



RESEARCH NOTE

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Petrol Price Rises: Causes and Consequences

The rise in petrol prices over the past 18 months has led to debate about the causes. This Note examines the main components of petrol prices and the reasons prices have risen.

An accompanying Research Note *Petrol Prices—The Statistics* contains supporting data.

Crude oil

The rise in petrol prices, which began in the first half of 1999, is mainly the result of higher international crude oil prices. Early in 1999, the Organization of Petroleum Exporting Countries (OPEC), whose members produce about 40 per cent of world crude oil, announced that its members would reduce output. These cutbacks to supply and higher demand resulting from growth of the world economy have boosted crude oil prices. They rose from a low of around US\$10 per barrel in December 1998 to US\$25 a year later and to around US\$31 in mid-

August 2000.¹ Crude oil producing countries are thus the main beneficiaries of the rise in prices while consumers are the losers.

Exchange rate

The second determinant of petrol prices in Australia is the exchange rate between the US and Australian dollars. World crude oil prices are denominated in US dollars. Depreciation of the Australian dollar relative to the US dollar causes Australian dollar prices to rise. The Australian dollar has fallen from around US 63 cents in March 1999 to US 57 cents on 25 August 2000, a depreciation of over nine per cent.

Refining, distribution and retailing margins

The profit margins of Australian refiners, and of the distributors and retailers of refined products are a third component of petrol prices. The evidence suggests that

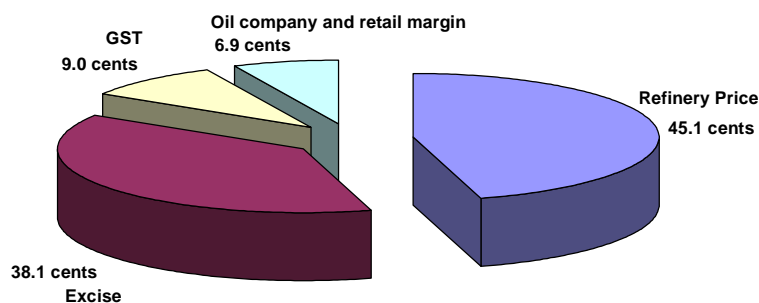
increased profit margins have not contributed to higher petrol prices over the past year. The Australian Competition and Consumer Commission (ACCC) used to set maximum wholesale petrol prices but, since 1 August 1998, it has had only a monitoring role. In November 1999, the ACCC found that average capital city and average country unleaded petrol retail prices had increased by less than international prices over a six month period. Indeed, the study concluded that some of the rise in international prices had not been passed on to consumers in both city and country areas.²

Taxation

A fourth component of petrol prices is taxation. The price of Australian crude has been set by world markets since import parity pricing was announced in the 1978–79 Budget. Since 1 July 1990, the Federal Government has imposed excise, a petroleum resource rent tax, and a royalty on petroleum produced in Australia.³ But most attention is focused on the excises on unleaded and leaded petrol and the Goods and Services Tax (GST) because they affect pump prices.⁴ The excises are indexed to movements in the consumer price index (CPI) twice a year. Petrol excise is estimated to generate \$7.3 billion in 2000–01.⁵

A common misconception is that the Federal Government spends the GST revenue. While it is true

Dissection of Typical Pump Price
Typical Pump Price=99.2 cents per litre



Source: Shell Oil Company

that the Federal Government collects the GST, all GST revenue is passed to the States.⁶

Tax reform

To offset the effect of the GST on petrol prices, the Government announced on 22 June 2000 that it would reduce excise by around 6.7 cents per litre. The Government also claimed that tax reform would result in estimated cost savings of 1.5 cents, bringing the total fall in prices to 8.2 cents.⁷ But the Australian Automobile Association (AAA) claims that, at best, it will take five years for the refining industry to realise the savings, and that savings will not be available to all petrol importers.⁸ This is evidence that, at current price levels, the reduction in excise has not been enough to offset the GST. To that extent, consumers are worse off.

There will be flow-on consequences from the interaction of the GST and the indexation of excises. The GST will cause the price *level* and the CPI to rise. The indexation of excises to the CPI will generate additional tax revenue.⁹ The indexation of excise will in turn increase the base on which the GST is levied. But it should be noted that indexation does not increase, but merely maintains, excise at the same level in real terms.

The GST, being based on value, will generate revenue for the States as petrol prices rise. But in this respect, petrol is no different from any other good whose price has risen. And the revenue-raising effects of the GST are no different from other value-based taxes, such as the former wholesale sales tax. It is sometimes noted that the GST is a tax on a tax. But the previous

tax system also had the same feature.

Petrol prices have risen relative to the prices of other goods and services, and there have been calls on the Government to cut excise or to halt indexation. But to maintain the integrity of the Budget, the Government would have to raise other taxes to offset the revenue loss or reduce outlays. For example, a one cent reduction in excise would result in revenue forgone of around \$180 million. Moreover, it can be argued that consumers should not be insulated from the relative price rise because that would delay desirable adjustment, e.g. by driving less or buying more fuel-efficient cars. The rise in the price of imported crude oil is, in effect, a redistribution of income from Australia to foreign producers. Failure of consumers to respond to the rise in the price of crude oil merely delays this adjustment.

Finally, it should be remembered that the rise in petrol prices is an international phenomenon, and that petrol taxes in Australia are still among the lowest in the world. For example, in 1999, only three of eleven OECD countries had a lower proportion of taxes in regular unleaded petrol prices.¹⁰

1. See <http://www.eia.doe.gov/emeu/international/crude1.html>
2. ACCC, 'Increase in the Average Retail Petrol Prices in Australia Compared with the Rise in International Prices', 23 November 1999.
3. For a brief description of the excise and resource rent tax, see Budget Paper No. 1, 2000–01, pp. 5–12 and 5–14.
4. From 1 July 2000, the excise rates are 37.481 cents per litre

on unleaded petrol and 39.725 cents on leaded petrol. GST is levied at 10 per cent of the final price, which includes excise.

5. Budget Paper No. 1, 2000–01, pp. 5–13.
6. Net of administration costs.
7. 'Petrol and Diesel Excise Reduction and Fuel Sales Grant Scheme'. Joint press release by the Acting Treasurer and the Deputy Prime Minister, 22 June 2000.
8. AAA, 'Petrol Prices to Rise as Result of the GST', Press release, 23 June 2000.
9. The last increase in excise on unleaded petrol in August 2000 was \$0.006 cents per litre. The increase due in February 2001 may be in the order of \$0.02.
10. International Energy Agency, 'Energy Prices and Taxes', quarterly statistics, fourth quarter 1999.

Richard Webb
Economics, Commerce and
Industrial Relations Groups
Information and Research
Services

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