PROPOSED NATIONAL FUELWATCH SCHEME

RACQ Position Statement July 2008

Introduction

Following an Australian Competition and Consumer Commission (ACCC) report into petrol pricing last year, the Federal Government has said it will implement a National FuelWatch Scheme by December 2008. FuelWatch currently operates in Western Australia and the Federal Government has announced it will expand the scheme "as a way to lower petrol prices for motorists and provide certainty and price transparency". The Federal Coalition has rejected the scheme and legislation to enact FuelWatch has been referred to a Senate committee.

The Royal Automobile Club of Queensland (RACQ) does not believe FuelWatch will benefit Queensland motorists. No clear evidence exists to show that FuelWatch will lower prices and potential risks associated with implementation have not been comprehensively assessed.

A modified FuelWatch scheme - one which does not include the requirement for fixed daily prices - would be preferable and of greater benefit to motorists. A review of FuelWatch after 12 months can then determine whether an additional requirement for 24 hour fixed pricing is justified. This would be based on the experience of the first 12 months and comparisons of capital city price movements against Perth, which would maintain its daily fixed pricing.

The initial 12 month period would also provide an opportunity to establish clear rules about the use of retail price boards and discount offers to reduce the potential for misleading conduct relating to types of fuels being offered.

Issues concerning FuelWatch, along with available data, have been summarised in this paper and used to inform the RACQ's position.

Background

FuelWatch

FuelWatch has been operating in Western Australia since January 2001 and covers the Perth metropolitan area and 52 regional locations. Like the Western Australian model, the proposed National FuelWatch Scheme will require petrol retailers to notify a central authority by 2:00 pm of their next day's retail price. The prices will be fixed from 6:00am the next day and must remain unchanged for 24 hours. Any retailer found to have raised or lowered prices within that period could be fined up to $110,000. Consumers will be able to access the price of fuel at service stations and by phone or internet.

FuelWatch will apply to unleaded, premium, diesel, LPG, 98RON and biodiesel blends in metropolitan areas and will be optional in regional areas. Federal

budget estimates show FuelWatch will cost $20.9 million over four years and the scheme will be reviewed 12 months after implementation to assess its effectiveness.

Petrol Prices

Since January 2008, oil prices have risen by 60 percent, trading at record high prices of $US140 a barrel. In Brisbane this has been reflected at the pump with prices of up to $1.60 a litre for ULP. While directly affecting motorists, elevated fuel prices impact the community as a whole. Increased transportation costs result in higher costs of goods and services. This cycle leads to inflationary pressure throughout the economy.

The main determinants of international fuel prices are global supply and demand for crude oil. Rising oil prices are a result of strong demand for oil relative to available supply. Last year daily global consumption was 85 million barrels, which exceeded the 81.5 million barrels of oil produced each day[1].

The disparity between demand and supply has been widening over the past few years and much of the growth in global demand can be attributed to developing economies. In some countries demand is intensified by government fuel subsidies, which shield consumers from the full impact of global oil price rises. Some economists also believe that recent speculative activity in oil futures trading is significantly inflating the price of oil. However, the upward trend in prices is likely to remain until there is a significant drop in global demand.

The currency exchange rate between the Australian dollar (AUD) and the United States dollar (USD), along with import parity pricing, significantly affects the price of petrol in Australia. Global oil is traded in US dollars and a strong AUD/USD exchange rate reduces the price of fuel in Australia.

As both oil and refined petroleum products are internationally traded products, linking Australian refinery prices for both petrol and diesel to an overseas benchmark has long been an accepted protocol for our fuel industry. This eliminates the incentive for Australian refiners to sell offshore at higher prices and allows them to compete with importers.

The benchmark prices for fuels refined in Australia are those achieved in Singapore – the major refining and trading centre for the Asian region. This “import parity price” is a calculation of what it costs to buy fuel from a refinery in Singapore and ship it to Australia

Other factors influencing the retail price of petrol and diesel in Australia include shipping costs, government taxes and subsidies, and the cost of storage, distribution, wholesaling, retailing and insurance.

[1] BP Statistical Review of World Energy June 2008
http://www.bp.com/statisticalreview

The retailing of petrol (but not diesel) is characterised by price volatility in most metropolitan areas of Australia. The weekly cycle of fuel prices in south-east Queensland is known as an Edgeworth cycle by some economists, and similar fuel pricing phenomena are seen in other parts of the world. Our cycle is generally characterised by a sharp and significant rise in prices each Wednesday, followed by a period of gradual price decline to a low on Tuesday, before the next rise. Other places have cycles of two weeks, three days or even 24 hours, with motorists needing to stay up late to get the cheapest fuel. The nature of the cycles appears to depend on government regulations, different wholesale prices offered to petrol retailers, price support by oil majors to their franchisees, and industry competitiveness, particularly where a high concentration of independent retailers exist. While some consumers may find the price cycles frustrating, the price variability gives the most price sensitive consumers an opportunity to buy at the lowest price of the cycle (often at or near wholesale price in south-east Queensland) and results in 60 percent of petrol being purchased at prices below the average price of the cycle. At the retail level in capital cities, there are many outlets and strong competition between oil company, major supermarket chain and independent sites. As such, unleaded fuel is generally sold with relatively low retail margins (unlike diesel, LPG and premium blends). Caltex reports average profits of about 2.2 cents/litre across their total volumes.

Retail outlets make a substantial part of their profits from the convenience purchases that customers make while paying for their fuel. The fuel attracts customers and pays the overheads, but the grocery and snack purchases provide the profit. This is part of the reason that many outlets now encourage purchases of some convenience items in order to get a fuel discount of four or five cents a litre. The other reason they do this is to compete with ‘Shopper Dockets’. With their ability to purchase very large volumes of fuel and effective marketing of perceived discounts, Coles and Woolworths appear to have done well. They have also increased the level of competition in cities with relatively fewer independents. This has especially been the case in Perth.

Expected Outcomes of FuelWatch

The Federal Government expects FuelWatch to lower petrol prices, although the extent of this price reduction has not been made clear. In announcing the national FuelWatch scheme in April 2008, the Government said FuelWatch would deliver petrol savings of between two and five cents a litre. This later became savings of two cents a litre. Most recently the Federal Government has moved away from quantifying the savings and emphasised that FuelWatch will put pressure on retailers to ensure prices are kept as low as possible.

The Australian Competition and Consumer Commission (ACCC) Chairman, Graeme Samuel, has highlighted that the system is not about reducing average prices, but rather is designed to empower motorists so they know where to find the cheapest petrol. The FuelWatch scheme will enable easy comparison of prices and allow consumers to make an informed decision about where to buy the cheapest petrol in their area. According to the Royal Automobile Club of Western

Australia (RACWA), FuelWatch also alleviates motorists' frustration, because prices no longer fluctuate throughout the day.

The benefits attributed to FuelWatch by the Federal Government have been compromised by recent reports that four government departments advised against implementing the scheme. The departments concluded that FuelWatch could raise petrol prices, hurt low income groups, reduce competition, and force small independent service stations out of business.

Public expectation of FuelWatch is low. A recent Nielson poll found limited public support for the proposed price monitoring scheme. While 78 percent of surveyed respondents said they would like to see the Government intervene to reduce petrol prices, only 22 percent were in favour of the FuelWatch scheme.

Scope of FuelWatch

The scope of FuelWatch is fairly superficial, relative to the overall price of fuel. It will address only retail price margins, and only in metropolitan areas. The retail margin is a small component of fuel price and typically accounts for less than 10 percent of the total price of petrol.

The 2007 ACCC Petrol Inquiry Report identified key areas that reduce competition in the wholesale market. These were the 'buy-sell' arrangements that exist between the refiner marketers and the lack of access to terminal facilities for independent fuel importers.

The national FuelWatch scheme's proposed mandatory application to metropolitan areas only is significant because it underlines that the system is designed primarily to deal with price volatility, rather than factors that put upward pressure on retail prices. Lack of price volatility is a prime characteristic of petrol prices outside south-east Queensland, where retail competition is generally less intense. It is likely that many regional motorists would be prepared to trade off 'price certainty' for the opportunity to buy petrol at lower than average prices one or two days a week.

Price

Will FuelWatch Reduce Petrol Prices?

Analysis shows that Perth is not the cheapest city for fuel and that FuelWatch is unlikely to lower petrol prices. No clear cause-and-effect relationship exists to establish that FuelWatch has reduced prices in Western Australia.

Period: 1st April 2007 to 31st March 2008 – All sites

Daily averages

Fuel	Perth	Sydney	Melbourne	Adelaide

ULP	130.5	130.4	130.9	**129.7**

Cheapest day of the week averages

Fuel	Perth	Sydney	Melbourne	Adelaide
ULP	121.9	120.3	**119.5**	**119.5**

Brisbane is excluded from the analysis because of the 8.35 cents per litre Queensland Government fuel subsidy.

(Source: Informed Sources FuelWatch Fact Sheet)

While FuelWatch has not made prices cheaper, it is difficult to determine whether the scheme has increased petrol prices. The ACCC Petrol Inquiry Report concluded that FuelWatch had not raised average prices in Western Australia[2] and a similar sentiment is echoed by the RACWA, which claim that although FuelWatch does not necessarily reduce prices, neither does it cause them to increase. However, there is a need to assess consumer purchasing patterns and review volumetric data before any inflationary price impact from FuelWatch can be ruled out. This is discussed in following sections.

The ACCC Report found a statistically significant price reduction of 1.9 cents a litre associated with the introduction of FuelWatch in Western Australia. The ACCC's econometric modelling further showed the fall in price varied significantly depending on the day in the price cycle. Prices decreased[3]:

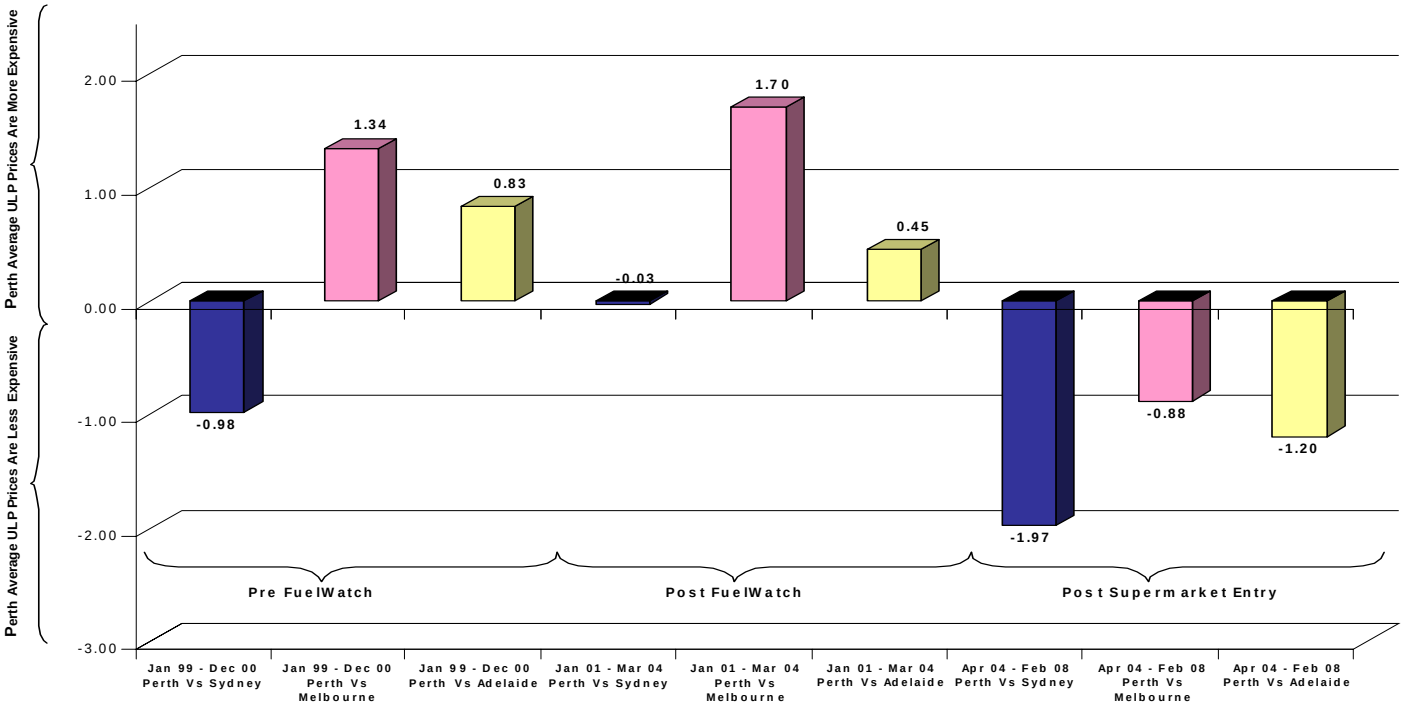
- 3.5 cents a litre on the highest price day
- 0.7 cents on the cheapest day
- 1.8 cents on the middle cycle days.

However, the ACCC report contained a number of caveats, one of which explained that something other than FuelWatch might have caused the average 1.9 cent price decrease. Two price monitoring organisations, Informed Sources[4] and FUELtrac[5], have since corroborated this qualification. Their data highlights that FuelWatch had very little impact on petrol prices when introduced into Western Australia and both organisations conclude that it was the entry of Coles into the Perth retail petrol market in 2004 that caused average prices to fall.

As shown below, the only real decrease in Perth petrol prices occurred after the entry of supermarkets in the Perth metropolitan area, and not as a result of the introduction of FuelWatch.[6]

[2] Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007 p. 252
[3] http://www.accc.gov.au/content/index.phtml/itemId/829429
[4] Informed Sources is an information management company that has been providing price monitoring and data to industry and government bodies since 1987. They provide major oil companies and retailers with real-time data about their competitors' prices.
[5] FUELtrac is an independent organisation that provides a range of fuel related services to organisations throughout Australia and New Zealand.
[6] FUELtrac FuelWatch Review prepared for the AAA, March 2008

Average Retail Petrol Price Variation: Perth Versus Sydney, Melbourne, Adelaide



(source: FUELtrac FuelWatch Review prepared for the AAA, March 2008)

Price Cycles

Perth petrol cycles have altered considerably since FuelWatch was introduced seven years ago. The amplitude of price cycles has narrowed, reducing the range between the highest price and the lowest price in a cycle. In most Australian cities the difference between the peak and trough of a petrol cycle is a 10-cent margin, however, in Perth it is half this amount. Perth also has a two-week petrol price cycle most of the time.

It is uncertain whether the two-week cycle is directly related to the introduction of FuelWatch. The extended 14-day cycle began in 2006, five years after the scheme was introduced in Perth. The ACCC Petrol Price Inquiry Report said it was possible that, under FuelWatch, retailers may have become more conservative and it might take longer for prices to reach the trough of a cycle.[7] Informed Sources, however, believes that FuelWatch has caused the 14-day price cycle because the scheme makes retailers cautious about setting prices and introduces "stickiness" into the market. The RACQ considers it likely that in the absence of FuelWatch, a two-week petrol cycle would not have emerged in Perth.

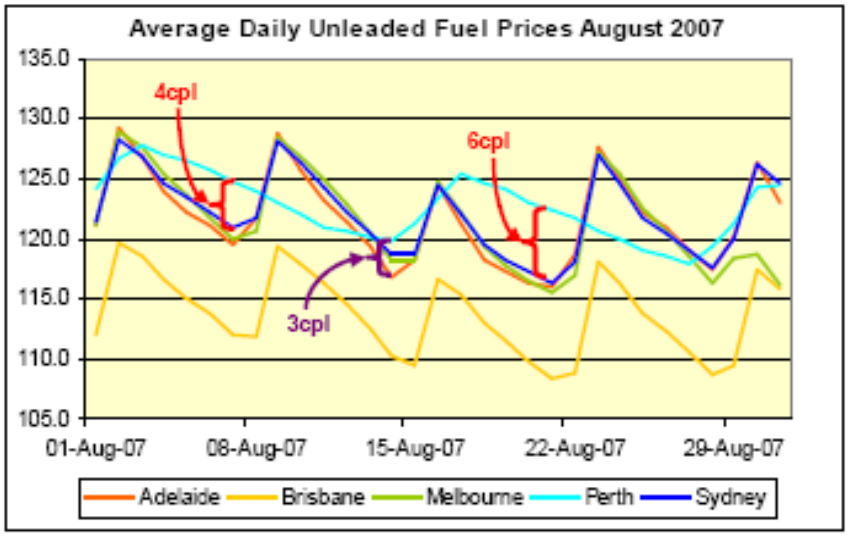
[7] Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007 p. 248

Price Impact on Consumers

It is reasonable to expect that under a national FuelWatch scheme, petrol price cycles will lengthen, significantly disadvantaging price sensitive consumers.

Two-thirds of motorists purchase fuel weekly. Most know when it is cheapest, and in Brisbane two-thirds of weekly petrol volumes are sold on the lowest priced days of the petrol cycle[8]. A two-week price cycle under FuelWatch will reduce opportunities for these motorists to purchase fuel at the lowest possible price.

The graph below shows Perth's two week cycle and highlights the missed opportunities for Perth motorists to purchase weekly discounted fuel around the 8th and 22nd of August 2007. It is also worth noting that the reduced amplitude of the Perth fuel price cycle (where prices do not sink as low or peak as high as the normal seven-day fuel cycle) results in consumers paying higher prices even at the bottom of a 14-day cycle.

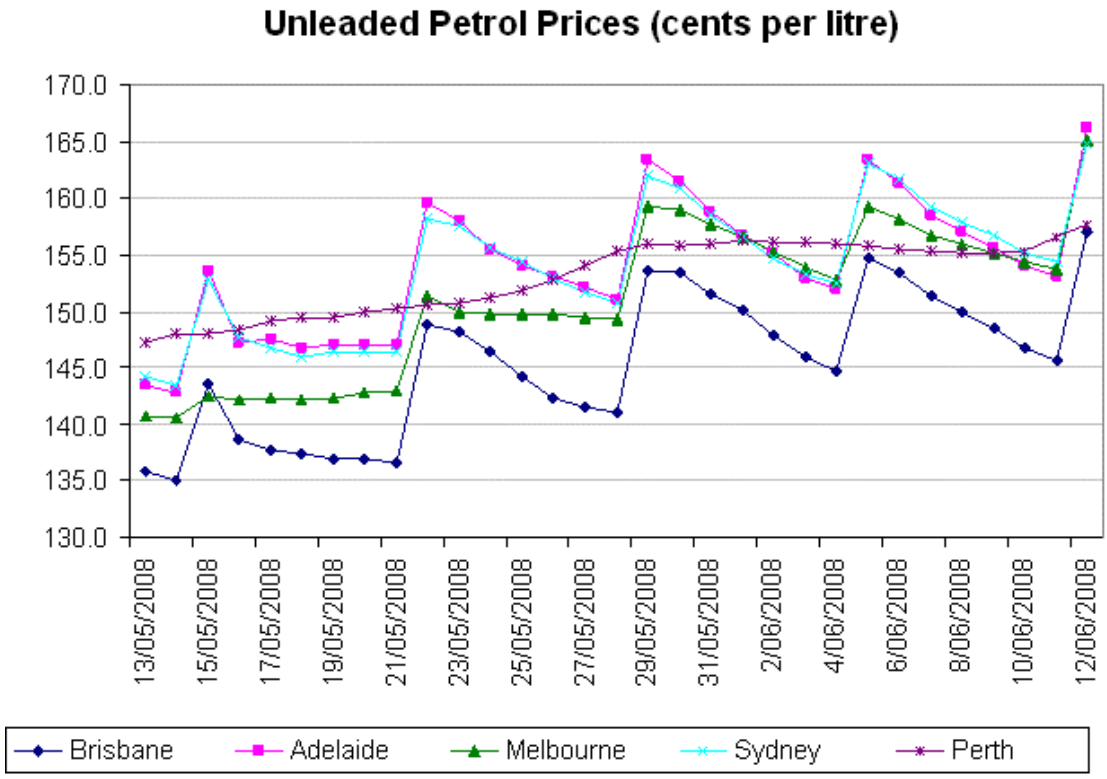


(Source: Informed Sources FuelWatch Fact Sheet)

Even if FuelWatch reduces average prices by one or two cents a litre, those customers who currently seek out the lowest prices in the weekly cycle will have fewer opportunities to buy cheap petrol, because of both the two-week cycle and the narrowing amplitude of the cycle. For the price sensitive motorist, it is not the forecast change under FuelWatch in the average petrol price that is relevant; rather, it is retaining the opportunity to purchase fuel at the low point of the price cycle each week. The only motorists who will benefit under FuelWatch are those for whom price is not an important consideration, and who consequently buy at the top of the cycle to avoid queues and wasted time.

[8] Caltex Petrol Pricing – the plain facts: http://www.caltex.com.au/pricing_pla.asp;
ANOP Researched commissioned by the ACCC: Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007 p. 280

It appears that the petrol price cycle in Perth is continuing to evolve and, since the middle of May 2008, has virtually disappeared. This is most likely attributable to the dual impact of FuelWatch and the overall price rises being experienced by motorists across the nation – both of which tend to flatten petrol price cycles. As a result, motorists in Perth have not been able to buy 'cheap' petrol at the lowest point of a cycle, unlike motorists in other capital cities who, over the same period, have had at least four opportunities to do so.



(Source: Australian Automobile Association. June 2008)

FuelWatch Price Data

Both the Government and the ACCC have focussed on how average petrol prices will change under FuelWatch. This is misleading and distorts the effect that FuelWatch will have in Brisbane and other eastern capitals, where a majority of motorists purchase fuel at below average prices each week.

Actual sales of fuel in Brisbane are cheaper than the average of daily published prices. This is because a greater volume of fuel (65%) is purchased on 'cheaper days', at the trough of the price cycle. To determine the impact of FuelWatch, data needs to be analysed on a volumetric basis, however, the ACCC has not yet made this available.

The Impact of FuelWatch on Independent Retailers

The future of independent fuel retailing in Australia is important, because motorists ultimately benefit from a market where there are many independent players, promoting greater competition.

In 2006, the current Queensland Treasurer, Andrew Fraser, chaired a Queensland Parliament Select Committee Inquiry into Petrol Pricing in Queensland. The Committee found that FuelWatch in Western Australia had negatively impacted independent fuel retailers and concluded that FuelWatch should not be introduced in Queensland.[9] This assessment is shared by independent retailers, who believe FuelWatch could reduce competition and put small petrol stations out of business.

Before FuelWatch was introduced in Western Australia, there were 200 independent retailers operating in the State. Seven years on, there are just 17. It is unclear to what extent FuelWatch contributed to this decline and there are conflicting opinions. The RACWA claims there is no evidence that FuelWatch had any impact, and the Federal Government has explained it as being part of the general industry trend.[10] However, the ACCC concluded that it is difficult to isolate what effect FuelWatch in Western Australia has had on the viability of independents.

Independent retailers oppose FuelWatch because they lose the ability to lower prices during the day to compete against larger fuel chains. They also fear large petrol chains will use FuelWatch to their advantage by discounting prices at a few sites to ensure their brand is displayed on fuel price lists as the cheapest.

FuelWatch is a tough ask for the independent retailers. Service stations are required to nominate their price for the following day, and then lock it in for 24 hours. If the fuel retailer picks a price that is too high, they will lose business. If it is too low, then they will get plenty of custom, but at a lower margin than they could have otherwise enjoyed. Errors in picking the 'right' price, in terms of the market price for the next day, are likely to occur. Large retail chains have an inherently greater capacity than smaller, independent chains or single site operators to take a hit to their margins, or lose business for an entire day. Independent service stations will be able to absorb far fewer pricing errors than oil company or major supermarket chain-operated sites before going out of business.

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[9] Legislative Assembly of Queensland: Inquiry into petrol pricing in Queensland, April 2006, p.136 http://www.parliament.qld.gov.au/petrol/view/committees/documents/PETROL/Report/tabledReport_040406.pdf

[10] The ACCC Petrol Inquiry Report found that rationalisation of retail sites in Australia is a long term trend and the number of retail sites has fallen by 20 percent since in the last seven years. The ACCC report also noted, however, that the independent retailers' market share nationally has not substantially changed in the last seven years. This suggests rationalisation of independent retail sites, but no loss of market share.
Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007 pp. 77-78

Multi-site franchises will find it much easier to use the FuelWatch scheme due to their advantage of market coverage. Large petrol retailers can subsidise incorrect or uncompetitive pricing at one location through alternate locations or discount prices at two or three sites, to ensure their brand is displayed on fuel price lists as the cheapest. This was acknowledged in the ACCC Petrol Price Inquiry Report as a strategy of 'rolling price leaders'.[11]

It is also possible that such tactics could be employed to eliminate, over time, competition from independent operators in a given area.

FuelWatch Compliance Costs

The compliance costs faced by individual service stations under a national FuelWatch scheme have not been confirmed. Some retailers estimate it will cost them up to $4,000 per annum, but the Government has said the amount will be nothing more than the cost of an email or phone call each day.

Any additional costs imposed by FuelWatch on retailers will be more easily absorbed by large chains, and represent a greater burden for small service stations.

Price Transparency and Consumer Knowledge

The ACCC Petrol Inquiry Report found that Western Australia's FuelWatch scheme enhanced information available to consumers and reduced consumer search costs, because prices remained stable for a 24-hour period.

It is clear that FuelWatch will reduce the information imbalance between petrol retailers and consumers. It is not apparent, however, that this is the best possible scheme to achieve this, or whether it comes at the lowest possible cost for taxpayers and motorists. Alternative mechanisms could also improve price transparency, however, these have not been thoroughly investigated by the Government. Motoring organisations, for example, already provide fuel price information. This system could be enhanced to accommodate daily price fluctuations and provide real-time website and phone data.

The ACCC Petrol Price Inquiry in 2007 did not analyse whether FuelWatch was the best possible scheme to implement. Nor did it recommend FuelWatch at a national level.

Price Boards

Even with websites, phone messaging and media reporting of fuel price information, price boards prominently displayed at retail outlets will remain a

[11] Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007 p. 253

major component of fuel price information provision. The high level of exposure of price boards make it important to ensure that accurate information is displayed to not mislead consumers.

Any FuelWatch system should ensure that all major fuels are accurately portrayed on price boards. This issue will increase in importance with the expected increase in discount schemes and availability of alternative fuels and blends.

Due Diligence

The value of a national FuelWatch scheme should be determined prior to implementation. This requires a comprehensive assessment of the benefits and costs associated with all possible policy options, one of which is adopting the current Western Australian system.

The Federal Government has said that FuelWatch will be formally reviewed after 12 months to assess its effectiveness. However, it is usually considered better practice to carry out an upfront assessment, as there is a risk that once a system has been implemented, it could be too costly to remove or modify.

Applicability of the Western Australian Model

Specific market factors mean the Western Australian FuelWatch experience cannot be automatically extrapolated to the eastern states of Australia. This makes it difficult to assess the full impact of FuelWatch in Queensland.

The ACCC noted differences in fuel standards, transport and port charges in Perth versus eastern capitals, but did not explicitly account for these in their modelling.

A national FuelWatch scheme based solely on the price transparency requirements should be implemented for a 12 month period. During review, this should be compared with prices in Western Australia, using the existing scheme. The Western Australia model of daily fixed prices should then be adopted if experienced prices demonstrate that the additional regulation results in consumer benefits.

Conclusion

The RACQ acknowledges that FuelWatch would provide greater price transparency and reduced search costs for motorists in south-east Queensland. However, these marginal benefits will come at the risk of higher petrol prices (especially for the most price sensitive motorists), reduced competition and a cost of $20.9 million nationally.

The Government has not presented a clear case for the benefits associated with FuelWatch; nor have concerns regarding the associated risks of implementation been addressed. The underlying data and process through which FuelWatch has been commissioned are flawed.

In its 2007 Petrol Inquiry Report, the ACCC concluded that there were potential benefits and potential costs of implementing a national FuelWatch scheme. The Commission said that a detailed assessment, addressing various issues, would have to be made before the Government could confidently take FuelWatch further. The RACQ has yet to see such a detailed assessment and, therefore, does not support the national FuelWatch scheme.

A modified FuelWatch scheme - one which does not include the requirement for fixed daily prices - would be preferable and of greater benefit to motorists. The FuelWatch scheme should focus on price transparency through the provision of accurate information to consumers through multiple channels. A review of FuelWatch after 12 months can then determine whether the additional requirement for 24 hour fixed pricing is justified. This would be based on the experience of the first 12 months and comparisons of capital city price movements against Perth, which would maintain its daily fixed pricing.

The initial 12 month period would also provide an opportunity to establish clear rules about the use of retail price boards and discount offers to reduce the potential for misleading conduct relating to types of fuels being offered.