

CHAPTER 8

Managing Petrol Prices into the Future

8.1 In this report the Committee has considered the major factors leading to the mid-year rise in petrol prices and examined how petrol prices affect people in the community and what the ACCC is doing to uphold integrity in the petroleum market.

8.2 As discussed in Chapter 2, events in the international market strongly influence the Australian petrol market. Fluctuations in exchange rates, shifts in the international supply and demand balance for both crude oil and refined product and occurrences like cyclones and violence in producer countries all influence domestic petrol price fluctuations. Nationally, petrol taxes add significantly to the price of petrol but have been at a fixed level or have decreased in real terms since 2000 and are amongst the lowest in the OECD. And within the petrol market, competition between sellers (both the wholesale and retail levels) leads to petrol price cycles, resulting in significant variations in the price of petrol. In areas where competition is limited or lacking, such as in the country, this generally results in consumers paying higher petrol prices.

8.3 These findings are not new, and their validity has been substantiated in the findings of a number of past reports. The ACCC has also completed several investigations into petrol pricing and has published a range of material to allay public concern about why petrol prices fluctuate and show consumers how they can take advantage of the price cycles.

8.4 The Committee heard from a wide range of stakeholders, including representatives from the petroleum industry, motoring organisations, consumer bodies and from consumers themselves. It was not uncommon for the views espoused by one submitter to vary greatly from those expressed by another. However, some key themes emerged, namely:

- rising petrol prices hurt consumers and certain industries, particularly when significant and rapid increases occur (such as the spike in pump prices observed around mid 2005) and so the question arises as to whether the Australian Government should intervene in the market to lower prices;
- there is a widespread lack of understanding about why some steep rises occur and there is suspicion that the oil companies use events such as conflict in the Middle East or events affecting international refinery production as opportunities to significantly raise prices and consequently, profit margins;
- there is a lack of appreciation of the overarching importance of international factors, including the nature of the international trade in commodities and parity pricing, and how these influence the petrol price;
- there is a lack of appreciation that Australian consumers pay less for their petrol than consumers in almost every comparable country in the world;

- many people don't understand the structural elements that make up the retail petrol price, the relative contribution of each, or how the market determines the price at the bowsers;
- regular price cycles are a source of frustration for consumers but they are a feature of competitive markets and understanding them can help consumers save money;
- many consumers apparently think that the practice of raising and lowering of prices almost in tandem by petroleum retailers is a sign of collusive behaviour and require assurances that anti-competitive behaviour in the market is not occurring;
- the petrol price differential between metropolitan and regional areas can be significant and the reasons for the difference go beyond higher transportation costs alone;
- there is misunderstanding about the application of GST to fuel prices and concern about whether the current level of taxes on fuel is appropriate;
- whilst the ACCC publishes a large amount of information on petrol prices and cycles, this may not be reaching consumers or sending out the right messages to consumers about the issues that they are really concerned about; and
- there is a lack of understanding in the community that proactive monitoring of, and reporting on, the behaviour of the petroleum industry at the refining, wholesale, and retail levels, as well as the investigation of consumer complaints, is occurring and is effective.

8.5 Evidence examining these issues was included in the body of this report. In this chapter the Committee outlines its conclusions, seeking to bring together the findings that emerged from this inquiry, and provide recommendations to improve the management of petrol prices in Australia.

Intervening in the market

8.6 A wide range of options are potentially available to Governments for increasing petroleum industry regulation, should that be demonstrated as necessary. Petrol prices could be controlled using previously used price notification provisions, meaning that retailers or wholesalers would have to notify the ACCC of any price rises if the proposed price is higher than the price level operating for the previous 12 months. Furthermore, price oversight methods could be imposed so that businesses must collect and report to a relevant Government body (such as the ACCC) relevant information on petrol pricing such as the breakdown of prices at the wholesale level including profit margins, operating costs and various other components which make up the price of petrol. Or a system could be implemented similar to that in Western Australia where fuel prices must be submitted to a Government body and then maintained by the petroleum retailer for a certain period of time such as 24 hours.

8.7 These are all options for intervening in the market. However, such intervention can have unwanted and unintended consequences that may negate any

perceived short-term benefits of intervening. Refiners may opt to exit the Australian market if they assess that it is no longer sufficiently profitable to maintain a presence in Australia, therefore leading to fewer competitors, less competition and less choice for consumers. Intervention can also confuse price signals to consumers, which are important if they are to respond appropriately to what may be fundamentally changing market conditions. Most importantly, intervention can interfere with competition in the market, leading to adverse outcomes for consumers. As a result, a number of motoring bodies, industry and community interest groups voiced strong support for not intervening in the market.

8.8 The Service Station Association told the Committee:

...you can never come up with an effective regulation that guarantees or enhances competition. A deregulated free market will always give you the best outcome. The measures that need to be taken are to make sure that you do not enable one sector or one player in the market to become so dominant that it actually inhibits competition. They are monopoly laws in the extreme, and again I come back to Trade Practices Act issues that the chair raised earlier. Again, none of the measures are absolutely perfect, and you will never come up with a perfect system, but the most important thing is that if we see the emergence of changes in the structure that could lead to a lessening of competition then we need to be wary and we need to put in place measures that stop that.¹

8.9 The Royal Automobile Association of South Australia submitted that:

In addition, the RAA advocates...[t]he recommendation of the 2001 ACCC Inquiry 'Reducing Fuel Price Variability' against legislating to eliminate or reduce price cycles given these price cycles enable consumers to buy fuel at lower prices overall.²

8.10 Whilst the effect of increased government intervention in the market were described by the Australian Capital Territory Government as providing little gain to consumers:

We believe that attempts to actively manage petrol prices through tighter industry regulation or the application of expensive subsidies leads to distorted price signals, which discourage consumers from considering more environmentally-friendly fuel/transport options.³

8.11 Caltex Australia commented that an unregulated petroleum market helps ensure the long-term viability of Australia's domestic refining industry:

Let me conclude by saying that Caltex supports the continuation of an unregulated petroleum products market in the belief that the current

1 Mr Ronald Bowden, Chief Executive Officer, Service Station Association Ltd, *Committee Hansard*, 23 August 2006, p. 34.

2 Royal Automobile Association of South Australia, *Submission 21*, p. 2.

3 ACT Government, *Submission 41*, p. 3.

arrangements provide the best environment to encourage the large, ongoing requirements for capital investment in the industry and the maintenance of a secure supply of transport fuel for Australia.⁴

8.12 The Committee concluded that the fluctuations consumers observe in the market, such as the rapid and reactive price increasing and decreasing that occurs between competitors when one alters its price, indicates the presence of a healthy, transparent and competitive marketplace:

...this is a market characterised by not only a very high level of transparency of prices but also a very high level of velocity of information about prices. When you get a high level of transparency and a high, almost instantaneous, level of velocity of information in a market with four or five players with a uniform commodity so that they have to compete on price, not on quality or anything else, what you will get is almost uniformly parallel conduct. On a superficial view, that might look like collusion but in fact it is driven by the very opposite set of phenomena...⁵

8.13 This view was shared by Mr Graeme Samuel, Chairman of the Australian Competition and Consumer Commission (ACCC), who stated:

...if you take steps to endeavour to regulate that or to diminish the price cycle, invariably what will occur is that the price will be set, on average, at a higher level, and those who take advantage of being informed and purchase at the lower points of the cycle will suffer loss. This price cycle is a very interesting thing. It is a highly emotive issue, and it causes extraordinary emotive reactions which, on the many observations we can make, seem to be somewhat irrational. The price cycle is evidence of a volatile market in pricing which, of itself, is evidence of competition. If you had less competition, you would actually see a steady price that would run throughout the week, throughout the month, and you would not see it drop to below cost levels...⁶

8.14 The most regulated petroleum market in Australia exists in Western Australia under the FuelWatch system. Whilst advocates of FuelWatch argued that it has led to lower prices overall, there is an absence of information to directly link such intervention in the market to lower petrol prices and a better outcome for consumers, as was discussed in Chapter 3 – The Petrol Price Rollercoaster.

8.15 Based on the findings of this inquiry, there are clearly many benefits to be derived from a 'free market'; that is, a market which is largely unregulated and where prices are set by market competitors according to the forces of supply and demand. This defines the nature of most commodity markets in Australia and ultimately leads to Australians paying more competitive prices. For example, deregulation of the

4 Mr Desmond King, Managing Director and Chief Executive Officer, Caltex Australia, *Committee Hansard*, 13 October 2006, p. 16.

5 Senator George Brandis, Chair, *Committee Hansard*, 19 October 2006, pp 27–28.

6 Mr Graeme Samuel, Chairman, ACCC, *Committee Hansard*, 19 October 2006, p. 24.

domestic airline industry in 1989 led to much greater competition between existing companies for market share and new competitors entering the market which resulted in price wars and cost cutting of fares to the benefit of consumers.⁷

8.16 The Committee does not consider that consumers would benefit in the longer term from artificially controlled prices, or alternatively, capped petroleum wholesaler and retailer profit margins. As described in Chapter 2 – Sourcing, Refining and Distributing Petrol, profit margins are only a very small component in the price of petrol. The factor most influencing petrol prices is the import parity price which is set on the international market and consequently, is outside the sphere of control of Australia's petroleum industry. Therefore, the most important action that should be taken by Federal, State and Territory Governments is to ensure the presence of a market which is healthy, competitive and free from interference.

Monitoring the market

8.17 The Service Station Association's comment included at paragraph 8.8 emphasised the importance of mechanisms to recognise and remove anti-competitive and predatory behaviours in the market. As discussed in Chapter 7 – Petrol Market Regulation, the ACCC plays a central role in monitoring, investigating and where appropriate taking proceedings in relation to suspected contraventions of the *Trade Practices Act 1974* (TPA). The Committee notes the benefits the Oilcode will provide in regulating the conduct of the petroleum industry and urges the early introduction of the foreshadowed amendments to section 46 of the TPA.

Facilitating understanding of petrol prices in the community

8.18 The Committee acknowledges the amount of material prepared by the ACCC to assist the public in understanding petrol prices. The Committee recommends to the public the online ACCC publication, *Understanding petrol pricing in Australia – answers to some frequently asked questions*.⁸ However, the Committee believes that greater community awareness of such publications is needed. Furthermore, whilst the outcomes of ACCC investigations or reports on topics of interest to the public are made available by the ACCC, these can be lengthy and detailed documents which may reduce their effectiveness in communicating across the community. The community may also benefit from information targeting how it can reduce personal consumption of fuel and make budget savings, particularly for people living outside of metropolitan areas where price cycles do not exist and who therefore are unable to take advantage of such market fluctuations.

7 John Kain & Richard Webb, 'Turbulent Times: Australian Airline Industry Issues 2003', Research Paper No. 10 2002-2003, 16 June 2003.

8 Available on the ACCC website, (accessed November 2006) at:
<http://www.accc.gov.au/content/index.phtml/itemId/759646/fromItemId/653960>

Recommendation 1

8.19 **The Committee recommends that the ACCC reviews the information on its website and in other publications to ensure this material provides simple, straightforward and concise information that is readily accessible to the wider community and addresses the issues at the forefront of public concern, including what individuals can do to reduce personal fuel consumption.**

8.20 **The Committee recommends that, in addition to price monitoring in the five largest metropolitan cities, the ACCC conducts spot checks and reporting on a wider range of locations across Australia to provide confidence to a wider range of consumers, particularly people in regional, rural and remote locations.**

Closing the gap between country and city prices

8.21 As reiterated across the many past inquiries and reports into rising petrol prices, country consumers on average pay a higher price for fuel than consumers residing in metropolitan areas. Higher costs of purchasing and transporting fuel to sites distant from refineries, a lower turnover rate of product at many non-metropolitan service stations and greater dependence on fuel rather than shop sales also results in these retailers charging higher prices, as compared to retailers in metropolitan areas.

8.22 However, one of the key reasons for the price differential is the relative lack of competitive pressures in many country petrol markets. For example, where only one or a limited number of distributors or wholesalers are operating in a location, then the retailer will generally pay a higher price to acquire the fuel and this cost will be passed onto the consumer. This adds weight to the argument that governments should encourage competition, which has been clearly shown to lower prices for consumers.

8.23 But the problem remains that people in country areas are commonly paying higher prices for petrol, and there are practical difficulties associated with increasing competition in many of these areas. The Committee notes subsidies provided by the State and Territory Governments (excluding Western Australia and the Australian Capital Territory). The Committee questions the equity and utility of some of the subsidy schemes, such as that in Queensland, where the subsidy provided is state-wide. This means that someone living in a metropolitan area where the market is competitive and prices are consequently lower receives the same benefit as consumers living away from the city who pay a much higher price for petrol. The Committee acknowledges the efforts of State and Territory Governments that have introduced zoned subsidy levels to ensure that those consumers which need the most help with petrol prices are afforded the most assistance.

Recommendation 2

8.24 **The Committee recommends the State and Territory Governments review subsidies to ensure they focus on consumers in markets where prices are high because of distance and a lack of competition.**

Decreasing petroleum consumption

8.25 The inquiry received evidence advocating higher petrol excise, to encourage reduced reliance on fossil fuels and the development of alternative fuel supplies, because of a possible peaking and subsequent decline in Australia and the world's oil supply. This is not a matter within the terms of reference for this inquiry. The Committee understands that Australia's future oil supply and alternative fuels will be addressed in a forthcoming Senate Rural and Regional Affairs Committee report.

Greater awareness of new fuel quality standards

8.26 As new fuel quality standards are introduced in Australia, refineries often need to reconfigure and adjust ageing equipment to meet new standards. This has substantial community benefits but imposes significant costs on refiners and can limit the ability of independent fuel operators to import cheaper fuel from the Asia-Pacific region where fuel standards may not be equivalent.

8.27 Whilst the Australian Government has provided financial assistance and incentives to domestic refineries to meet new fuel standards, increased refining costs result in higher costs of petrol which are passed onto consumers. It is important consumers understand the origin of such increases and why higher fuel standards are important.

8.28 The Committee encourages fuel retailers to ensure petroleum retailers sufficiently publicise when and why new Australian fuel quality standards will be introduced and how petrol prices will be affected. The Committee recognises that the Department of Environment and Heritage has an important role in working with fuel retailers to achieve this aim.

Reviewing taxes on petrol

8.29 The Committee was presented with a range of evidence discussing the merits of restructuring taxes applied to petrol. This included removing the GST or excise from petrol in its entirety or lowering the rate of excise. However, the Committee did not believe that there was compelling evidence submitted either way to justify the raising or lowering of petrol taxes. The Committee notes that one of the principal reasons why the price of petrol in Australia is relatively low is that Australian fuel taxes are amongst the lowest in the world. The Committee considers that the rate of excise on petrol and application of GST should remain unchanged.

