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**Power Failure:
Why Victorian Households Are
Not Plugging into Electricity
Competition**

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Power Failure: Why Victorian Households Are Not Plugging into Electricity Competition

Abstract

In January 2002 the competitive electricity market was opened to include Victorian and New South Wales domestic electricity customers. This research surveyed Victoria households to obtain an understanding of their initial experience of the new market (full retail competition). It was anticipated that corporate strategies to acquire attractive customers whilst shedding unattractive ones would be apparent. Of more immediate interest was the finding that households are pessimistic about the purported benefits of this market. The survey revealed extensive customer inertia and argues that customers' attitudes underlay this inertia. While policy makers had reason to investigate customer attitudes before implementing full competition, they failed to do so, despite the need for active consumer participation to make the market work. The Victorian government faces the spectre of a costly market and policy failure that has its roots in elite policy making that overlooks the importance of popular support if competition policy is to succeed.

Key words

electricity
competition
markets
choice
inertia
switching

Introduction

The Victorian electricity industry has been revolutionised over the last decade as a result of two distinct but related policies: privatisation and market liberalisation, or as it is more often referred to, National Competition Policy (NCP). While NCP does not require privatisation, many of its proponents such as the various Commissions of Audit¹ established by governments over this period have advocated it. The Kennett Liberal/National government (1992-99) pursued both policies, disaggregating and fully privatising the former State Electricity Commission of Victoria (SECV) and taking the lead in introducing competition into the industry.

The purported benefits of competition were a key element of the Kennett government's reform program. Finance Minister Ian Smith said in a statement of government policy:

all Victorians will ultimately benefit from competition in the Victorian electricity industry, in particular from the empowerment that choice will give them in their dealings with their suppliers...it is expected that...retailers will offer innovative price/service mixes tailored to individual customer's needs (Office of the Regulator-General 1994, p. A.2.1.3).

Treasurer Alan Stockdale also stated that:

¹ For example, Department of Finance 1996 *National Commission of Audit: Report to the Commonwealth Government*, Australian Government Publishing Service, Canberra.

Our second aim is to increase choice for both domestic and industrial consumers. Marketplace competition plus greater power in the hands of consumers will return benefits to both households and businesses as they gain greater freedom to choose products, prices and suppliers to suit their preferences. Maximum customer choice is designed to ensure that consumers obtain benefit for themselves rather than the benefits of greater efficiency flowing to those able to exploit monopoly rent (Stockdale 1994, p. 5).

The Bracks Labor government, which replaced the Kennett government in 1999, ultimately delivered competition to the household sector in 2002. Minister for Energy, Candy Broad (2000, p. 3), said the government 'supports the commercial drive in [the electricity] industry. We recognise the benefits that competition and choice can deliver for customers and the State's economy'.

Remarkably, in developing policies to introduce competition to the household sector, neither the Kennett nor Bracks governments assessed Victorians' attitudes to competition. Yet both had reason to believe that competition did not enjoy the level of public support that might have been expected.² The Office of the Regulator-General's (ORG) preparatory research for full retail competition (FRC) revealed that there was significant resistance to reform. Millward Brown (2001a), on behalf of the ORG, found in April 2001 that 71% of respondents to their survey had concerns about competition. This dropped to 55% in July 2001 and rose again in the period from 3 September to 25 November (rolling sample) to 73%. Asked what they were concerned about, respondents indicated costs, reliability, customer service, privatisation, lack of information and foreign ownership (Millward Brown 2001b, 2001c). A year later, consultants working for the Essential Services Commission's report on the effectiveness of FRC concluded, 'Victorians believe that competition is inevitable and they are not strongly for or against it, however they strongly support putting in place measures to ensure that every Victorian has access to essential services' (Wallis Consulting 2002, p. 33).

This is to beg the question of why Victorians believe competition to be 'inevitable'. It is well known that privatisation of the electricity industry was and remains deeply unpopular and that competition, as Millward Brown found, elicited troubling levels of concern. Could it be that competition in electricity is a policy that consumers do not endorse? This possibility raises a further intriguing question: Could lack of support for competition affect households' willingness to participate in the market created by government policy? As the Essential Services Commission (ESC 2002, p. 58) put it, 'Ultimately, the most important indicator of the effectiveness of competition is the extent to which customers are entering into market contracts'. The ESC reported that, six months after the market had opened, only 5% of customers had switched. Their research found, however, that despite retailers recording certain customers as having switched, some of them did not believe or were unaware that they had done so (Wallis Consulting 2002, p. 58). Only 7% of households indicated they were 'very likely' to switch in the near future. On this basis, the ESC (2002, p. 77) had to conclude that 'the performance observed in the electricity retail market to date is not yet consistent with that of an effectively competitive market'. Nevertheless, they are optimistic that customer inertia is only temporary.

Consumers' views of and initial experience with competition in electricity provision form the subject matter of this paper. More specifically, it aims to assess the extent to which Victorians see competition as a desirable policy goal, and to tease out the policy implications. The paper draws on the results of a stratified survey of Victorian households. The stratification involved dividing households into four groups: 'inner Melbourne' (within 10 km of the GPO); 'outer Melbourne' (between 10 km and the boundary of the Melbourne Statistical District); 'rural urban centres'; and settlements with less than 1,000 persons, which includes people residing outside

² Irving Saulwick poll commissioned by Uniting Church in Australia's Commission for Mission in 1995 and the AGB McNair poll commissioned by the *Age* (4 Feb. 1995), and the 'Public Good' survey conducted in 2001 by the Institute for Social Research, Swinburne University of Technology.

of towns ('rural'). The numbers sought for each category reflected the proportion of the total population of households living in these areas. The sample was randomly selected using the White Pages telephone directory, and surveys were mailed to the respondents. Supplementary surveys were delivered by hand to specific low income localities using 2001 Census data, to increase the likelihood of obtaining an adequate number of low income households. The surveys were delivered during August, September and October 2002. Overall the response rate was about 10%. Respondents were asked to reply to the circumstances of the account holder.

Results³

Sample Characteristics

There were 576 responses to the survey. Compared with the 1996 Census data,⁴ the sample was highly representative of the numbers of people born in Australia (71%) and overseas (24% in sample, 23% in Census). One respondent, or 0.17% of the sample, indicated they were of Aboriginal or Torres Strait heritage compared with 0.5 in the Census. Census data revealed that 75% of households speak only English at home. The survey sample over-represented these households at 85%.

In terms of median individual income (which was used rather than household income because retailers' market strategies will reflect what they know about the account holder), the sample under-represented those with less than the median income of \$300 to \$399 per week (37%). 218 households or 37.8% of the sample claimed government concession status for their electricity. 40% of Victorian households claimed concessions in 2003.⁵

Compared with the 1996 Census, the sample slightly under-represented families (Table 1), while over-representing couples without children. Sole parent families, sole person households and group and other family households were reasonably representative.

Table 1: Household structure

	% n=574	1996 Census*
Live alone	21	22.4
Live with partner	35	22.8
Sole parent family	7	9.5
Nuclear family	30	36.6
Share house	5	3.6
Other family	2	1.4
TOTAL	100	100

* ABS 1996 Census of Population and Housing B27 Dwelling structure by household type and family type

The dispersal over geographical areas was reasonably consistent with the state population (Table 2). The 'rural urban centres' and 'rural' categories have been combined for reporting because postcodes were used to identify the localities for the stratification but do not accurately reflect the division between the two.

³ Where percentages in tables and text do not total 100, this may be due to rounding, exclusion of 'don't know' categories, multiple answers or 'not stated'. Throughout the paper, an asterisk denotes any value of less than zero.

⁴ Comparison made with the ABS 2001 Census data on Population and Housing and Census Basic Community Profile and Snapshot

⁵ Total number of households in receipt of electricity concession (740,330) according to 2003-04 Victorian government budget paper no. 3, compared with total number of households in Victoria (1,838,000) according to the ABS (*Australia Now*, Cat. no. 4102).

Table 2: Distribution of sample as percentage of Victorian population

Locality	% Victorian population	% share of sample
Inner Melbourne	25	16
Outer Melbourne	48	52
Rural urban centres	18	13
Rural (other)	10	18
Don't know	-	*
Total	101	100

Switching

Respondents were asked about competition, the benefits that might flow to Victorians as a result of it, and their own choices since the market opened. A key argument raised by proponents of market based reform is that it can be expected to lead to price falls, as consumers gain the power to choose the best deal available for them. After ten years of policy settings intended to foster support for competition in electricity provision, and significant effort on the part of government and electricity retailers to promote the opening of the market to households, it would be expected that domestic customers would exhibit interest in choice.

The tariff that domestic customers were on at the opening of competition is known as the *deemed* tariff. This is intended to be a temporary tariff until customers take up a *market* contract. Customers who unable to obtain a market contract or choose not to enter the market (for example, when they move dwelling) are able until the end of December 2004 to get supply under safety net provisions. This tariff is called the *standing offer*. Each former 'host' or local retailer is required to provide this to customers within its former franchise territory.

The ESC (2002) found that around 5% of customers had switched, which in their opinion and that of the government was too little to permit a conclusion that the market was at present effective. This survey found that 13% of customers had switched (Table 3), but this figure needs to be treated with caution. Firstly, the survey may over-represent switchers as they had more capacity to self-select in responding to the questionnaire. Secondly, as will be discussed later in this paper, around half the switchers had moved residence and few of those who moved indicated they had actively exercised 'choice'. Discounting these customers, the number of switchers was around 7%, which confirms the customer inertia found by the ESC.

Table 3: Customers moving off *deemed* contract

Movement off the <i>deemed</i> contract to	No.	% n=576
<i>Market</i> contract with new supplier	34	5.9
<i>Market</i> contract with existing supplier	25	4.3
Moved dwelling without knowing to what	19	3.3
Off <i>deemed</i> onto <i>standing offer</i> contract	1	*
Total	79	13.5

There are a number of possible explanations for customer inertia. Householders may be satisfied with their current supply arrangement and not interested in switching. It may be the case that, as the ESC believes, it will take time, additional information and education of consumers for the market to mature. Conversely, it may be the case that householders do not want choice. Customer inertia may also be a direct result of retailers' marketing strategies. The survey tested customers' attitudes and experience of the market in order to tease out the implications of customer inertia.

Customer Attitudes

When asked whether they thought competition would mean that they would be better off due to price falls, surprisingly only 10% (n=572) of respondents answered positively (Table 4). The non-English speaking background (NESB) customers' expressed views similar to those expressed by customers as a whole. Rural customers were twice as likely as their Melbourne counterparts to believe prices would increase. Less than 2% of rural customers thought prices would decrease.

Table 4: Attitudes to the price benefits of the electricity market

Do you think that for <i>you</i> competition in electricity will lead you to paying⁶	% n=572
Higher prices	29
Same price	27
Lower prices	10
Don't know	24
Total	100

Such arguments are central to the belief that competition can be expected to lead to improved levels of service. Businesses know that if service levels fall, customers are likely to shift to another company. Again somewhat surprisingly, respondents to our survey were sceptical about this. Only 20% felt that they would experience improved service, with a higher percentage among NESB customers (30%). 15% thought that customer service would worsen, with 48% thinking it would remain the same. Melbourne and rural customers had about the same degree of pessimism concerning the possibility of customer service levels worsening, but there was a significant difference about whether it would improve, with outer Melbourne customers being four times more likely than either inner Melbourne or rural customers to believe that it would do so (4% versus 12%). This difference can be explained at least in part by the higher support for the market amongst NESB customers and their absence from rural areas.

Retail competition has no impact on reliability of supply but there is a fairly wide held misconception that it does, with almost 44% indicating an impact (Table 5). Only 9% expected reliability would improve, while 19% thought it would deteriorate. As with price and customer service, NESB respondents held more favourable attitudes to the market, with 24% believing that reliability would improve (compared with only 9% of non-NESB respondents).

Table 5: Attitudes towards reliability of supply in the private market

In terms of reliability of supply, do you think that competition will mean that most electricity customers will be	% n=574
Better off	9
Same	41
Worse off	19
Varied impact	16
Don't know	15
Total	100

Attitudes varied only slightly by income. Respondents with individual incomes under \$20,000 p.a. were four times more likely to think that competition would result in them paying higher rather than lower prices. Those with incomes over \$20,000 p.a. were around three times more likely to believe they would pay higher rather than lower prices.

⁶ Customers were given the option of stating that they thought they would pay higher prices for greenpower, to avoid confusion relating to a higher price for a different product.

It might be expected that the 10% of respondents who felt positively about lower prices in the market would be highly represented amongst those who had taken the opportunity to switch to a market contract. Of the 59 households who thought they would be better off, only 16 actually switched. In relation to customer service, only 23 of the 117 who thought customer service would be better with competition exercised choice.

Awareness of the Market

When asked to name their own supplier in 2001, 21% (n=532) admitted to not knowing the answer without looking at their bill (Table 6). One respondent named a gas company and 56 used company names that are out of date. Asked to list names of retailers, 4.5% could not name any. Asked if they thought *other* people knew who supplied them, given the changes to the industry, 41% (n=564) felt that other people did not know the name of their own supplier

Table 6: Knowledge of retailers

How many retailers can you name? (please name)	% n=484
0 retailers	4.5
1 retailer	39.5
2 retailers	33.5
3 retailers	15
4 retailers	5
5 retailers	2
6 retailers	*
7 retailers	*
8 retailers	*
Total	100

As Table 7 indicates, most respondents (54%) failed to recall any retailer contacting them, but 16% recall receiving more than one contact. Of the 750,000 offers which the ESC (2002) says retailers made, it is evident that there is considerable unevenness in the distribution across the total of 1.2 million small business and domestic customers. This may suggest, as the ESC indicates, that retailer activity is confined to specific market segments.

Table 7: Retailer activity in the market

Number of customer contacts initiated by retailers	% n=552
Contacted by 0 retailer	54
Contacted by 1 retailer	29
Contacted by 2 retailers	14
Contacted by 3 retailers	2
Contacted by 4 retailers	*
Total	100

'Offers' need to be distinguished from the final agreement to contract. For example, an offer can be made on an unsolicited basis that does not preclude the retailer from later withdrawing it should a customer exhibit interest. From these contacts, 18.5% (n=524) of respondents believed they had been made one offer, 6% two offers, and less than 1% 3 offers. Most respondents had received letters (33%, n=385), with 9% (n=522) approached by telemarketers and 7% (n=534) by door-to-door salespeople. Less than 1% had encountered salespeople in shopping centres. There were no significant differences between NESB and non-NESB households being contacted by retailers.

A small number of the respondents (9%) actively sought out an offer, although not all of these were successful in obtaining a contract. While customer interest is low, low participation may also be explained by retailer preference for higher margin customers.

Factors Influencing Choice

Respondents were given a list of factors that may have influenced them when considering a choice of supplier. They were not asked to rank these factors in relation to each other.

Table 8: Factors that are important in shopping around

Comparison of influences on shopping ⁷	% Very Important	% Important	% Not Important	n=
Price	64	25	11	476
Greenpower	30	37	33	443
Combined bills	31	30	38	460
Energy efficiency help	20	25	55	434
Help buying appliances	16	23	57	437

Perhaps predictably, those in full-time work and on higher incomes were more interested in 'greenpower' (renewable energy) deals. During this period, known greenpower offers were more expensive than *deemed/standing offers*. Social security beneficiaries were three times more likely to say that greenpower was not important rather than very important. Nevertheless, there was still interest, with just under 20% (n=429) of respondents with incomes under \$20,000 saying greenpower was very important or important. The perception at the time (based in reality) that greenpower was more expensive clearly deterred these customers from switching for this reason. There is currently no greenpower *deemed/standing offer*. Interest in energy efficiency is far less across all income groups, with the exception of social security beneficiaries who rated it equally with greenpower. Combined bills (known as 'dual fuel' deals) have popularity, but these are commonly offered with a price discount, and the survey did not attempt to distinguish between the price incentive or other perceived benefits of combining bills. There was a considerable level of interest in linking the buying of appliances with purchase of electricity. Some retailers currently offer such services.

Why Customers Did Not Switch

Up until this point we have sought to understand why the switching rates in the fully competitive electricity market have been so low. Respondents to the survey indicated a strong interest in price savings but lacked faith in the market to deliver price reductions or better service. The survey also found that retailer activity would appear to be focused on some customer groups but not others.

Table 9 shows that of those respondents who had considered changing but had not done so, 19% (n=278) were still thinking about the possibility. The majority (52%) of customers in this group of potential switchers had been deterred from entering the market by their experience to date, including 42% (n=40) of those respondents who held positive views about the benefits of competition. The perceived 'hassle' of changing deterred the most (18%), while insufficient information and inability to compare offers were also problems. 9% felt the incentives to switch were too small.

⁷ These are the top five choices out of a set of nine. Support for the remaining four options was low.

Table 9: Reasons for considering switching but not doing so

	% n=278
Have not taken next step	19
Unable to obtain sufficient information	12
Unable to compare offers properly	13
Put off by hassle of changing	18
Did not see anything worth changing for	9
No supplier made an offer	27
Other	2
Total	100

27% had not received an offer. These may be low value customers who, from a retailer's perspective, do not warrant the cost of their acquisition.

Of those respondents who had not considered switching at all, 11% answered that they were unaware of competition (Table 10). 15% were anticipating possible switching, but 68% were resistant, either actively or passively. Comments in the 'other' category are worth closer inspection: 'all the same', 'can't be bothered', 'can't see the point', 'expect minimal impact', 'lack of knowledge', 'no time to shop around' and 'privatisation protest' were some. None were positive towards competition.

A number of respondents volunteered unsolicited comments. There was only one theme: a belief in the collective public interest of public ownership. The following are two examples:

Believe profit motive will result in me paying more and all companies will be out to screw me out of money, not give it to me.

At midnight on 24 March 1944 I was shot down in a Manchester bomber after bombing Berlin. One objective was to keep the world free and own our country and its services. Now the idiot politicians have sold all our essential services putting us all at risk. We could now manage with half the bastards.

Table 10: Reasons for not considering switching

	% n=241
Did not know I could	11
Satisfied with current arrangement	55
Have not got around to it	11
Waiting to join community buying group	*
Waiting for gas competition	1
Waiting for market to development	3
Put off needing to learn so much	4
Afraid to change	2
See not changing as a kind of protest against privatisation	7
Other	5
Total	100

These less than positive views about the market, combined with those who are satisfied with the pre-competition status quo, means that about half of the respondents are not looking to enter the market at this point or look likely to. There was nothing to distinguish one income group (or source) from another among these respondents.

Discussion

The Economic Planning Advisory Committee (1989) and the Industry Commission (1991) promoted electricity competition well over a decade ago. The Hilmer Report (Hilmer 1993) rapidly became the basis of NCP. Subsequent reforms to a range of sectors, including electricity, were largely based on later Industry Commission (1995) modelling of the Australian economy that anticipated \$23 b worth of savings should competition be implemented. However, NCP has been criticised for being implemented on the basis of theory rather than 'economic analysis' (Quiggin 1999, p. 74). After ten years of policy settings intended to foster support for competition in electricity provision, and longer for markets more generally, it could be expected that there would be more popular support for the policy, but this is doubtful in relation to essential services.

Graeme Samuel (2003), the then National Competition Council chairman and now chair of the Australian Competition and Consumer Commission, captures the continuing lack of support for competition policy: 'In a society predicated on the notion of a "fair go", we should also not be too surprised when we see a questioning of policies that may appear to sacrifice fairness for economic growth.' He articulates a collective resistance to elite policy, noting that people are resistant to economic reform because of its perceived impact upon community and because 'corporations [are] perceived to be delinquent citizens'.

The introduction of competition into the electricity sector to the household level is highly reliant on customer endorsement and participation. The levels of antipathy exhibited by respondents to this survey have antecedents that should make the finding of customer inertia unsurprising. The 1990s witnessed both a Senate inquiry and a House of Representatives inquiry in response to community concerns about NCP. In addition, customer inertia has been evident in other jurisdictions and analogous industries. The decision to implement FRC when customer endorsement was uncertain was therefore a considerable risk, and arguably a poor basis for policy making.

Domestic customer inertia in the electricity sector may well be enduring. This raises important policy implications, some of which were foreseen. SRC International (1998) warned the New South Wales Independent Pricing and Regulatory Tribunal that Australian domestic customers were unlikely to be motivated to switch for amounts that would sustain the profits of retailers. They envisaged that customer inertia would result in retailers raising prices to monopoly levels.

In order to protect customers from such monopoly prices, SRC International argued the response of governments would be to impose price controls. In Victoria as in the United Kingdom, the market opened with price controls (price caps) already in place. These are a maximum price sanctioned by the regulator or government. Price caps in Victoria were imposed because the incumbent retailers proposed substantial price increases on the eve of the opening of the market. The retailers argue that the tariff that domestic customers are on at the beginning of competition (the deemed tariff) and the safety net (standing offers) need to be higher than the prices offered in the market; competition is stimulated by new entrant retailers perceiving an opportunity to take profits by undercutting incumbents, and hence competing the price down. This gap between the opening price and the lower market price (the competition incentive) is known as 'headroom'. The Victorian government agreed that prices needed to be above market prices at the outset of competition.

The difficulty for government is the possibility of continuing and widespread inertia. This would denote market failure and by default leave customers exposed to price limited only by price caps, that is, government sanctioned monopoly prices. There is already evidence in the United Kingdom that customer inertia has resulted in extensive monopoly pricing, raising doubts as to

whether the domestic market could ever be considered functionally competitive (Brigham and Waterson 2003, p. 12).

In addition to what may be sustained customer inertia, the single largest group who are actively participating in the market are low income (therefore likely to be low volume) and hence low margin customers. This suggests that such households are very price sensitive and responsive. Retailers may well instigate changes to their marketing and customer acquisition programs to minimise the migration of this customer segment. As the ESC (2002) noted, retailers appear at the outset to be avoiding low volume customers. If this is the case, it would result in a declining number of customers switching unless it was offset by increases in other customer segments, but there is no evidence to suggest that higher margin customers (other than the small group seeking greenpower deals) are likely to change their attitude to competition.

As this survey also identified, around half of the switchers entered the market as a result of moving dwelling. These customers have higher transaction costs and as a consequence lower the margin available for the retailer. This is especially true of renters, who move on average once every five years, compared to home owners' average of every seven years. Rental housing is also the growth segment of the housing market increasingly servicing low income households (Burke and Ralston 2003).

It is already evident that retailers are attracted to acquisition methods that reach wealthier customers while effectively screening out many low income customers. Loyalty programs are a prime example. Whilst exclusion from the market is disturbing, the alternative is the possibility that price-conscious low income households may be subject to exploitation by retailers. For example, offers of large cash rebates are attractive to those on low fixed incomes. One Victorian retailer provides such inducements, but these offers also involve tariff structures that can be highly disadvantageous to small volume users. The upfront rebate benefit may be more than offset by a higher cost of consumption.

Conclusion

This research sought to understand the attitudes and initial experience of households in the recently opened fully competitive electricity market in Victoria. The survey discovered a substantial gap between the views of elite policy makers and the aspirations of ordinary Victorians. This gap can help explain customer inertia in the market. The survey also found that current participation rates are largely the result of households moving dwelling and/or the experience of fuel poverty.⁸ The small margins and high transaction costs may result in retailers attempting to recoup a greater proportion of costs from these customers, or minimise their migration to market contracts.

There are important policy lessons here for government. It cannot be assumed that competition will emerge simply because a competitive framework has been put in place. Not only is there the risk that customer inertia will result in customers paying higher prices than if there had been no market, but the costs of implementing and running the market, estimated at between \$1.5 and \$4 billion nationally over the first five years,⁹ must be recovered from households regardless of the success or failure of the market. Customers may legitimately ask about the adequacy of the analysis that was used to support the Victorian government's decision to proceed with FRC. The issue now is what levels of customer inertia will the government tolerate

⁸ 'Fuel poverty' refers to people's inability to meet their basic needs for energy and arises as a result of an intersection between inadequate income, poor thermal efficiency of housing, inefficient appliances, needs (life cycle stage) and tariff structures.

⁹ Energy Action Group 2002 *Submission to COAG Energy Markets Review*, <<http://www.energymarketreview.org/submissions/EAGcl.pdf>>.

and for how long. Persistent customer inertia means that as more time passes, the loss to the community and to the economy more generally mounts.

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