

Challenges of Successful Deregulation: the Rôle of the Consumer

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Successful Deregulation & the Rôle of the Consumer: challenges for policy

- ✦ From the old (supply side) to the new (demand side) regime
- ✦ Evidence on consumer behaviour in UK electricity markets
- ✦ Success: in process or outcome?
for whom?
- ✦ Active consumers and growth
- ✦ Policy implications

From the old to the new regime

Should policy **protect** inactive consumers?

old regime, regulation, ex ante constraints on companies
traditional response to market failure

Or **empower** active consumers?

new regime, competition policy, ex post rules
response to regulatory limitations

Can we change the inactive to the active?

Are protection and empowerment substitutes or complements?

Need some consumer activity for supply side competition to deliver



If sufficient rivalry, companies will compete against each other

But why would they compete (which takes effort and money) if no consumers respond at all to lower prices, better quality?

So need at least **some** consumers to respond **sometimes**
~ not necessarily all the time (*need to know there are profits tomorrow from good deals today to justify marketing costs*)

How many is enough?

Does it matter who?

Can active consumers deliver benefits for the inactive?

Yes~if companies can't distinguish/discriminate between them

Can force connection through tying prices – *reregulation* –

Can increase rivalry under some circumstances, but decreases it under others

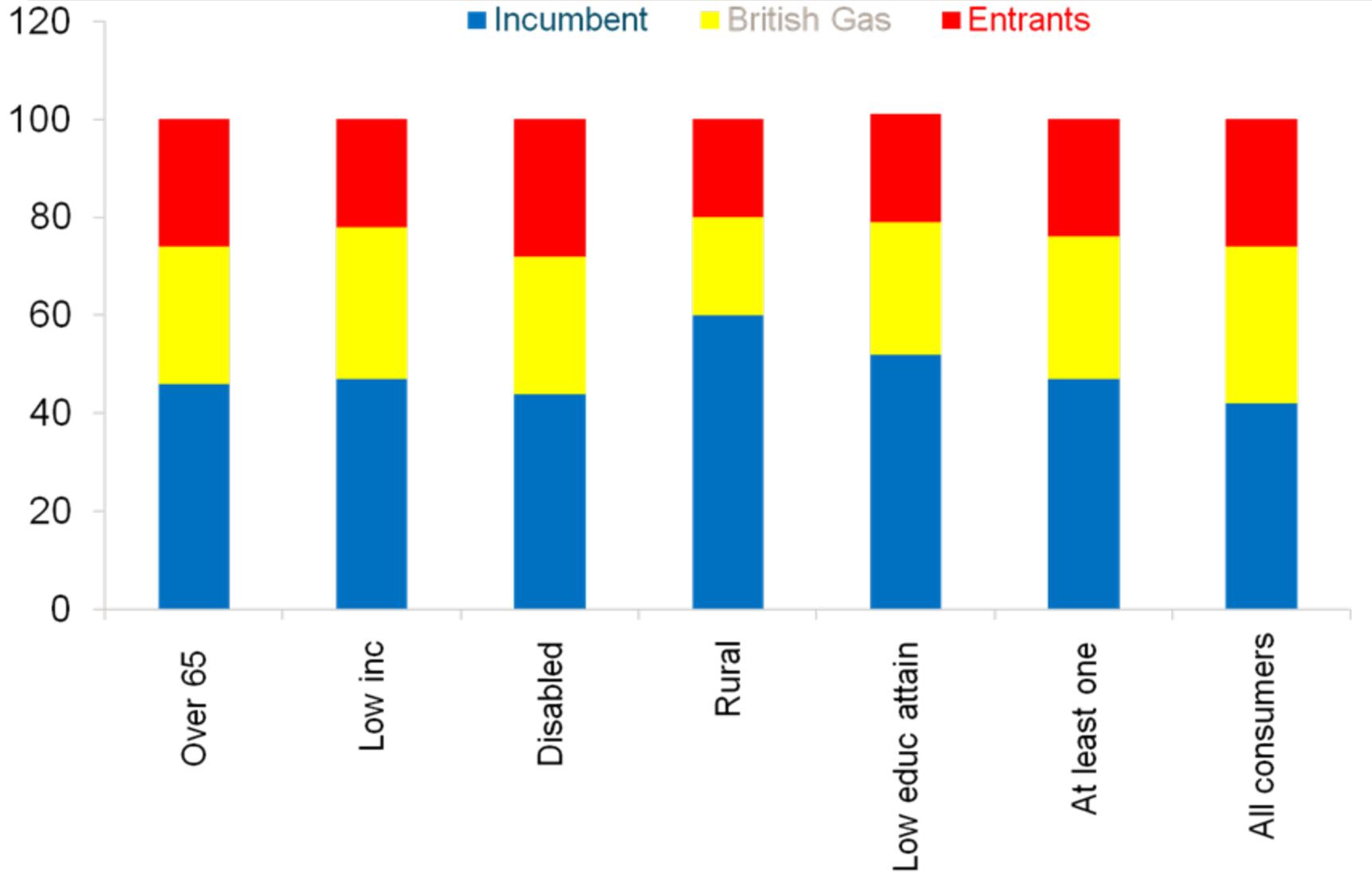
Danger of undermining incentives:

- for companies if have to lower prices to all

- for active consumers if no benefit from effort

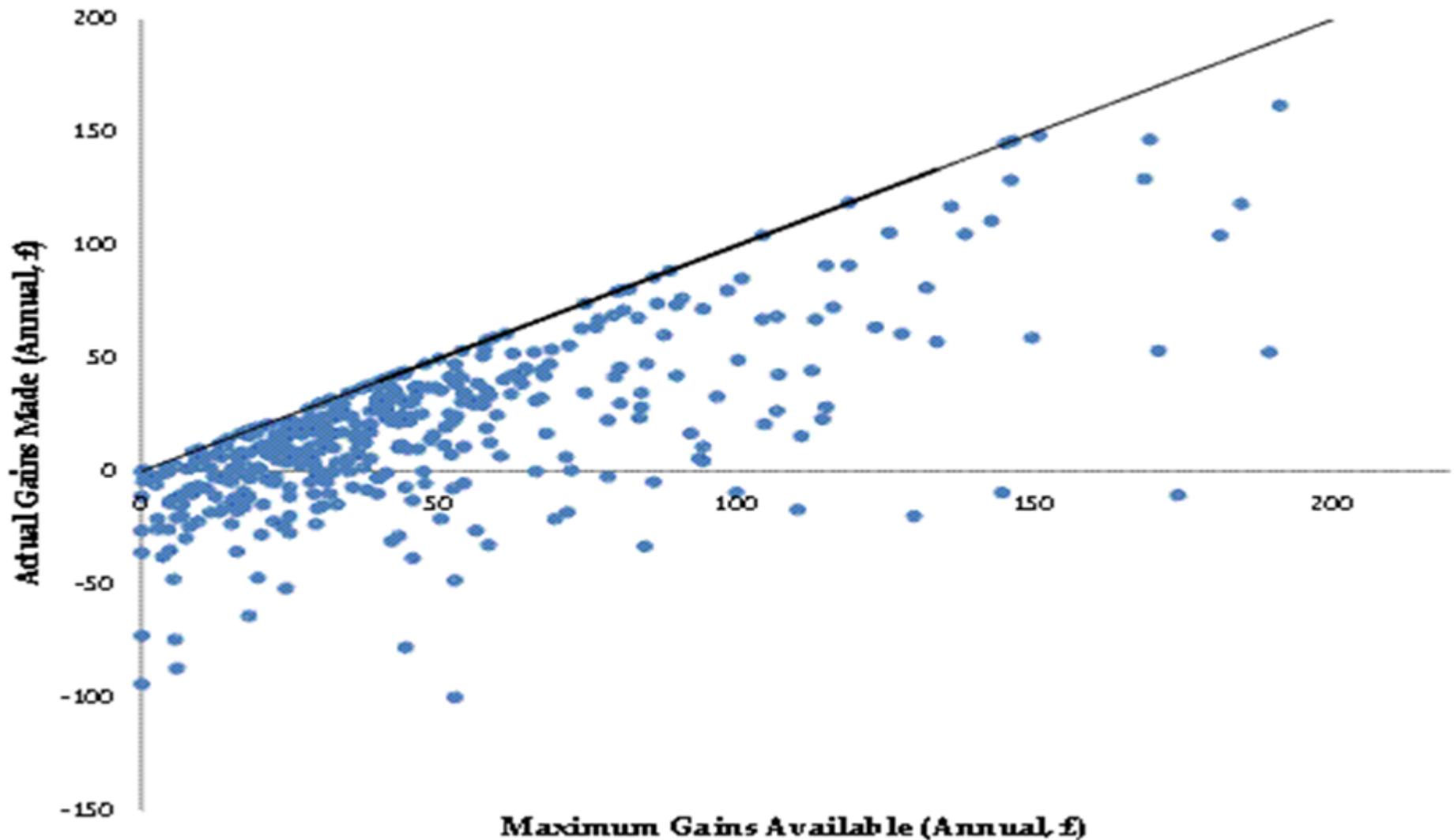
Are vulnerable less likely to be active?

A bit - but the majority have switched(2005)



Did bargain hunters save money?

Mostly, less than potential, 1/5 paid more



Success ~ process or outcome?

Process of competition depends on incentives
~ for companies and consumers

In equilibrium, prices may be equal across consumers,
unlikely in short run

Imposing the outcome of equilibrium will distort competition

Markets powerful to deliver many things
but not particular distributional outcome

There are better instruments

Protect in short run? If so, who and how?

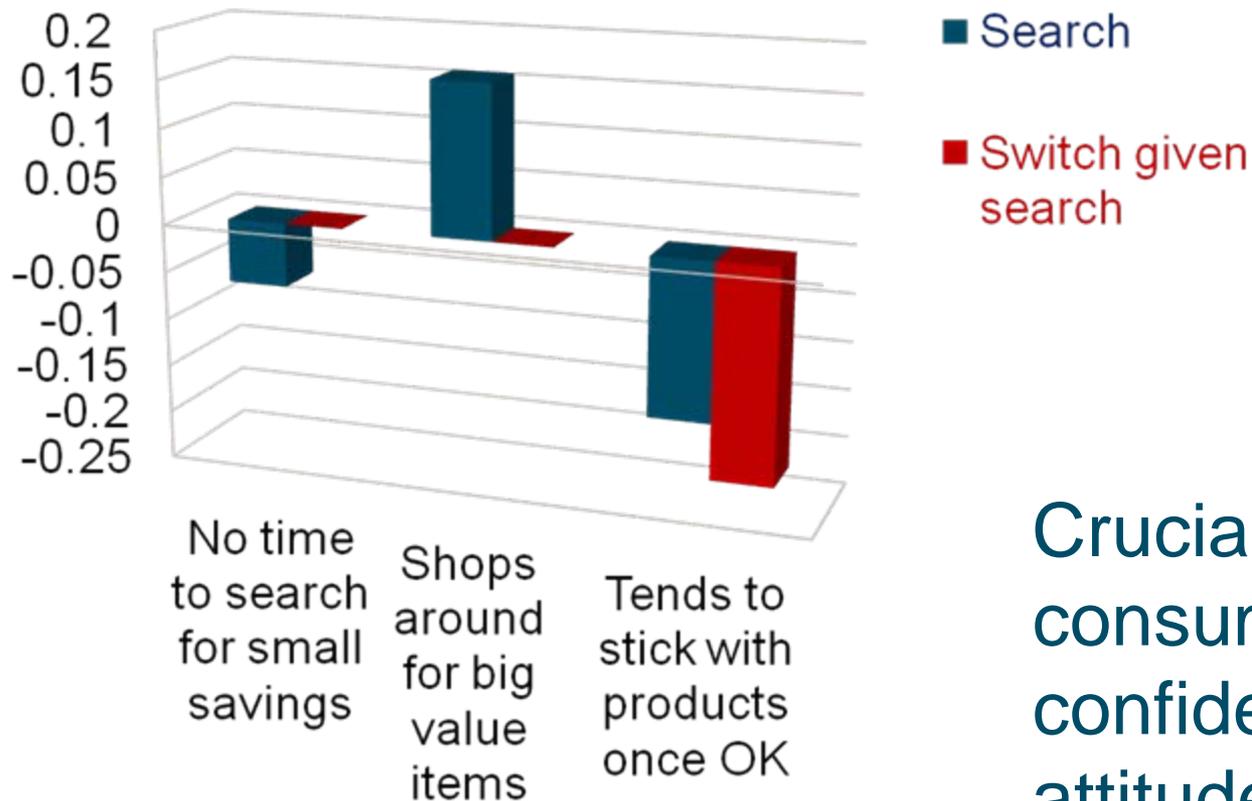
Very difficult to do this without distorting the markets
UK energy regulator tried with non discrimination clauses
May have made things worse

Now trying more intervention through tariff structures

Danger that gains through activating consumers
Are less than losses through distortion of competition

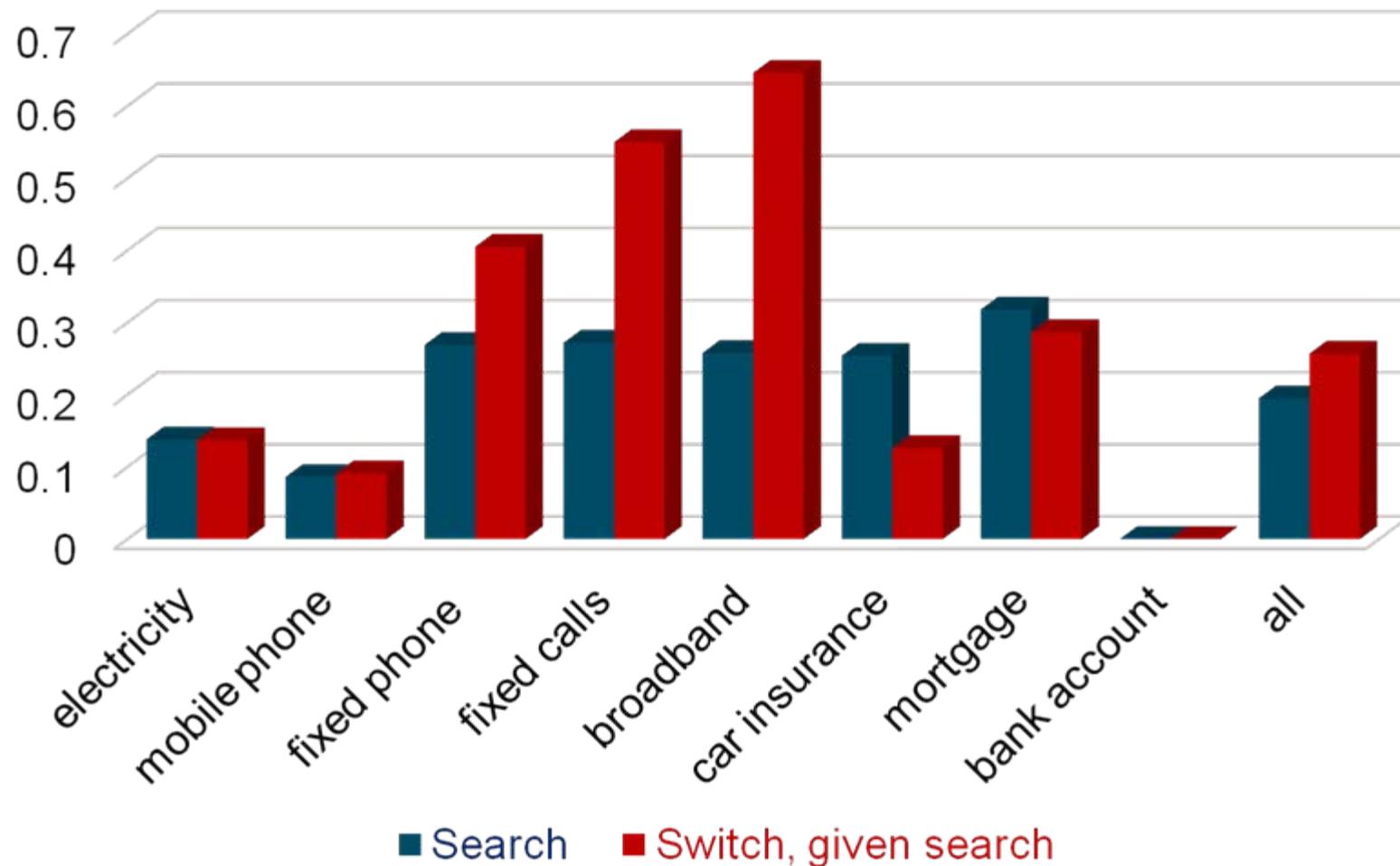
Deregulation, consumers and growth

Effect on probability of search & switching-given-search



Crucial role of
consumer
confidence &
attitude

Link across markets: marginal effect of switching in another (of these) markets



Confident consumers and growth

- ✦ Consumer confidence crucial to activity across suppliers within markets

 - Within traditional regulated markets unlikely to affect spend directly

 - Lower bills can release more funds for spending in other markets

- ✦ Confident consumers may be more resilient to downturn in other markets

- ✦ **But** activating the inactive is complex

 - Companies likely to be better communicators than regulators or government

Protection or empowerment?

- ✦ Empowerment of ‘average’ should discipline suppliers
- ✦ Do some consumers need protection?
 - If so which: market?
 - average consumer?
 - vulnerable consumers?
- ✦ Protection of some reduces empowerment/ incentives of others, and suffers from unintended consequences
 - Likely to be substitutes rather than complements
- ✦ If protection paramount, regulation may be better