



PRICE OF PETROL IN AUSTRALIA

ACCI Submission to the
Senate Economics Committee

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ABOUT ACCI

ACCI has been the peak council of Australian business associations for 105 years and traces its heritage back to Australia's first chamber of commerce in 1826.

Our motto is "Leading Australian Business."

We are also the ongoing amalgamation of the nation's leading federal business organisations - Australian Chamber of Commerce, the Associated Chamber of Manufacturers of Australia, the Australian Council of Employers Federations and the Confederation of Australian Industry.

Membership of ACCI is made up of the State and Territory Chambers of Commerce and Industry together with the major national industry associations.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including over 280,000 enterprises employing less than 20 people, over 55,000 enterprises employing between 20-100 people and the top 100 companies.

Our employer network employs over 4 million people which makes ACCI the largest and most representative business organisation in Australia.

SUMMARY

Fuel prices have increased very strongly over the past few years. These costs have put significant pressures of businesses and households.

Fuel prices have also been a major contributor to higher inflation, which has led to two interest rate increases in 2006.

There are a number of proposals that are raised to try to reduce fuel costs:

- Competition in retailing and refining should be encouraged. The standard competition rules and a new industry code should assist in this goal. Other industry-specific measures should not be introduced.
- ACCI rejects proposals to introduce price regulation for fuel. Price controls are entirely counterproductive.
- Fuel taxes should be reformed, to reduce distortions and broaden bases. Excise indexation should not be

reintroduced.

The Government has already taken important steps to reduce the costs of fuel used as an input into production. However, it has also imposed extra and unnecessary costs on some businesses that use fuel for non-combustion purposes. These changes work directly against the other reforms that will reduce fuel costs for many other businesses.

INTRODUCTION

The Senate Economics Legislation Committee is inquiring into the price of petrol in Australia, with particular reference to

- the relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol;
- regional differences in the retail price of petrol;
- variations in the retail price of petrol at particular times;
- the industry's integrated structure; and
- any other related matters.

PRICE LEVELS

Fuel costs have increased substantially for business and the community. A graph of petrol prices since 1999 is shown in Figure 1.

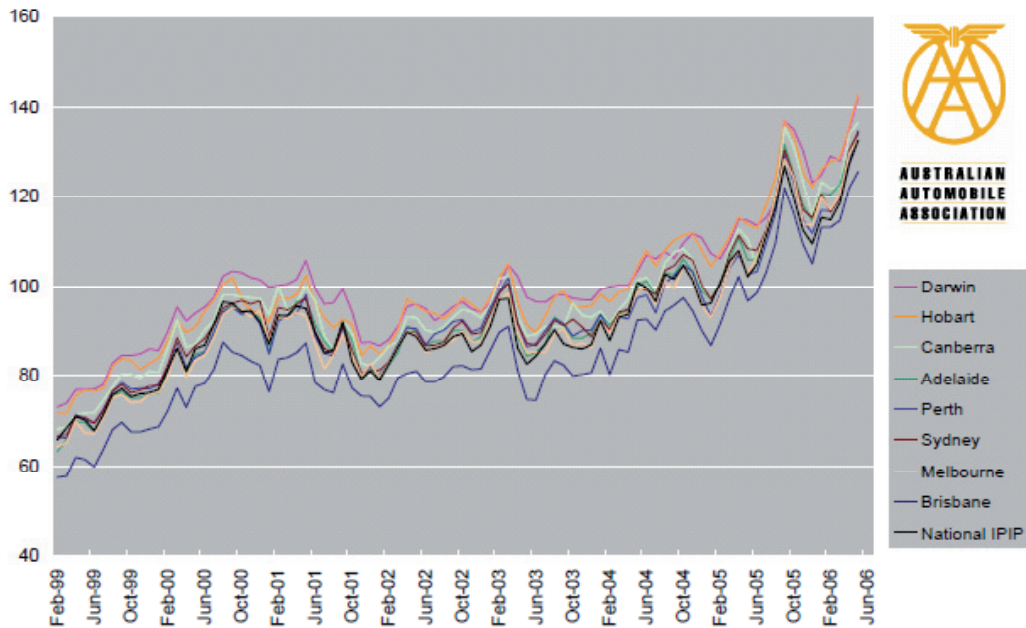
Fuel is a major cost for most Australians, as well as businesses in many industries, including:

- farming;
- mining;
- manufacturing; and
- transport.

ACCI represents businesses in all these industries.

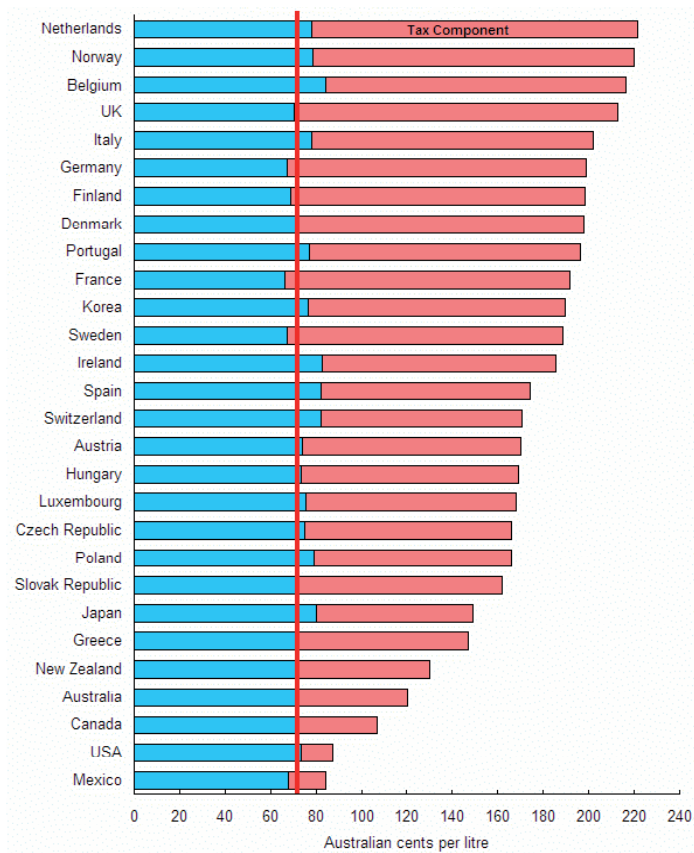
While there are very strong concerns about fuel prices in the community and in businesses, it needs to be remembered that Australia's fuel prices are fairly low by world standards, as shown in Figure 2.

Figure 1
Average Monthly Capital City Unleaded Petrol Prices (cpl)



Source: Australian Automobile Association

Figure 2
Petrol Prices and Taxes in OECD Countries
December Quarter 2005



Source: Australian Petroleum Statistics

INFLATION

Higher fuel prices are naturally having an effect on inflation. Figure 3 shows the increase in fuel prices each quarter and the contribution this increase makes to the total inflation figure for the quarter. The figure for the year to June 2006 is also included for comparison.

Inflation hit 4.0 percent in the year to June 2006, with 0.9 percent of this increase caused by automotive fuel prices alone.

Higher inflation has led to two interest rate increases in 2006.

ACCI rejects some arguments that businesses should not pass on higher fuel costs. Businesses cannot absorb higher costs forever.

Businesses will respond to higher fuel prices by improving the efficiency of fuel use, which will cut costs and allow previous price increases to be reversed, at least partly. However, this will take some time.

COMPETITION

Many commentators argue that there is a lack of competition in fuel refining or retailing in Australia.

If there are legitimate concerns, then these should be addressed by the normal competition rules that apply to all industries. In particular, the prohibitions on anti-competitive conduct (Part IV) and abuse of market power (section 46) in the Trade Practices Act.

We do not consider that special rules should apply to fuel retailing or refining (other than the industry code of conduct, discussed below). If the competition rules do not work for this industry, then this suggests that broader changes are needed to the competition rules.

However, these rules have been subject to substantial review over recent years and so should provide an adequate basis to address any competition issues that arise in fuel refining or retailing.

Price Fluctuations

Petrol prices fluctuate on a weekly basis in most urban parts of Australia.

The reasons for these fluctuations are discussed in more detail in a number of publications, including ACCC (2001) Reducing Fuel Price Variability.

ACCI notes that these fluctuations do not necessarily indicate a market failure and do not necessarily harm consumers. In particular, some consumers are assisted by the price fluctuations because they are able to choose to purchase fuel when prices are lower. The ACCC supports this argument in its submission to this Inquiry.

ACCI also rejects the argument that similar movements in fuel prices indicate collusion or price fixing. They may actually indicate strong levels of competition. This issue is discussed in more detail in the ACCC's submission to this Inquiry.

Price Controls

ACCI specifically rejects price controls on fuel, because:

- they can lead to fuel prices being higher on average;
- they are an unnecessary regulatory burden on business; and
- they will harm those individuals who were able to take advantage of the fuel price discounting cycle.

The ACCI examined the retail price controls that existed

Figure 3

	2005		2006		Year to June 2006
	Sept	Dec	March	June	
Fuel Price Change over Period	11.6%	-0.9%	1.4%	11.2%	24.6%
Contribution of Fuel to Total Inflation for Period	0.4%	0.0%	0.1%	0.5%	0.9%
Inflation for Period	0.9%	-5%	0.9%	1.6%	4.0%

Source: ABS Consumer Price Index, Cat No 6401, Table 5.

in Western Australia and has found that the controls:¹

- were not supported by industry, including ACCI's member CCIWA;
- did not appear to be achieving their objectives; and
- were likely to have an adverse effect on competition.

Price monitoring continues for fuel prices and ACCI considers this should provide adequate information for the ACCC and other regulators if needed.

The Oilcode

The Government is currently attempting to repeal the Petroleum Retail Marketing Sites Act 1980 and the Petroleum Retail Marketing Franchise Act 1980 and replace with an industry code (the so-called Oilcode). There is some debate about this change. ACCI supports initiatives in this area which will promote competition at the retail level as this will benefit industry where fuel is an essential business input.

ALTERNATIVE FUELS

Rapid increases in fuel prices over recent years have provided the Government with the impetus to engage more fully in the alternative fuels debate.

Current Policies

The State and Commonwealth Governments have introduced a range of measures to encourage the use of biofuels, without damaging the market competitiveness of other types of fuel. The Australian Government has set a target of producing 350 million litres of ethanol and other biofuels by 2010.

The Australian Government has provided \$37.6 million in capital grants for biofuels projects; extended the 38 cents per litre temporary excise arrangements for biofuels until 2011; and set the final rate of excise on ethanol in 2015 at 12.5 cents per litre (less than the 38.143 cents per litre excise on petrol and diesel).

The Australian Government has rejected the notion to mandate the use of ethanol-blended fuels. However, the Government is continuing to encourage the greater use of biofuels.

The Prime Minister on 14 August 2006 announced a

package of incentives for alternative fuels, including subsidies for the conversion of cars to use LPG and incentives for petrol stations to install ethanol pumps.

Key Issues

Issues that need to be considered in relation to alternative fuels include:

- Health effects – alternative fuels produce different emissions to standard fuels. The Australian Medical Association backs mandatory use of ethanol in petrol on health grounds.²
- Regional development – biofuels can provide significant benefits to manufacturers and grain growers. However, users of feed grains can face higher prices due to increased production of biofuels. The Centre for International Economics (CIE) found that a mandatory blend of 10 percent ethanol with petrol will create an artificial demand for grain that would have significant adverse effects for the pork, dairy, chicken and lot-fed cattle producers using feed grain.
- Balance of payments – reducing reliance on fuel imports may reduce our trade deficit. However, offsetting effects need to be considered. For example, the CID found ethanol blending will reduce petrol imports by about \$1.3 billion a year; however, that would be more than offset by forgoing wheat exports of about \$2.9 billion.
- Environmental – alternative fuels often reduce smog and greenhouse gas emissions.
- Energy security – alternative fuels can provide greater energy security, either because the fuels are extracted in Australia or are not fossil fuels and so are not in fixed supply.
- Consumer confidence – consumers currently have some reluctance to use alternative fuels. An ANOP survey in February 2005 indicated that 56 percent of people would be either unhappy or would have reservations in buying petrol containing ethanol.
- Economic viability – the Prime Minister's Biofuels Taskforce concluded fuel ethanol will be viable at least while it has an excise advantage, which is scheduled to finish in 2015. Beyond 2015 however, the viability of ethanol blended fuel is not certain – dependent on the price of oil, the exchange rate and the price of ethanol.

Taskforce Report

The Prime Minister's Biofuels Taskforce suggested actions that could readily be taken to increase the viability of alternative fuels without affecting key policy settings or distorting markets. The policy options were mainly confined to using information rather than legislation, including:

- modifying ethanol-blend labelling standards by:
 - stating no need to label ethanol blends of up to 5 percent. Suppliers would then be able to use ethanol in the fuel mix up to 5 percent, including where it cost-effectively contributes to octane levels
 - changing the labelling on 5–10 percent ethanol blends so that it does not have to appear like a warning label. It could simply inform. For example: 'E10' or 'Contains up to 10% ethanol'
- Information on vehicle/fuel compatibility could be provided to consumers in a more accurate and user-friendly way than the Federal Chamber of Automotive Industries' current listing. For example, labels on fuel-filler caps and forecourt pamphlets with simple tick boxes could be used.

The Prime Minister, the Hon John Howard MP, released an Industry Biofuels Action Plan in response to the findings of the Taskforce. The Plan indicates that Industry will exceed the government's biofuels production target of 350 million litres by 2010. The Government will review progress towards the targets on a six-monthly basis and the Industry participants have agreed to update their Plans annually.

The Action Plan undertaken in consultation with industry is a process very much supported by the business community. ACCI supports the non-regulatory aspects, such as improved consumer information, of the Industry Biofuels Action Plan.

FUEL TAXES

Governments have traditionally imposed sizeable taxes on fuel use, for a number of reasons, the most significant one being revenue raising. The current taxes imposed are fuel excise and GST.³ The taxes on fuel impose a heavy burden – equivalent to a tax rate of 63 percent at a pump price of 130 cpl (cents per litre). These taxes generally do not provide for the correct costing of infrastructure use.

In particular, economists have argued:

- The same tax rate applies to fuel use in vehicles causing little congestion (travelling at midnight) and vehicles that cause much more congestion (travelling at peak hour).
- The same tax rate applies to fuel use in vehicles causing little pollution (newer vehicles) and vehicles that cause much more pollution (older vehicles).
- Due to the onroad fuel grant, the tax rate applying to vehicles causing less road damage (cars) is actually higher than the tax rate applying to vehicles causing more road damage (trucks).
- Australia does not have a carbon tax, so the fuel tax cannot be seen as appropriate charging for greenhouse emissions.
- The revenue raised from fuel taxes is greatly above the amount spent on roads.

The Government's Fuel Tax Inquiry summarised a number of previous inquiries into fuel taxes, stating that these inquiries consistently found that *"fuel usage is a poor proxy for transport externalities such as pavement damage and congestion, and that direct pricing mechanisms are a superior way of funding infrastructure."*²⁴

ACCI supports reform of fuel taxes to enable better charging for infrastructure use. In particular, ACCI supports the following principles for the taxation of fuel:

- The number of distortions in the tax treatment of different fuels and in their uses should be minimised. Environmental or regional considerations provide possibilities where a differential treatment may be appropriate. These, however, need to be explicit and transparent.
- Market failure as a justification for higher taxation has to be very carefully justified. Attempts to remedy alleged market failures often merely add to economic distortions, reduce overall growth and create additional inefficiencies.
- There should be no advantage provided to one form of fuel relative to another unless there are specific public policy considerations that need to be addressed and these are clearly articulated.

- Taxes should be broadly based so as to allow lower taxes on each taxed item, rather than applying large distorting taxes to fewer items;
- Care must be taken to minimise the risk of unintended technological consequences of the adoption of differential fuel taxation. Fuel taxes should be long-term technology neutral.
- No taxes should be applied to non-transport uses such as power generation.
- Indexation of fuel taxes should not be reintroduced. Increases in excise should be subject to the explicit approval of Parliament rather than occurring automatically due to increases in the general price level.

At this stage, ACCI is not calling for a reduction in fuel excise. We consider that the priority should be for tax reforms to:

- Reduce the top personal tax rate over time to be equal to the company tax rate at 30 percent;
- Index personal income tax thresholds to abolish bracket creep;
- Reduce the burden of Capital Gains Tax (CGT); and
- Simplify tax compliance.

However, fuel taxation is a matter that should be kept under review.

Fuel Tax Reform

The Government has recently implemented major changes to the fuel tax system for business. These changes have significant benefits to business:

- The offroad grant will be extended to cover other offroad activities, including building, manufacturing and power generation;
- The onroad grant will be extended to metropolitan areas; and
- The onroad grant will be extended to fuels other than diesel.

The reforms will simplify compliance costs for many businesses because:

- the claim mechanism through the BAS is simpler;
- the complex eligibility criteria for existing grants will be simplified; and
- the administrative and compliance arrangements for the fuel tax system will be aligned with the arrangements for other indirect taxes.

There are a large number of businesses that will benefit from these changes and ACCI supports the reductions in tax and compliance costs that will result.

These changes should lead to lower fuel costs for business and hence result in lower prices for consumers.

However, some businesses are being adversely affected by the Government's changes. These businesses could previously buy fuel excise-free, because they were using the fuel for non-combustion purposes (particularly for manufacturing). The Government's changes removed this exemption, so these businesses will now have to buy fuel with excise included in the price and claim this excise back through the BAS.

The Government's changes are imposing significant compliance costs on these businesses.

Further details on ACCI's concerns are contained in our submission to the Senate Economics Committee on the Bill implementing the Government's changes (the Fuel Tax Bill 2006), available from our website: www.acci.asn.au.

END NOTES

- ¹ ACCC (2001) Reducing Fuel Price Variability
- ² Media release of 27 July 2005
- ³ In addition, there is the Petroleum Resource Rent Tax, which is imposed upstream and should not flow through to higher fuel prices.
- ⁴ Fuel Tax Inquiry Background Paper No 1 – Previous Reports on Petroleum Products.

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