

## **State-Market Confrontation over Energy Issues**

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There are various viewpoints for looking at energy issues. When looking at the energy situation from various viewpoints or through different lenses, we see different pictures of the world. In this report, I would like to look at energy issues from the viewpoint of the state-market confrontation.

Energy is indispensable for supporting our lives and economic activities. No one could survive without energy. In this sense, energy exists as a good that is extremely close to our lives and indispensable. However, energy is made available through various and complex global supply chains covering from energy resource development and production to their transportation to consumption locations, the processing and conversion of resources into final products, their distribution and their utilization by consumers. In each supply chain, various market participants conduct transactions to produce prices, leading to payments and revenue. Investments are made in supply chains for their future development in various ways, leading to future supply and demand environment changes through which new transactions are implemented. Energy is thus traded in a giant market covering various complex transactions.

As a matter of course, prices are determined basically according to supply-demand relations in the energy markets, leading to transactions under market functions. This means that energy issues must be seen first from the viewpoint of pure market functions. However, energy issues are complicated by price spikes, supply disruptions and other frequent events where all cannot be left to market forces. Massive consumption of energy including fossil fuels cause environmental problems such as air pollution, as well as climate change problems like global warming. In this sense, it is inadvisable to leave all to market forces. In other words, energy issues always include how to address market externalities such as energy security and environmental problems.

When the impacts of externalities become grave or serious issues, it is insufficient to leave all energy issues to market forces. Then, the state is required to address these issues or proactively engage and intervene in the market. Representing a typical historical case are responses to oil crises in the 1970s. Oil crises came as oil-consuming countries grew more dependent on the Middle East while leaving energy choices to market forces. Japan and other developed countries then embarked on strong national policies to enhance energy security and reduce their dependence on the Middle East.

Some types of government engagement in energy issues are characteristically different from the abovementioned type. In many energy market sectors and industries, natural monopoly is of great significance. Given economies of scale, large monopolistic market players can grow easily. Natural monopoly may contribute to cost efficiency. To avoid harmful effects of monopoly, however, governments have proactively intervened in and regulated relevant market and industry sectors, controlled prices and profits for protecting consumers and imposed restrictions on business operations and investment. As a matter of course, governments frequently implement regulations to secure safety

in the energy market.

In this respect, the framework clearly existed in the 1970s for governments to take leadership in addressing energy issues. In the 1980s, however, an energy market liberalization and deregulation trend emerged in Western countries under the growing influence of new global liberal economic policies. As the trend spread gradually in the world, it became remarkable in Japan from the 1990s. In the 1990s, crude oil prices basically stayed at low levels, leading interest in energy security issues to decline relatively. As the crude oil futures market developed for pricing, crude oil was increasingly considered a commodity. Market forces grew dominant in the energy world. As a matter of course, we should pay attention to the fact that state energy market initiatives were enhanced in regard to global warming rather than energy security in the 1990s.

Even as the 21st century started, the state-market confrontation regarding energy issues remained. In Japan, for instance, the 2002 Basic Act on Energy Policy specified three major energy policy principles – the securement of stable supply, environmental adaptation and the utilization of market forces – as the harbinger of the current 3E's – energy security, environmental protection and economic efficiency. The first two of the three major principles address energy market externalities, while the last one emphasizes the performance of market forces. Energy policy must be designed to strike a balance among the three principles that occasionally contradict each other and lead to a trilemma. However, the balance is not easy to realize or achieve. The balance of power among the three principles changes in line with the changing situation.

In Japan, for instance, the government comprehensively reviewed its energy policy in the wake of the 2011 Great East Japan Earthquake and Fukushima nuclear power plant accident and came up with a basic principle of pursuing the 3E's on the premise of safety and implemented electricity and gas system reforms. The basic principle was dubbed "S+3E's." Later, electricity and gas retail sales were fully liberalized, with the network sector separated from the sales sector legally, invigorating new entries into electricity and gas markets. A wholesale electricity market has grown rapidly, exerting great influence on the overall electricity market and industry. In the meantime, energy security and climate change have remained significant. As the global carbon neutrality trend accelerated from 2020, the government emphasized a national decarbonization policy.

However, the situation has been changing dramatically again. As the Ukraine crisis has added fuel to the destabilization and price spikes in the international energy market from 2021, energy security has been revived as a key urgent challenge regarding energy. Then, governments have globally taken leadership in resolving and addressing the challenge, leading to a wide range of developments. Developed countries have introduced and enhanced energy subsidies in response to energy price spikes. Interest in nuclear energy emerged first in Europe and expanded globally. Powerful energy policy packages have been formulated, including the European Union's REPowerEU initiative to reduce dependence on Russia. Energy companies such as French electric utility EDF and German gas company UNIPER have been nationalized. The United States and Saudi Arabia held a bilateral summit in July this year to help stabilize crude oil prices. Strong requests to save energy including electricity have come to respond to potential energy shortages or blackouts. All possible options to increase energy supply have been mobilized to address Ukraine, including increased coal power generation. Initiatives to expand local fossil fuel production have been launched. An overall-cost recovery financing approach has been introduced for promoting stable zero-emission power sources.

At present, the power and presence of the state regarding energy issues has been emphasized in a manner to move the world. Nevertheless, market forces have not been lost. The state and market

IEEJ : September ©IEEJ 2022

may confront each other again. Toward the future, we must keep close watch on the state-market confrontation over energy issues.

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