

What the Constitutional Treaty means in practice: Energy as a case study

Executive Summary

- If the revised Constitutional Treaty comes into force the EU will acquire new energy powers which the UK Government originally opposed when the Constitution was being drawn up.
- The powers will allow it to resuscitate a proposal to take control of EU member states' emergency oil reserves and increase the size of those reserves by a third. The UK has blocked this proposal in the past but would be unable to block such a proposal under the Constitutional Treaty.
- As well as the UK losing control of its reserves policy to the Commission, the UK taxpayer will be landed with a bill of nearly £6 billion to implement the plans and an ongoing cost of nearly £600 million a year.
- The Government's oft repeated claim that the EU needs the new energy powers in the revised Constitution in order to liberalise European energy markets is false. The EU has the power to pass liberalising measures by majority vote already under internal market rules.
- The Commission has proposed legislation to break up large continental energy monopolies like EDF and Eon. The legislation is proposed under the internal market article (Article 95) and is covered by majority voting. The UK's problem is not that one country is exercising a veto, but that many of the largest member states are opposed.
- When the new energy powers were originally proposed Europe Minister Peter Hain correctly argued that they were "unnecessary, as all aspects of energy policy are effectively covered elsewhere in the Treaty e.g. single market, environment."
- Energy is a good case study of the failure of UK policy in Europe in several respects:
 1. The Government made a good argument against giving the EU more powers in this area, but then later gave in.
 2. Moving to majority voting in this area will leave the UK powerless to block a costly and unnecessary proposal which we already know is in the pipeline.
 3. The Government is now advancing an argument which is completely dishonest to cover up its failure in this area.

Introduction

If the revised Constitution comes into force the EU will acquire new powers relating to security of energy supply. There will be no national vetoes in this area and the EU will be able to pass measures by a majority vote. There will also be a new obligation (not included in the original Constitution) for security of energy supply policy to be framed "in a spirit of solidarity between member states."

The European Commission has proposed measures which would increase member states' holdings of emergency oil stocks and hand control of those stocks to Brussels. The Government successfully opposed these plans in 2002 but they remain on the table.

There have been strong indications from the Commission that the proposals will be revived once the Constitution is in place. Brussels is keen to exploit concerns in the EU about security of energy supply from Russia and the Commission President has spoken of the need of new action on emergency oil stocks.

Using the Government's 2002 regulatory impact assessment as a base, the proposals would now cost the UK taxpayer nearly £6 billion to implement with an ongoing cost of nearly £600 million a year.

Following the introduction of majority voting and the new solidarity provisions under the Constitution, the Government will find it much harder to stop the Commission's plans. Ten Central and Eastern European states have joined the EU since the proposals were blocked. Most of these countries are heavily dependent on unreliable imports of Russian oil and there is a high chance they will support the Commission's plans.

Avoiding the new solidarity provisions in the Constitution and keeping a national veto are the only ways the Government can guarantee that the UK will keep control of its oil reserves and avoid the huge compliance costs. To achieve this the UK needs to renegotiate the terms of the Constitution or block it.

The Government justifies the new energy powers in the revised Constitution on the grounds that they are in the UK's interest. Ministers claim that these powers are necessary to complete the liberalisation of European energy markets. This is a false claim - the EU already has the power to pass liberalising measures by a majority vote.

Indeed, the Commission has just proposed a series of draft directives designed to liberalise gas and electricity markets by breaking up national energy monopolies. These proposals are being brought forward using powers in the existing EU treaties and will be decided by majority voting. No single country will be able to veto them.

New energy powers for the EU under the revised Constitution

The revised Constitution would give the EU extensive new powers to set policy on energy.¹

¹ A consolidated version of the treaties following the ratification of the revised Constitution can be found here: <http://www.openeurope.org.uk/research/comparative.pdf>

Paragraph 1 of new Article 176a of the Treaty on the Functioning of the European Union (TFEU) states that:

“In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim, in a spirit of solidarity between Member States, to:

- (a) ensure the functioning of the energy market;
- (b) ensure security of energy supply in the Union;
- (c) promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
- (d) promote the interconnection of energy networks.”

Article 100 of the existing treaties is also enhanced by the revised Constitution to allow significant energy measures. The underlined sections are added to the existing text of Article 100.

“Without prejudice to any other procedures provided for in the Treaties, the Council, on a proposal from the Commission, may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.”

What did the Government think about the energy powers when they were first proposed?

The EU treaties have never contained any specific powers on energy policy. When it was first proposed that these powers should be created during the European Convention (i.e. the conference which drew up the Constitution in 2003), the UK Government was strongly opposed and tried to get them deleted.

The Government said at the time:

“This provision is unnecessary as all aspects of energy policy are effectively covered elsewhere in the Treaty e.g. single market, environment. In addition, we have detailed concerns on the text, which we consider may have the unintended effect of changing the boundaries of EU competence and the types of measure which will be subject to unanimity.”²

The provision was not deleted and any worries about it now appear to have been abandoned. By signing up to the latest version of the Constitution the Government is effectively supporting the energy powers it previously opposed.

² <http://european-convention.eu.int/Docs/Treaty/pdf/845/Art%20III%20152%20Hain%20EN.pdf>

The changes to Article 100 were created by the IGC mandate agreed at the European summit in June 2007. They were not in the original Constitution and are therefore entirely new powers. The Government has not expressed a view directly on these specific innovations but has agreed to them by signing the IGC mandate.

What will the new energy powers mean for the EU?

The Commission has great ambitions in the energy field. The Commission President, Jose Manuel Barroso, called for a common energy policy in May 2006 to tackle problems like climate change, declining energy reserves and rising energy demand.³ Since then the Commission has produced some legislative proposals. These were announced last month and relate to the liberalisation of energy markets.⁴

The EU would also like to have more of a role in dealing with security of supply issues. For instance, the Commission has argued that it should have the right to negotiate bilateral energy agreements with non-EU countries like Russia. In its January 2007 White Paper on energy policy the Commission noted that "the EU already speaks with one voice in negotiations of international agreements, notably in the field of trade," and that steps should be taken "towards speaking with one voice [in the energy field]."⁵

Proposals in this area will be greatly assisted by the new powers which give the EU the specific ability to propose measures which will "ensure the security of energy supply in the Union" and pass them by majority voting.

New energy powers will also bring back failed Commission proposals

Another implication of more majority voting in energy policy is that it will encourage the Commission to reintroduce proposals that it failed to drive through in the past, but which are still on the table.

One proposal that the Commission has never given up on is a draft directive that would give it control over member states' emergency oil stocks and increase the size of those stocks by a third. This proposal first appeared in September 2002 but was blocked by some member states, including the UK. However, the Commission has not abandoned its plans: the draft directive is still on its list of proposed legislation.⁶

There are strong signs that the Commission will try to push the same proposal through once the revised Constitution is in place. When the Commission President announced the need for a common energy policy in March 2006 he gave at the same time a pretty unambiguous signal that the Commission would like to re-

³ <http://news.bbc.co.uk/1/hi/business/4785474.stm>

⁴ The EU Electricity & Gas markets: Third legislative package, September 2007, http://ec.europa.eu/energy/electricity/package_2007/index_en.htm

⁵ Commission Communication, AN ENERGY POLICY FOR EUROPE, January 2007, http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lq=en&type_doc=COMfinal&an_doc=2007&nu_doc=1

⁶ Proposal for a Directive of the European Parliament and of the Council concerning the alignment of measures with regard to security of supply for petroleum products, [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002PC0488\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002PC0488(01):EN:HTML)

launch its emergency oil stocks proposal. "We must respond better to sharp emergency oil and gas shocks. There should be no taboos in this debate," he said.⁷

The Government is certainly expecting proposals in this area. As it noted in a recent paper on the future of the UK's emergency oil stocks, "the European Commission is likely to be making proposals in the second half of 2008, after consultations, for changes to the oil stocking system."

Presumably the Commission thinks the time is ripe to revive its plan. Russian oil makes up 30% of the EU's oil imports.⁸ There is great concern in European capitals about the security of Russian energy supplies and the proposals are likely to receive considerable support.

The detail behind the Commission's emergency oil stocks proposal

The proposal, known as the 'Directive concerning the alignment of measures with regard to security of supply for petroleum products,' would repeal existing legislation on emergency oil stocks and replace it with new arrangements.

Existing EU legislation requires that member states maintain a level of emergency stocks corresponding to at least 90 days of average daily internal consumption. If a member state has domestic oil production it is allowed to hold less than 90 days worth - the UK, for example, is required to hold a minimum of 67.5 days. If difficulties arise with regard to supplies, the Commission can arrange consultations between the Member States about what action should be taken. Currently, though, the Commission has no powers to distribute stocks if there is a shortage.⁹

The UK also has stockholding commitments through its membership of the International Energy Agency (IEA). In terms of actual stocks these tend to complement rather than add to EU obligations. The key commitments are to maintain emergency oil reserves equivalent to at least 90 days of net oil imports, and to participate in oil allocation among IEA countries in the event of a severe supply disruption.¹⁰

The proposed Directive has four key features:¹¹

1. The minimum level of stocks held is to be increased from 90 days to 120 days;
2. The derogation which allows producer member states like the UK to hold a lower stock level will be removed;
3. All member states will each have to set up a public agency which would be responsible for owning and holding the oil;

⁷ <http://news.bbc.co.uk/1/hi/business/4785474.stm>

⁸ http://ec.europa.eu/energy/oil/crude/doc/2005_cce_eu.xls

⁹ Existing EU legislation on minimum stocks of crude oil and/or petroleum products can be seen here: <http://europa.eu/scadplus/leg/en/lvb/l27045.htm>

¹⁰ For more detail of the UK's IEA stock holding obligation see: <http://www.berr.gov.uk/files/file37711.pdf>

¹¹ Proposal for a Directive of the European Parliament and of the Council concerning the alignment of measures with regard to security of supply for petroleum products, [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002PC0488\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52002PC0488(01):EN:HTML)

4. The Commission, assisted by a committee made up of member states' representatives, will have the power to adopt measures in case of a potential disruption in supplies (i.e. it will have the power to distribute the stocks).

How would this impact on the UK?

Financial costs of the proposal

When the Commission first suggested the oil stocks proposal in September 2002, the Government carried out a Regulatory Impact Assessment (RIA).¹² The RIA calculated that the proposal would cost the UK nearly £1.3 billion in additional stocks of crude oil and oil products. The cost of providing additional storage for between 6 and 7 billion tonnes of oil was thought to be about £1 billion. In addition to these start up costs, the RIA anticipated there would be annual maintenance costs of around £500 million.

All of these costs have gone up in the last five years. When the cost of the extra oil was calculated in 2002 the oil price stood at \$25 a barrel. The price is now over \$80.¹³ Using the Government's 2002 assessment as a base, this means that the additional oil cost would rise from £1.3 billion to about £4.2 billion. Based on price changes since September 2002 as reflected in the retail price index, storage costs would also have risen - from £1 billion to £1.17 billion.¹⁴ Annual running costs are also likely to have risen from the Government estimate of £500 million to £585 million. The start up costs for the proposed directive would therefore be over £5.5 billion. All of this would have to be met out of general taxation.

The UK would lose control of its emergency stocks

The proposal would also give the Commission the power to dispose of member states' emergency stocks, including the UK's. Aside from the issue of a further loss of power to the EU over a key area of policy, the new system would create new risks. It is not difficult to imagine a scenario where the Commission disposed of oil stocks for inappropriate reasons. For instance, there could be a situation where political pressure is applied by some member states on the Commission to dispose of UK stocks in the short term in response to a price spike.

The proposal would therefore jeopardise the independence of member states to act in response to a genuine crisis, override the UK's commitments under the IEA, and put in place a system which gives the Commission the power to manipulate oil prices in response to political pressure.

¹² The RIA was supplied to the House of Commons European Scrutiny Committee, <http://www.publications.parliament.uk/pa/cm200203/cmselect/cmeuleg/63-i/6301.htm>

¹³ 15 October 2007.

¹⁴ <http://www.statistics.gov.uk/StatBase/tsdataset.asp?vlnk=229&More=N&All=Y>

What was the Government's position when the proposal was first mooted?

The Government had very strong concerns with the proposal and opposed it.¹⁵

Its main objections were as follows:

- existing EU arrangements for holding stocks already provide sufficient cover for oil supply disruptions, and the IEA has a track record of acting sensibly and effectively in an emergency;
- oil is an internationally marketed commodity which is freely traded worldwide, and emergency plans need to cover key world players, such as the United States and Japan, which only the IEA is in a position to do;
- whilst the existence of stocks helps to reassure the market, this would not be true if the EU were thought to be using them to try and influence prices;
- the proposals have not been adequately costed by the Commission, and would impose considerable burdens on government, business and the consumer;
- in terms of subsidiarity, individual countries, acting as members of the IEA, are best placed to respond to an international oil emergency.

So how was the proposal stopped in 2002?

Having scrutinised the proposal a number of member states including the Government concluded that the Commission was using the wrong legal base (Article 95 of the EC Treaty) to justify the Directive. The Commission maintained that Article 95, which gives the EU the power to create the single market, was appropriate because the proposal related to intra-EU trade in oil products. However, the member states disagreed - they pointed out that the proposal related to emergency stocks and not the functioning of the single market. As a result the legal service of the Council of Ministers changed the legal base to Article 100.¹⁶ This was chosen because it gave the Commission the power to propose measures "if severe difficulties arise in the supply of certain products". Moreover, this was the article used to bring existing EU legislation on emergency oil stocks into effect.

The article change was a huge blow to the Commission's plans. For a measure to be passed under Article 100, unanimous support of member states would be needed, whereas a measure under Article 95 could have been passed by a majority vote. The article change effectively put the UK in a position where it could kill the directive by using its veto. The Commission realised that this would happen and dropped the proposal.

¹⁵ See the Government's submission to the House of Commons European Scrutiny Committee, <http://www.publications.parliament.uk/pa/cm200203/cmselect/cmeuleg/63-i/6301.htm>

¹⁶ <http://www.publications.parliament.uk/pa/cm200304/cmselect/cmeuleg/42-xiv/4211.htm>

So if this proposal was stopped in 2002, won't it be blocked again if it is brought back?

The UK will find it much harder to stop the proposal. There are two new factors at work.

As mentioned above, the revised Constitution gives the EU the specific power for the first time to pass measures which will, "in a spirit of solidarity between member states", "ensure the security of energy supply in the Union" by majority voting. These powers are perfectly designed for reintroducing the emergency oil stocks measures. There will be no national veto available to the UK.

The second factor is that attitudes in the EU on the need for action on security of energy supply have changed dramatically since 2002. This stems from the EU's growing dependency on unreliable Russian oil supplies. In 2005 Russia provided 30% of the EU's oil imports. This was the EU's largest single source followed by Norway (17%) and Saudi Arabia (10.5%).¹⁷ In January this year Russia cut oil supplies to Belarus leading to shortages in Eastern and Central Europe, particularly in Poland and Germany. This was a salutary reminder to many member states of their growing vulnerability.¹⁸ Central and Eastern European countries are particularly dependent on Russian oil. Some, like Poland and Hungary, get over 90% of their imports from Russia (see table below).

in 1000 tonnes of oil	Gross Inland Consumption of crude oil and petroleum products, 2005	Crude oil imports, 2005	Crude oil imports from Russia, 2005	Crude oil imports from Russia as a percentage of total crude oil imports, 2005
Bulgaria	4,846	6,328	5,406	85%
Czech Republic	9,748	7,595	5,501	72%
Lithuania	2,746	9,205	8,871	96%
Hungary	7,420	6,523	6,453	98%
Poland	22,525	18,386	17,466	94%
Romania	10,162	8,751	4,854	55%
Slovakia	4,045	5,558	5,353	96%
Croatia	4,514	4,350	3,435	78%
Germany	123,409	113,833	38,170	33%
UK	82,701	59,696	5,051	8%

Source: Eurostat¹⁹

¹⁷ For European Commission figures on oil imports, see http://ec.europa.eu/energy/oil/crude/doc/2005_cce_eu.xls

¹⁸ <http://www.europa.eu/rapid/pressReleasesAction.do?reference=IP/07/24&format=HTML&aged=0&language=EN&quiLanguage=en>

¹⁹ http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-PC-07-001/EN/KS-PC-07-001-EN.PDF

The change in the composition of the EU and a growing dependency on Russian oil raises significantly the chances of a majority of member states being in favour of the emergency oil stocks proposal. Indeed, the new provisions on the need for 'solidarity' in energy policy were inserted as a result of Polish pressure. This, coupled with the introduction of majority voting on security of energy supply issues, makes it likely that if the Commission brings back the proposal it will be passed.

But doesn't the Government claim that the new energy powers in the revised Constitution will bring benefits to the UK?

The Government has performed a U-turn in terms of its attitude to the new energy powers in the revised Constitution. As discussed above, when the old Constitution was being drawn up the Government opposed the creation of the new energy powers. At the time Europe Minister Peter Hain said that they were "unnecessary as all aspects of energy policy are effectively covered elsewhere in the Treaty e.g. single market, environment."²⁰ Now the Government says that the new powers are in the UK's interest. So what has changed?

Ministers claim that the energy powers are now desirable because they will enable the EU to liberalise the European energy market. As Jim Murphy, the Europe Minister, said recently: "Energy policy will move to qualified majority voting (QMV) in the Reform Treaty, making it easier to liberalise energy markets and improve energy security. More open markets will promote energy efficiency and allow consumers greater choice. Energy is an example of where the Reform Treaty moves to QMV can unlock decision-making in Britain's interests".²¹

But, this argument is bogus. The Commission tabled proposals in September which would require the breakup of monopolistic energy giants like EDF and Eon.²² The Commission sees this as being the most important step in the process of energy liberalisation. All the proposals will be decided by majority voting using the EU's existing single market powers (Article 95). No single country is currently able to exercise a veto.

The Government is therefore wrong to claim that the revised Constitution assists the cause of energy liberalisation. The EU has the ability to pass the appropriate measures by majority voting already. It doesn't need the new powers in the Constitution.

Conclusion

The Government opposed the directive on emergency oil stocks when it was first proposed by the Commission in 2002. But by supporting the revised Constitution the Government is paving the way for its return.

²⁰ <http://european-convention.eu.int/Docs/Treaty/pdf/845/Art%20III%20152%20Hain%20EN.pdf>

²¹ Parliamentary Answer, 9 October, <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm071009/text/71009w0025.htm>

²² The EU Electricity & Gas markets: Third legislative package, September 2007, http://ec.europa.eu/energy/electricity/package_2007/index_en.htm

Only a national veto guarantees that the proposals will not become EU law. The Government was once against the new energy powers in the rejected Constitution. By signing up to the new version of the Constitution the Government is giving the EU those powers.

With no veto, and a growing desire within the EU to see the Commission act on security of supply problems with Russia, it is likely that the UK will lose control of its emergency oil stocks if the Constitution comes into force. In addition, the UK taxpayer would face a bill of £6 billion to implement the directive and an ongoing annual bill of nearly £600 million.

The Government's claim that the new energy powers are needed to liberalise European energy markets is false. The EU has the powers it needs already. Instead of supporting the revised Constitution it should renegotiate its terms or block it altogether.