

### **Dramatically Changing State-Market Relationship (3) - Wavering Energy Market Liberalization -**

Ken Koyama, PhD  
Chief Economist, Senior Managing Director  
The Institute of Energy Economics, Japan

In the third serial story on the changing state-market relationship, I would like to take up issues regarding relations between energy market liberalization or the utilization of market principles, and state control or intervention.

Until the 1970s, governments had played major roles in the energy market, implementing various regulations, controls and interventions in the energy industry and market. The reasons for such government measures vary by country but can be roughly summarized into the following two.

The first reason is the view that it is impossible or inappropriate to leave energy-related issues to market forces alone because energy is of special importance. Energy has been considered indispensable for human life and an important strategic good that supports economic and industrial activities and influences national management. When the destabilization of the market for such important energy becomes a serious issue, the government responsible for human life stabilization and national management should not refrain from taking any action against the issue. It has been seen as natural for the government to impose direct and indirect regulations on the energy market or stakeholders involved in energy supply and demand such as the energy industry, and to implement inductive policies to stabilize the market and secure stable energy supply in response to and preparation for market destabilization such as an oil crisis in the 1970s. Energy externalities that the government should address include not only energy security and stable energy supply but also energy-related environmental issues, such as air pollution and other public hazards in the past and climate change in the present. Priority has been given to policies for promoting the transition to cleaner energy that market forces alone cannot facilitate sufficiently.

The second reason is related to economies of scale and natural monopolies. As economies of scale work in energy infrastructure development frequently, natural monopolies have the potential to gain an advantage for efficient investment and infrastructure development. It has been seen as important and necessary for the government to conduct both market control and consumer protection by imposing direct regulations on relevant industries, companies and markets to avoid the adverse effects of market monopolies while exploiting such peculiar advantages.

Even in the energy market put under strong state control for the abovementioned reasons, liberalization and competition promotion trends became conspicuous in the 1980s. While crude oil prices decreased on the calming-down of the oil crisis chaos in the 1970s, the growing influence of neoliberal economics enhanced the thought that competition should be introduced even in the energy market to promote liberalization and deregulation. These trends originated in the United States and the United Kingdom and spread to other European countries and Japan, and even to developing countries. In many cases, liberalization and competition promotion began first in the oil market and spread to the

electricity and gas markets known as network-type industries. In Japan, oil market liberalization began to gain momentum in the second half of the 1980s and came to completion in the early 2000s. Electricity and gas market liberalization was phased in over the 1990s and 2000s. As energy policies were comprehensively reviewed in response to the Great East Japan Earthquake and the Fukushima nuclear power plant accident in 2011, Japan implemented the fundamental liberalization of electricity and gas markets. The liberalization trends took advantage of market principles to thoroughly promote efficiency, rationalization and cost reduction.

Recently, however, the relationship between the state or policies and the energy market has shown extremely great changes again. Those changes are related to carbon neutrality and other decarbonization initiatives. Few people believe that carbon neutrality through a fundamental transition from the present energy supply/demand and infrastructure system for fossil fuels can be achieved through market forces alone. It is globally recognized that the government should implement strong policies to change the market system comprehensively.

Another driver of the extremely great changes is the revival of energy security initiatives. Energy price spikes since the second half of 2021 and the Ukraine crisis that added fuel to the price spikes and destabilized the energy market have exerted great influence on the world. In October 2021, developed countries including European nations and Japan began to introduce energy subsidies in response to energy price spikes. The United States then strengthened the call for oil-producing countries to increase production and released strategic oil reserves to suppress gasoline prices. As the Ukraine crisis escalated, the Western bloc imposed sanctions on Russian energy, introducing caps on Russian crude oil and European gas prices. The European Union has strongly promoted the REPowerEU plan to phase out dependence on Russia while promoting decarbonization. European and other major countries have adopted powerful policies to enhance energy security and secure a stable energy supply. The paradigm that energy is especially important and should not be left to market forces alone has been revived. Moves to nationalize energy companies have been seen in Europe as well.

In another remarkable development regarding the energy market, interest in nuclear energy has grown for the simultaneous achievement of energy security enhancement and decarbonization. In France, the United Kingdom and other European countries, plans to construct new nuclear power plants have been announced, indicating pragmatic efforts to achieve both energy security and decarbonization. In the United Kingdom, the decision to introduce the Regulated Asset Base Model close to the overall cost coverage formula for new nuclear power plant construction has attracted interest. This indicates that the U.K. government has seemingly recognized that regulation rather than liberalization is required for constructing new nuclear power plans. Here is a major change in the state-market relationship regarding energy.

What is more important is that the world's division and growing geopolitical risks, as well as the relevant trend of giving priority to economic security, support the state-market relationship regarding energy. In an important typical case, the concentration of critical mineral supply sources in China has become a matter of great strategic concern in addition to the tightening supply-demand balance and price hikes for critical minerals at a time when the demand for such minerals is expected to substantially increase due to the future promotion of energy transition. Such a situation has resulted in a trend in which the government depicts a desirable picture and implements strong policies to guide its nation in the desirable direction, instead of leaving energy choices to the free market. Priority is given to de-risking, if not decoupling, rather than relying on free trade and the international division of labor. A typical initiative in this regard is related to industrial policies. As shown by the U.S. Inflation Reduction Act, government initiatives to promote clean energy investment (and greenhouse

gas emission reduction), and economic growth and industrial development are being promoted around the world. The abovementioned trend differs far from the energy market liberalization and the utilization of market forces promoted since the 1980s and should be viewed as a major development exerting great influence on the future energy situation.

Contact: [report@tky.iecej.or.jp](mailto:report@tky.iecej.or.jp)

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