

Response to consultation on Retail Market Review

1. I write this response in a personal capacity based upon my knowledge of the retail markets gained through academic research. The views expressed here should not be taken to represent the views either of the University of Warwick or the Competition Commission, both of whom are my employers. Nor do they relate to any other body.
2. Research I have carried out (Giulietti, Otero, Waterson, 2010) has shown that, even prior to the period of tariff proliferation, there was little pressure on those suppliers setting high prices and there remained wide differences between the tariffs of different firms. Moreover we found that what had appeared to be a wise choice of electricity supplier when chosen, would on average have lost this status within a year. Hence, whether the tariffs were excessive or not, choice between them was not obvious and needed to be exercised often in order to achieve a competitive result.
3. Research (in which I have had a minor role) (Waddams Price and Wilson, 2010) has shown that, within particular groups of consumers, switching by consumers markedly often led to them being on a tariff actually worse than the one they left.
4. There is evidence (Giulietti, Waterson, Wildenbeest, 2010) that consumers, for whatever reason, act as if search costs (and switching costs) in switching between suppliers are high. In particular, as work commissioned by OFGEM itself has shown (Accent, 2005), for a significant fraction of consumers, the fact that up to 30% of switchers seemingly switch supplier without searching strongly suggests that search costs are high.
5. For all these reasons, I welcome OFGEM's proposals to simplify tariffs with the aim of making the search and choice process more straightforward than it has become. Availability of a simple standard tariff enabling clear comparisons between suppliers' offerings (for example as you propose by an OFGEM- set fixed charge plus a unit charge chosen by the supplier) should go a long way in this direction.
6. However, such a tariff type would not be useful if it was an uncompetitive offering- it would offer consumers a choice, but not a wise choice.
7. In particular, it is important to be aware of potential unintended consequences. A sobering case study is provided in the paper by Albaek, Mollgaard and Overgard (1997). There they document how a Danish competition authority initiative to simplify pricing in the Concrete industry led to cartel- like behaviour, and increases in prices, because each supplier became more easily aware of its competitors' offerings as a result of a competition agency designed information resource.
8. Could this happen in energy in Great Britain? We do have a number of suppliers and previous initiatives have facilitated lowering of wholesale prices. However, evidence (Giulietti, Grossi, Waterson, 2010 and others) suggests that whilst wholesale prices fell as a result of the introduction of NETA, retail prices rose correspondingly so the net effect was not a lower order of retail pricing. The integrated supply companies simply made their money at a different stage.
9. Moreover, independent entry into the retail energy market has made very little headway and the impact of NETA (and subsequently BETTA) possibly exacerbated the difficulty of entering as a supply-only company into what could be a competitive market. This occurred through the unintended consequence of internal transactions making the wholesale market more illiquid and opaque which facilitated the position

of the integrated suppliers, as various Parliamentary inquiries (e.g. Energy and Climate Change Committee, 2011) have suggested.

10. For this reason, I view it as essential that development of an OFGEM- sponsored retail tariff structure, if it is to be a genuine competitor, needs to be accompanied at the same time by wholesale market- opening measures which enable potential new retail suppliers to source wholesale supplies at competitive prices. The two are natural complements and a simple retail tariff without market opening is likely, in my view, to be ineffective.
11. Without market opening, suppose the existing suppliers were to take the attitude of applying very similar but un-competitively high unit prices to the OFGEM-set fixed charge, so rendering the “OFGEM Tariff” uncompetitive, and thereby destroying its worth to consumers as compared with tariffs of their own design. If the big six have no viable competitors, this would be a plausible scenario. If, on the other hand, seeing uncompetitively high retail prices, new entrants could purchase energy inputs easily, then they would impose a downward pressure on the retail unit prices offered within the OFGEM tariff.
12. In sum, I welcome the OFGEM proposals set out in the “Domestic Proposals” document. I am not best-placed to choose between the detailed alternatives offered. However, I welcome the broad proposals only on the basis that, at as near to the same time as possible, a portion of the wholesale supply market is opened up to competitive purchase by any competent supplier.



References

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