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Energy Price Hikes as Seen from Viewpoints of Market Functions and Politics

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Simultaneous energy price hikes, as well as the accelerating decarbonization trend, may be cited as the most important issue in the 2021 international energy situation. Crude oil prices topped $80 per barrel, natural gas and spot LNG prices posted abnormal spikes, and coal prices shot up more than five-fold from last year's low. In Europe and China, the electricity supply-demand balance tightened, leading to electricity price spikes. I remember few such simultaneous energy price hikes before 2021. Energy price hikes became a major global issue at a time when the global economy was insecurely recovering from the disastrous COVID-19 pandemic.

Energy is indispensable to civic life and economic operations. Energy may look like air or water as far as it is supplied stably at affordable prices. Once energy prices spike, however, the spike becomes a grave issue and makes headline news. This year's energy price hikes have become a grave issue attracting global attention since October.

Energy sources are priced according to the supply-demand balance in their respective markets. Market players, actors and other influencers on supply and demand and their influences differ by market. In the history of international energy market development, energy markets have basically become gradually competitive, leading market forces to work more easily. Such structural changes have been seen in international markets including the oil market for pricing crude oil. In electricity, gas and other domestic energy markets, market liberalization and deregulation have promoted structural changes.

As various energy markets grow competitive, prices become dependent on supply and demand fundamentals. Energy prices thus change in line with supply and demand fluctuations. Even in competitive markets, prices may not necessarily stay low. If the supply-demand balance tightens, prices may naturally shoot up. Behind the latest simultaneous energy price hikes, all energy markets basically saw tighter supply-demand balances.

In the crude oil market, a demand recovery from the COVID-19 disaster was coupled with a coordinated oil production cut by the Organization of the Petroleum-Exporting Countries and non-OPEC oil-producing countries to reduce oil inventories and tighten the supply-demand balance. In the Asian LNG market, the supply-demand balance tightened as supply growth failed to catch up with robust demand growth represented by a rapid increase in China. The coal supply-demand balance tightened due to production shortages in China that accounts for a half of the global coal market, leading to global spot coal price spikes. In Europe, a long suspension of wind power generation triggered a tighter electricity supply that has been coupled with power generation fuel price hikes to push up electricity prices. In each energy market, changes in supply and demand fundamentals caused price hikes in line with market principles.

Given that energy is indispensable to civic life as noted above, however, governments cannot leave price hikes' negative effects untouched even if the price hikes are based on market principles. While it is a right principle that prices of goods are determined by market forces, price hikes can become issues that are politically difficult to be left untouched. This was the case with the latest energy price hikes.

Political reactions to energy price hikes in global markets were seen. In reaction to crude oil price hikes, oil-consuming countries including the United States asked the OPEC-plus group to additionally increase oil production. As the OPEC-plus group decided to shelve any additional production increase in defiance of the request, the United States led a coordinated international release of oil reserves to push down oil prices. These actions represented political reactions. In reaction to European natural gas price hikes, the European policy side urged Russia, the largest gas supplier to Europe, to increase natural gas production beyond the levels under long-term contracts. Over the European gas price hikes, Europe and Russia exchanged claims at the political level. As energy is important, governments attempt political engagement or intervention in response to energy price hikes even in international markets.

Engagement or intervention in domestic markets has also been seen during the latest energy price hikes. In Europe, energy subsidization for low-income people was offered as early as in October. In Japan, the government decided to introduce a subsidy system to hold down gasoline prices in November. The U.S. administration exerted pressure on oil-producing countries to increase production and decided on the coordinated release of oil reserves to lower gasoline prices that have influence on support for the administration. Thus, government market intervention to protect consumers (in particular, low-income consumers) emerged during the latest energy price hikes.

A key basic principle of many policymakers is that they should leave market forces to price goods and should refrain from market intervention that could distort markets and prevent market forces from working fully. However, they may choose to intervene in markets in defiance of the basic principle. Particularly, they cannot leave price hikes untouched for energy that is linked directly to civic life and economic operations. The philosophy of making maximum use of market functions can conflict with the political need for protecting consumers. The energy issue is potentially sensitive to international and domestic politics to such extent and difficult to handle.

Policy responses to the latest energy price hikes featured explicit reactions seen in advanced economies such as the United States, Europe and Japan. This indicates that energy price hikes are not necessarily a negligible issue even in advanced economies with higher average income levels. In emerging market and developing economies with relatively lower income levels, energy price hikes can be easily expected to exert serious negative impacts. Europe introduced energy subsidization for low-income people out of concern that energy price hikes would exert great impacts on low-income people. Energy price hikes have the potential to become of great significance to advanced economies and of even greater significance to emerging market and developing economies.

In considering energy price issues, the impact from externalities such as energy security is as important as that from responses to the externality of climate change. What impact energy cost hikes through the enhancement of decarbonization measures would exert on advanced economies and on emerging market and developing economies and how they should respond to such cost hikes may become key challenges in the world's implementation of energy and environmental policies.

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