autumn. Some Member States have already introduced measures to encourage households to buy more energy-efficient appliances, including direct subsidies, and the possibility to offset spending on energy saving against income tax.
- ***High prices for oil, coal and gas require greater diversification of the EU's energy supply.*** They will also narrow price differences between renewable energies and fossil fuels. As close substitutes for petrol and diesel, the market prices of biofuels can be expected to follow closely developments in petrol and diesel prices. This implies that greater use of sustainable biofuels will not reduce the impact of higher oil prices on energy consumers, but it will improve security of supply through diversification of sources. This will help to mitigate the effects of any future oil crunch, provided a higher share of renewables can be used in fuel blends. While recognising that it is for each Member State to decide whether or not to rely on nuclear power, Member States could also re-examine the role that they wish nuclear power to play in their energy mixes.

## 7. CONCLUSIONS

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;

- 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.