Governance by Indicators:
the Pitfalls of the EU's Retail Energy Market Barrier Index

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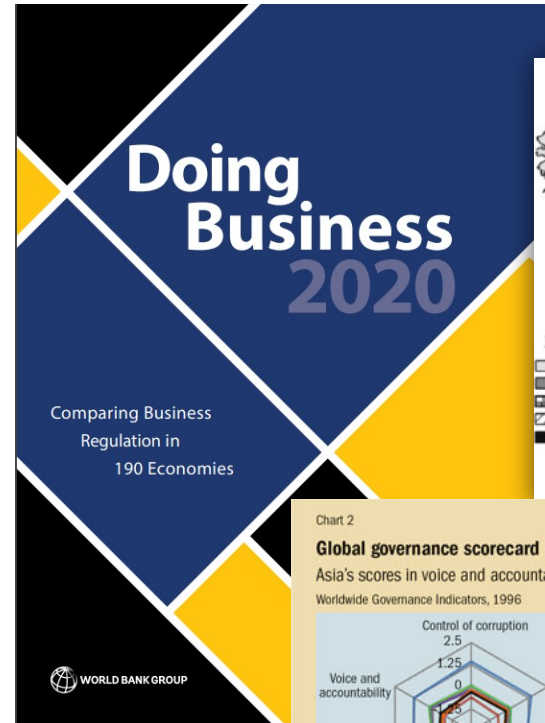Josephine van Zeben, Wageningen University & Research

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Structure of the Presentation

1. What 'Governance by Indicators' means;

2. The Barrier Index and the hypothesis of its pitfalls ;

3. Testing the reliability of Barrier Index:

      3.1. Methodology;

      3.2. Data Collection in the National Reports in the Netherlands and Portugal;

      3.3. Conclusions;

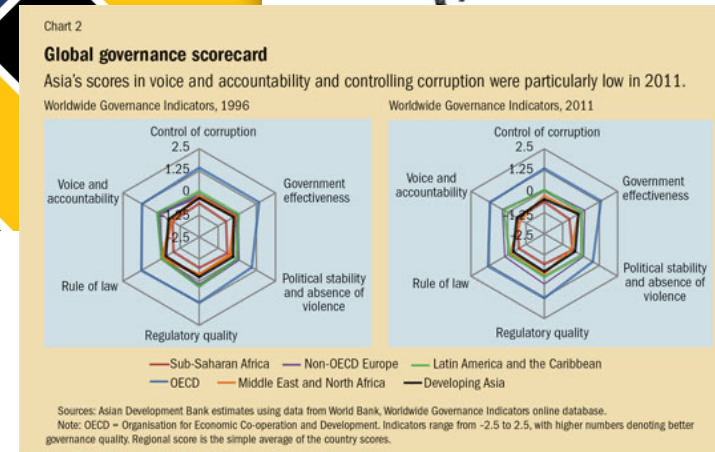4. Policy recommendations.

The use of indicators as a technique of global governance is increasing rapidly. Major examples include the World Bank's Doing Business Indicators, the World Bank's Good Governance and Rule of Law indicators, the Millennium Development Goals, and the indicators produced by Transparency International.

The burgeoning production and use of indicators have not, however, been accompanied by a systematic comparative study of, or reflection on, the implications, possibilities, and pitfalls of this practice.

La Porta el al. 1997 (legal origins)

Global Governance Scored

The Barrier Index (BI) is the result of the European Barriers in Retail Energy Market Project (thereon, the EB Project).
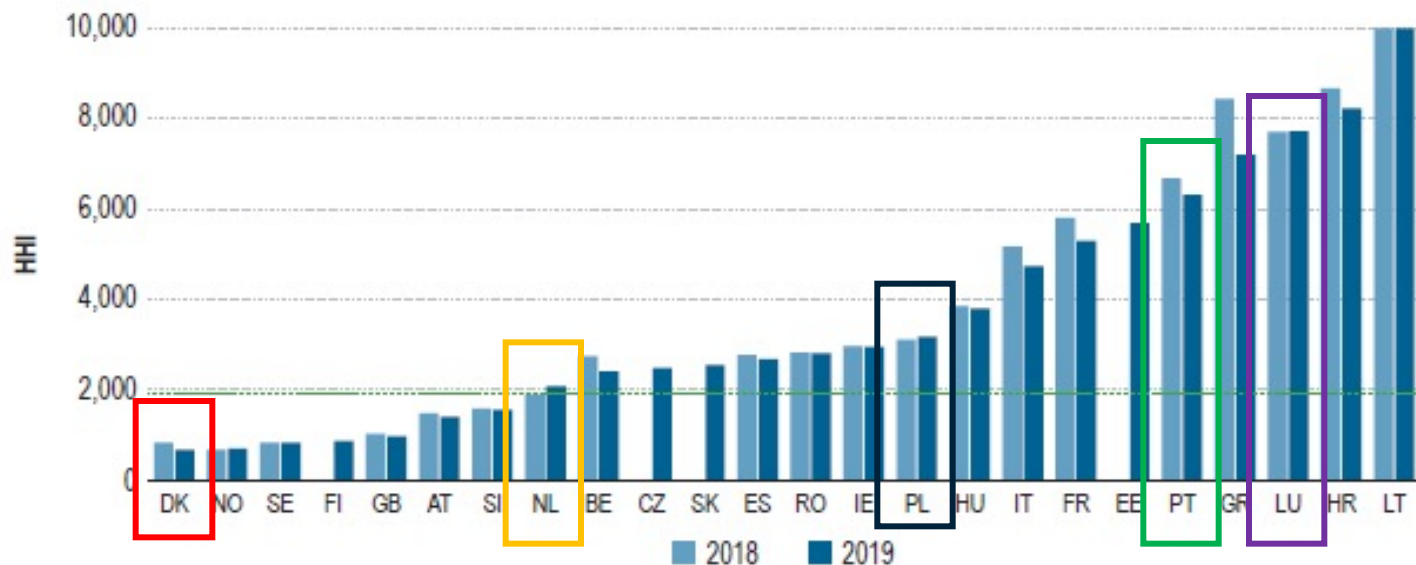
The EB Project was commissioned by the European Commission to research the extent to which energy suppliers across Europe encounter barriers to entering and competing in the retail electricity and gas markets, targeting the residential market segment.

The final report presents the results to a general audience (Final Report 2021). The index report comprises the detailed methodology for the index and the country rankings (Index Report 2021).

The findings are supplemented by 28 lengthy national reports—for a total of more than 2000 pages.
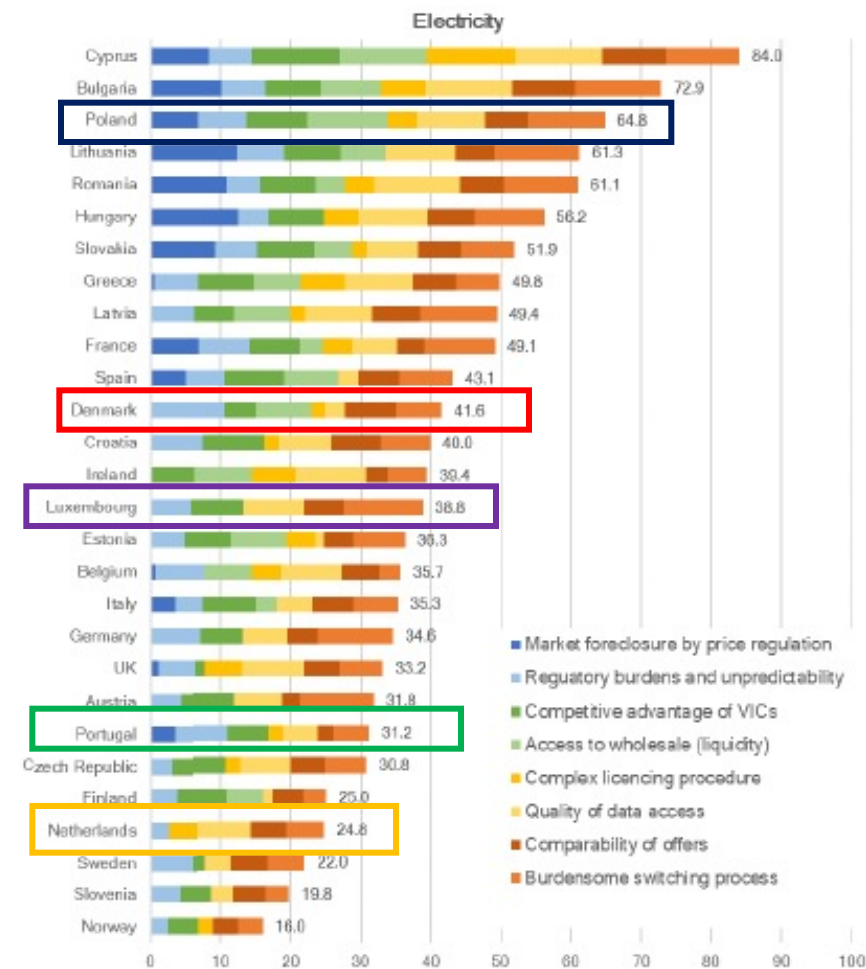
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Source: *ACER (2020)*

The HHI ranges from 0 to 10,000: if a market is occupied by a large number of firms with a small market share, the HHI will approach 0; in case of a monopoly – a market controlled by a single firm – it will reach 10,000.

For each indicator, the BI scores European countries between 0 and 100, with barriers to entry increasing with the score (i.e. a score of "0" means no barriers at all, a score of "100" means it is impossible to enter).
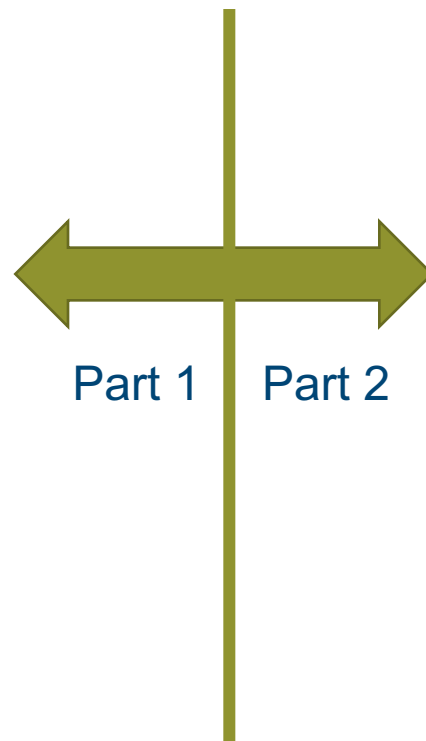
Source: *Felsmann, B., & Vékony, A. (2021)*

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Part 1   Part 2

Index Methodology

Quality of National Data Collection

Handbook on Constructing Composite Indicators by the Organization for Economic Cooperation and Development and the Commission's Joint Research Center (OECD-JCR 2008)

| 1. Theoretical Framework | 2. Selection of variables | 3. Imputation of missing data | 4. multivariate analysis, | 5. Normalisation, | 6. Weight and aggregation, | 7. Robustness and sensitivity, | 8. Back to real data, | 9. Links to other variables | 10. Presentation and visualisation |

1. Barriers are conditions that constrain the ability of actual or potential suppliers to enter the retail market. Second, barriers could also hinder a supply from competing effectively in operating and expanding its market share after entering the market.

2. The BI project develops a categorisation of barriers to enter and effectively compete in the retail energy market, composed of 4 barrier blocks, divided into 9 sub-groups of barriers categories and 45 individual barriers

BLOCKS	CATEGORIES	
Regulatory Disincentivi-sation	Price regulation	Price regulation discriminates against certain suppliers
		High penetration of price regulation
		Low margin of regulated offer (margin squeeze)
	Burden sharing	Obligation to collect tariffs unrelated to energy on behalf of others.
		Obligation to keep a minimum-security stock as a gas reserve
	Regulatory unpredictability	Suppliers face uncertainty because of a newly liberalised regulatory environment or uncertain future development of the regulatory framework
		Uncertainty caused by industry actors influencing legislation
		Attitude of authorities hinders development of the market
		Uncertainty regarding environmental obligations and non-renewable generation capacity
	Access to Innovation	Data protection issues
		Lack of incentivisation for novel pilot projects or post-pilot market rollout
		Lack of data for innovative product development
		No fit between new business models and existing regulation/obligations
		Missing flexibility in tariff structures
		Market structures do not incentivise novel products (missing perceived value)
Marquet inequality	Unbundling and market power	Lack of brand unbundling
		Discriminating, strategic behaviour of incumbent, and obstruction by other market players
		Strategic, unfair advantage of vertically integrated market players and lack of transparency
		Limited or biased access to production.
		Discrimination against new and small market players in capacity and ancillary services markets.
	Equal access to and maturity of wholesale market	Discriminatory market platform access (standards, guarantees, etc.)
		Low liquidity in the wholesale market
		High price or volume risk in energy procurement
Operational and procedural hindrances	Sign-up & operations compliance	Poor availability of information for market entrants & active participants
		Heavy administrative process for entry (registration / licensing)
		High financial requirements (incl. long working capital cycles) and forced risk during operations
		Excessive reporting requirements during operations
		Excessive information requirements around billing and energy labelling
		Highly complex or country-specific systems & processes
		Regional differences or differences between DSOs within a country
		Cumbersome or biased switching process
		Unduly burdensome environmental obligations
		Unduly burdensome or insufficiently regulated market exit
	Data access & processes	Lack of data hub
		Complex, heterogenous IT infrastructure and/or low level of digitalisation
		Missing access or poor quality of operations-critical data
Customers inertia	Customer orientation	Lack of information regarding available offers and switching possibilities
		Low customer awareness or interest makes it difficult to attract customers
		Insufficient price signals for end-users
		Changing supplier is cumbersome or has little pay-off for the customer
		Consumers prefer status quo
		Lack of trust in new or foreign suppliers and in new technology

No information about the categorization of 45 individual barriers. E.g., switching fees are not considered a barrier.

BI vs. ARCI (ACER Retail competition Index)

Handbook on Constructing Composite Indicators by the Organization for Economic Cooperation and Development and the Commission's Joint Research Center (OECD-JCR 2008)

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3. The EB Project considers five selection criteria: the extent to which an individual barrier is **solvable by regulation, relevant, easily interpretable and understandable by the target audience, reliable, and available.**

The EBI Project evaluates each barrier by scoring them between +++, ++, +, and - for all the five data selection criteria.

BARRIER BLOCKS	INDICATORS	SUB-INDICATORS
Regulatory Disincentivi-sation	Market foreclosure by price regulation	1A: Penetration of price regulation
		1B: Mark-up of the regulated offer
	Regulatory burdens and unpredictability	2A: Regulatory burdens
		2B: Regulatory unpredictability
Market inequality	Competitive advantage of vertically integrated suppliers	3A: Market share of vertically integrated suppliers
		3B: Strictness of DSO unbundling
	Unequal access to wholesale markets	4: Liquidity of the wholesale market
Operational and procedural hindrances	Length of licensing procedure	5: Time to get a supplier license
	Quality of data access	6: Quality of data access
Customer inertia	Comparability of offers	7A: Consumer's inability to compare offers
		7B: Availability of comparison websites
	Perceived difficulties of switching	8: Perceived difficulties of switching

Accuracy, timeless, and comparability of the data are not considered as a selection criterion (Eurostat).

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The focus on the analysis of the **Dutch and Portuguese national reports** rests on the following considerations.
➢ these two countries are of similar size, and the liberalisation process started at the same time.
➢ an undeniable mismatch exists between the image provided by the HHI by ACER and CEER and BI developed in the EB Project.

In addition to choosing two countries to compare, it is also necessary to select a subset of indicators as terms of comparison:
➢ we focus on the indicators where the differential between the points scored by the Netherlands and Portugal is the highest in absolute value.

- market foreclosure by price regulation (0 vs 2.9),
- ~~regulatory burdens and unpredictability (2.2 vs 5.9),~~
- competitive advantage of vertically integrated suppliers (0 vs 4.6),
- comparability of offers (4.1 vs 1.8).

3.2. Data Collection in National Reports

Indicators	Netherlands	Portugal
competitive advantage of vertically integrated suppliers (0 vs 4.6)	• The EB Project, for reasons that are not made explicit, has not used the HHI as a reference. • Not clear whether they are including the non-household market, but there are pieces of evidence that numbers are imprecise.	• EB Project, for reasons that are not made explicit, has not used the HHI as a reference. • The use of national data concerning retail market including non-households.
market foreclosure by price regulation (0 vs 2.9)	• While the report argues Dutch survey prices, in fact, Dutch regulator performs on a general overview of the reasonableness of the contractual conditions, including prices.	• It fails to point out consider in this analysis the fact that 87.1% of households have already opted to join the liberalised market.
comparability of offers (4.1 vs 1.8)	• the 2018 MMS ("Market Performance Index published by DG Justice and Consumers") presents the comparability of offers in electricity services as within the European average (European Commission 2018, p. 83). When we look at the 2020 MMS, we find that 59% of European consumers were satisfied with the comparability of offers. Crucially, the remarkable number of 81% of consumers in the Dutch market was satisfied (European Commission 2020a, p. 4).	In the 2018 MMS, comparability in electricity services was below the European average (European Commission 2018, p. 95). It follows that Portugal could hardly be considered the best country based on this data. In the 2020 MMS, instead, the situation has improved. Country to the European average of 59%, 68% of Portuguese consumers are satisfied (European Commission 2020b, p. 4).

Our analysis identifies several pitfalls in the construction of the Dutch and Portuguese BI:

- obscurity on how the collected data are quantified to build the Barrier Index (Section 3);
- relevant data about market concentration (the HHI) ignored with no explanation (Section 4.1);
- report of data that is misleading (again about market concentration and also price regulation—Section 4.1 and 4.2) or of unclear origin (consumer perception of comparability—Section 4.3);
- missing data that is inexplicably used to quantify an indicator (existence of comparison websites in the Netherlands—Section 4.3).

The pitfalls found in the methodology, data collection, and choice to exclude data compromise the reliability of the policy recommendations formulated by the EB Project for at least the Netherlands and Portugal.

- Transparency > transparency is the duty of index builders to disclose all the meaningful choices made while building an index.

  Is it enough?

- Accountability for pitfalls in the methodology > liability for the flaws in the methodology, namely identification, selection, and categorisation of indicators, is unplausible. Are the principles of administrative law (transparency, access, participation, and review) enough to regulate indicators?
I.   Indicators created by public institutions;
II.   Indicators created by private actors under the contract with a public institution and exercising a function expected from public institutions;
III. Indicators created by Private institution on voluntary basis.

- Accountability for pitfalls in the data collection > on the contrary, liability for misrepresentation of collected data is plausible.

Thank you!

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