CONDITIONS FOR EFFECTIVE COMPETITION

I am responding to your request for views on your Discussion Paper of May 29 about effective competition.

In general, the paper seems to me well directed, particularly because it regards competition as a rivalrous process of discovery, rather than a state, and it then seeks to define conditions that will indicate such a process is in operation. However, I would make the following comments on parts of the paper which may indicate some remnants of outdated models of competition.

1, The definition of effective competition (in the Executive Summary and Figure 1) as involving "rigorous rivalry" seems an odd use of the word "rigorous" which usually refers to logical accuracy in argument or strict enforcement of rules. Since competition, in the sense of a discovery process led by entrepreneurs, is inevitably marked by numerous errors as well as by profitable ventures, to describe it in terms that imply strictness and accuracy seems misguided. "Vigorous" rivalry would be a better description.

2. There are several references to a "two tier market" which is said to result in poor outcomes for less active consumers. In my view, the concept of a two tier market as used in the paper is unhelpful and indeed misleading. A two tier market in that sense could be found in almost any consumer market and could therefore be used to justify intervention (including price caps) almost everywhere. Consumers do not simply shop for products with particular physical characteristics (as they are assumed to do in perfect competition theory): they buy bundles of characteristics, including quality, expected standards of service, expected continuity of supply and so on. They are also aware of the implications for their time. As time allocation theory shows, purchases and consumption of products involve the allocation of scarce time to particular uses. In the case of household energy consumption, a decision to move from one supplier to another is perceived to have a significant cost in terms of time. Some consumers, with a relatively high opportunity cost of time, will therefore decide not to switch. These consumers, counted among the "less-active" in the paper, do not need help or protection: they have voluntarily decided not to incur the expected time costs of switching supplier, the market process is working and there is no market deficiency to be remedied. It is not true that these consumers face "excessive prices" (para 3.21 of the paper) and I would urge Ofgem to be careful not to label all those who decide not to switch as disadvantaged.

3. In the light of the above, I think it will be extremely difficult for Ofgem to make the assessment described in para 3.21 – of the "…potential extent of dispersion of prices in a competitive market" – and it seems to me the danger in such an assessment is that it fails to exclude voluntary non-switchers from the disadvantaged category. Judging whether less active consumers face "excessive prices" is not at all straightforward because the "less active" category conceals many different types of consumers, including many who clearly are not in need of protection.

4. I can summarise my concerns by pointing to Ofgem's argument (for example, in 1.1) that "…the retail energy market has not been working as well as it should for all consumers", with benefits for the active but disadvantages for others who pay "substantially more". The implication seems to be that the disadvantaged can be identified by their lack of activity. However, as explained above, the less-active group is bound to be heterogeneous and it seems to me important that Ofgem should acknowledge that heterogeneity. Policies to protect the disadvantaged are most efficiently carried out through government social policies, financed through taxation. But, if Ofgem is to continue to be an instrument of such policies, I would suggest it is very careful in its market analysis to try to identify only the genuinely vulnerable as candidates for protection.

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