Managing the liberalization of Italy’s retail electricity market: A policy proposal

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Outline

- Italy's electricity retail market: a long awaited reform
- Structure-Conduct-Performance
- Challenges ahead
- A policy proposal: asymmetric regulation and opt-out collective switching
- Conclusion

Italy's retail electricity market design

- July 1st, 2007: all customers are **free to choose**…
- …but **if they don't** they are covered by the **Maggior Tutela** [Greater Protection] service:
  - They will be supplied by the local DSO…
  - …at a price that reflects the procurement costs of the Single Buyer [Acquirente Unico];
  - The Maggior Tutela is a **temporary regime** that will be phased out by July 1st, 2019;
- Issues with the Maggior Tutela:
  - May work as a focal point;
  - May nudge customers into the regulated regime, thereby discouraging engagement;
  - Prevents commercial innovation.

Research question

- **How to manage the phasing out of the Maggior Tutela?**
- No conclusive evidence on retail competition's effect on prices, depending on: i) actual competition; ii) customer engagement (Newbery and Pollitt 1997, Polo and Airoldi 2017, Fernandez-Gutierrez et al. 2017);
- Competition successful in creating better opportunities for consumers, but they often fail to catch it (Waddams and Zhu 2016, CMA 2016);
- Larger consensus on the nexus between retail competition and innovation (Eakin and Faruqui 2000, Littlechild 2002, Rassenti et al. 2002, Cooke 2011, Stagnaro 2017);
- Growing (behavioral) literature on how to make customers more active (CEER 2016, Crampes and Waddams 2017);
- No "textbook" architecture to rely on for the transition (Joskow 2008).

Structure-Conduct-Performance

- Structure:
  - Customers under the Maggior Tutela declined from 79% in 2012 to 66% in 2016 but
  - Extremely concentrated market **by design**: largest retailer 73% (slightly declining over time);
  - High number of operators: low entry barriers;
- Conduct:
  - Switching rate (8.7%) slightly above EU average but high number of non-switchers (circa 90%), high rate of internal switching (circa 60%);
  - Increasing number of offers;
- Performance:
  - Price dispersion as expected (converging energy-only tariffs, diverging if other services are bundled);
  - Markup around the EU average.

Challenges ahead

- Market concentration
  - Reducing the incumbent’s market share…
  - …while creating the conditions for competitors to grow
- Customer engagement
  - Promoting switching activity;
  - Discriminate the “truly” disengaged customers from those who do not switch because they are just happy;
- Customer protection
  - Protecting vulnerable consumers *via* targeted measures (energy poverty)

A policy proposal

- Target: reducing market concentration while promoting customer engagement;
- Three pillars scheme: graduality, asymmetric regulation, opt-out collective switching:
    1. Graduality allows competitors to grow and consumers to get accustomed with the new rules;
    2. Asymetric regulation lowers the incumbent’s market share;
    3. Opt-out collective switching turns inertia into a convenient feature.

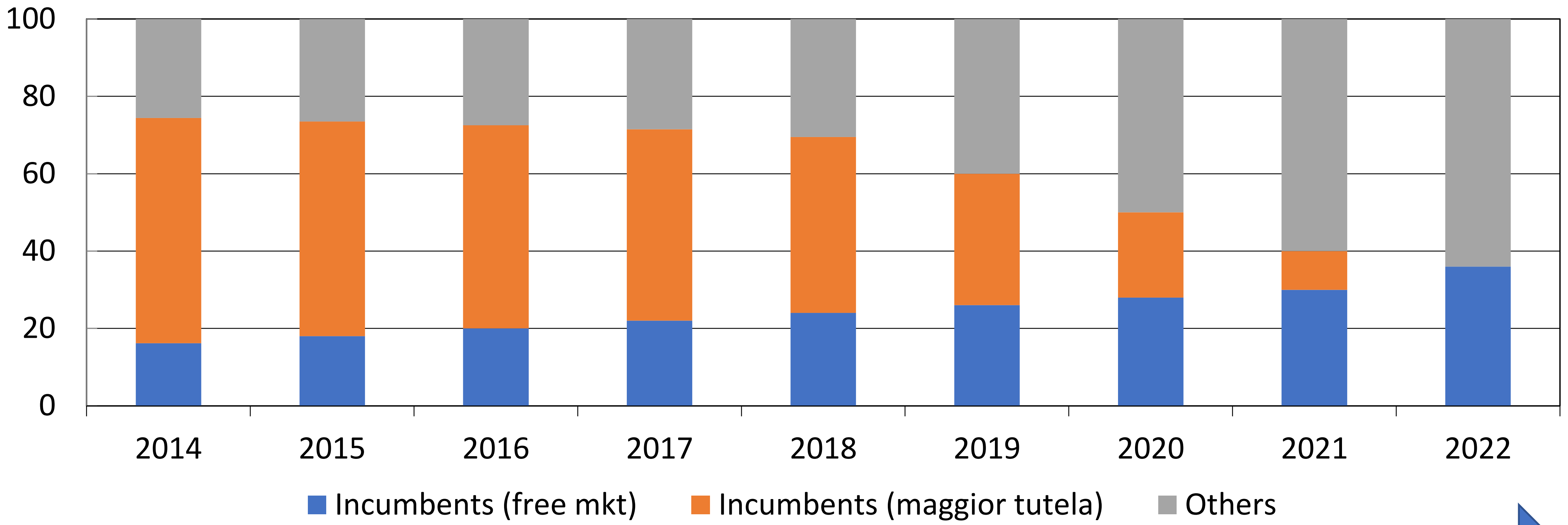
Three pillars: graduality and asymmetric regulation

- **Graduality:** 3 years transitional period when:
  - Former regulated customers are still supplied by the (brand unbundled) incumbent i) under standardized terms & conditions; ii) price variations should be approved by the regulator;
  - The incumbent cannot win formerly regulated customers neither can it win them back as they switch but it can compete for other customers;
- **Asymmetric regulation:**
  - A transitional, decreasing antitrust ceiling is introduced under which the incumbent market share (73% in 2016) shall decrease to:

less than 60% in 2019, < 50% in 2020, < 40% in 2021

Three pillars: opt-out collective switching

- If the incumbent's market share is above the ceiling, the exceeding share of its customers is enrolled in a collective switching exercise:
  - The customer basis is (randomly) picked from the formerly regulated ones;
  - Customers **retain an opt-out option**: if they are happy, they can stay with their supplier, otherwise inertia will lead them to a more convenient supplier;
- Auction design:
  - Either reference price – one-off discount, or spot price + head-on;
- By the end of the transitional period:
  - **Final opt-out collective switching** with all the former regulated customers who have never switched.



2019 **2020** **2021** **2022**

July, 1st 2019
- Phasing out starts
- Clients in MT to PLACET

Late 2019
- Check % former MT
- Auction for Δ(%MT-60%)

Early 2020
- Auction for Δ(%MT-50%)/2

Late 2020
- Auction for Δ(%MT-50%)/2

Early 2021
- Auction for Δ(%MT-40%)/2

Late 2021
- Auction for Δ(%MT-40%)/2

Early 2022
- Auction for residuals

Mid 2022
- Final auction

Ceiling: **60%** **50%** **40%**

Conclusion

- Retail competition may create opportunities for customers and innovation but it needs a careful design;
- No “textbook” solution;
- Italy’s challenges: market concentration and customer disengagement;
- A solution “as plain as the nose on your face”: instead of nudging customers into the regulated tariff, nudge them into the most convenient offer!
  - Transitional period, asymmetric regulation, opt-out collective switching;
- No easy solution, but a comprehensive process.

Thank you for your attention

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