Green transition will be less painful if we avoid repeating 1970s western policy errors in the oil market

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Russian energy giant Gazprom has announced record profits for the first nine months of the year, and is forecasting even stronger results for the

fourth quarter. This is thanks to the very high price of natural gas, which Russia is accused of exacerbating by limiting supplies to Europe in recent months.

Gas prices have eased a little compared to their peaks in late September, but they are still close to double what they would usually be, and the futures markets are indicating that they could rise higher again over the winter. The prices of coal and oil are also some way above 2020 averages, despite the recent market panic over the COVID variant omicron.

There is already a tendency for some people to blame the green transition for driving up energy costs and to demand that the pace is slowed down, and we can expect more of this in the months ahead.

But the green transition is not optional, and the truth is that governments have often made prices worse with cheap and easy policies. The US government has banned drilling for petroleum on federal land and refused to approve the proposed Keystone pipeline from Canada, but it does little to curb consumer demand for fossil fuels. The combination of unabated demand and constrained supply helps to drive up prices.

This has echoes of events in the crude oil market in recent decades. These can provide some useful lessons to help navigate the green transition.

Oil in the 1970s and 1980s

World energy markets went through turmoil in the 1970s from two oil shocks: the price increase in 1973 following the war in the Middle East, and then more supply problems in 1979 following the Iranian revolution. The 1973 crisis caused oil prices to near-triple. They stayed high for the rest of the decade before going even higher in 1979, with major

consequences for growth, inflation and people's wages.

What is less well known is that government interference made these problems worse. President Richard Nixon's price controls introduced in 1971 put a cap on petrol prices in the US, which discouraged domestic petroleum exploration, production and refining. Oil production seriously declined after 1973, and was further discouraged by punitive taxes for new production introduced in 1975. So while cheap petrol kept demand high, domestic supplies were far tighter than they might have been.

Meanwhile in Europe, market competition in the energy sector was essentially illegal in most countries. Energy markets in the key consuming countries were inflexible and inefficient, so they were unable to respond to the oil shocks by curbing demand and increasing supply. And to make matters worse, Nixon's adviser Henry Kissinger had directed the US to support autocrats like the Shah of Iran to push for higher oil prices in return for buying US weapons and building up his army to help Israel and counteract the Soviets.

It wasn't until the 1980s that nations like the UK and US finally withdrew their ill-advised market interventions. Now artificially high demand for petrol fell, ingenuity was unlocked, and new cheaper oil resources were found and developed. The net result was that prices tumbled.

Unfortunately markets are fragile, and people have short memories. In 2020 another US president brokered a deal between oil-producer cartel Opec and Russia to end the price war started by the Saudis when they cut production earlier in the year. President Trump scored short-term political points by pleasing US oil producers, and the world has been "rewarded" with higher oil prices when it can least afford them.

Lessons to learn

So how does this relate to the green transition? In an echo of the European monopolists of the 1970s, the countries finding it hardest to move to new, cleaner forms of energy are precisely the ones with sclerotic monopolies with little reason to change the status quo.

Japan and Russia are good examples. Japan has been liberalizing its energy market since 2013 to allow more competition against the incumbent utilities, but progress has been slow. As a result, coal still comprises 26% of energy consumption. Meanwhile, the country's regulation of its nuclear plants has been shambolic, and this has meant that more coal and gas has been used to generate power.

As for Russia, only 2% of power is renewable. Incumbent monopolies have no incentive to invest in clean technologies as they are guaranteed a return on the existing assets.

In countries where energy is supplied by monopolists, it is also particularly difficult to attract sufficient private investment for clean technology. So even when their governments do drive the green transition forward, they are likely to end up creating new "green" monopolies.

Instead they need competitive markets based on various clean energy sources including nuclear, solar and wind. This means that all nations should be keeping infrastructure operators independent from electricity suppliers, ensuring that markets are competitive, transparent and the rules are clear.

Unlike in the 1970s, we also need to take demand more seriously. Even the world's most liberalized electricity systems offer few or no tariffs to incentivise consumers to save power during peak times when power is scarce. Peak demand is usually met by switching on plants powered by fossil fuels, which seriously curtails our efforts to stop climate change.

For oil itself, demand also needs to fall significantly, even if it will still probably be used for transport and plastics. This means curbing demand through carbon taxes, good public transport and plentiful charging points for electric vehicles. Without tackling both sides of the demand/supply equation, our gas and power shortages may last for years.

As this implies, markets can't be relied on for everything. One answer we've learned already is to charge polluters for the damage they cause. A great example is the Acid Rain Program initiated by the US in 1995. It forced coal-burning power plants to buy tradeable emissions permits for sulfur dioxide, and was so successful that acid rain is rarely talked about now.

By the same token, we have to put a proper price on carbon. The European Emissions Trading System (ETS) was long ineffective thanks to fossil industry lobbyists successfully securing exemptions. It is finally starting to function now that the rules around emissions permits have been tightened, but it might have happened more quickly if some "environmentalists" had not opposed this kind of market-based solution.

Elsewhere, unfortunately, carbon trading is still in its early stages. One of the goals of the COP26 climate conference was to tackle this, which was not successful, though numerous key leaders were at least vocal about such markets being necessary, and there was an agreement about the standards they should follow. The challenge for the future is to convert this into action.

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