COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Price of petrol in Australia

THURSDAY, 28 SEPTEMBER 2006

CANBERRA

BY AUTHORITY OF THE SENATE

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to: **http://parlinfoweb.aph.gov.au**

SENATE

STANDING COMMITTEE ON ECONOMICS

Thursday, 28 September 2006

Members: Senator Brandis *(Chair)*, Senator Stephens *(Deputy Chair)*, Senators Bernardi, Chapman, Joyce, Lundy, Murray and Webber

Substitute members: Senator O'Brien for Senator Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fielding, Fifield, Forshaw, Hogg, Kirk, Lightfoot, Ludwig, Ian Macdonald, Marshall, Mason, McGauran, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Brandis, O'Brien and Stephens

Terms of reference for the inquiry:

To inquire into and report on:

The price of petrol in Australia, with particular reference to:

(a) the relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol;

(b) regional differences in the retail price of petrol;

(c) variations in the retail price of petrol at particular times;

(d) the industry's integrated structure; and

(e) any other related matters.

WITNESSES

Committee met at 9.00 am

ENDRES, Mr James, Economist, Public Policy, NRMA Motoring and Services

EVANS, Mr Alan Hanson, President, NRMA Motoring and Services

CHAIR (Senator Brandis)—I declare open this hearing of the Senate Standing Committee on Economics. Today the committee will continue its hearing in relation to petroleum pricing in Australia, beginning with representatives of the NRMA and then continuing in accordance with the published program, which is available in the hearing room.

These are public proceedings, although the committee may agree to a request to have evidence heard in camera or it may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground claimed. If the committee determines to insist on an answer, a witness may request the answer be given in camera. Such a request may also be made at any other time.

I welcome Mr Evans and Mr Endres from the NRMA. The committee has before it your submission, No. 33. I now invite you to speak to that submission, and then we will have some questions.

Mr Evans—On behalf of two million members throughout New South Wales and the ACT, NRMA Motoring and Services welcomes the opportunity to appear before the Senate committee in relation to petrol prices in Australia. As you have indicated, NRMA Motoring and Services has lodged a detailed submission outlining our views in relation to the inquiry's terms of reference.

While our submission raises a number of issues in relation to petrol pricing, we believe there are two overarching messages for this inquiry. The first is that Australian petroleum companies are entitled to make a normal rate of return on their investment. To deny them this would only jeopardise investment in Australia's oil refining industry. However, they should not be allowed to earn supernormal profits at the expense of Australian motorists, businesses and the economy at large. The second message is more of a question that this inquiry should seek to ask: to what extent, if any, do the oil majors have market power in the Australian market for petrol? If they do, has this resulted in higher prices for Australian motorists?

It is unclear to NRMA how, in the face of rapidly rising oil prices, the retail price of petrol has risen by more than the cost of crude oil, to the extent that companies such as Caltex and ExxonMobil are announcing record profits. In a competitive market, it is to be expected that sellers of a product will pass on any cost increases to buyers in the form of higher prices. However, the competitive process should limit the sellers' ability to increase prices by more than this. What we have seen over the past 18 months is that the price of petrol in Australia has increased by more than the increase in the price of crude oil.

This leads us to question how competitive the Australian petrol market is and whether or not any of the market participants have pricing power. The NRMA does not have sufficient access to the relevant cost and pricing data to answer this question fully, nor do we have the resources. Moreover, it is not the role of the NRMA, the AAA or any of our associated state motoring clubs to determine whether the Australian market for petrol is sufficiently competitive to deliver maximum benefits for Australian consumers. We believe that this is the role of the ACCC and the federal and state governments. Having said that, let me congratulate the government and this committee on undertaking this inquiry.

In terms of the issues that members of the NRMA raise with us, petrol prices and their fluctuation would be the single largest issue that is raised by members as causes for concern in their motoring life. NRMA hopes that the findings of this inquiry will shed further light on the pricing practice of the Australian petroleum industry and recommend that the ACCC be given further powers to formally monitor changes in petrol prices and discourage price increases that serve only to increase the petrol companies' profits above acceptable levels.

Finally, I would like to share with the committee some preliminary economic research undertaken on behalf of the NRMA by the Centre for International Economics. Using a global economic model, we asked the Centre for International Economics, the CIE, to model what the likely impact of sustained increases in oil prices would be on the Australian economy. What they modelled was a scenario incorporating actual price rises since 2002, followed by a sustained price level of around $US75 a barrel, which was the price of crude oil just a couple of weeks ago. While we note that the price of crude oil has decreased quite markedly in recent weeks, it remains at levels well above the long-term average.

Looking at the impact of this scenario, the initial results show that sustained high crude oil prices and hence high petrol prices will have adverse long-term consequences for the Australian economy, including household consumption in Australia, which will be around 0.3 per cent lower in 2006 than it otherwise would have been. In 2006, GDP would have been around one per cent lower than otherwise. For the financial year 2005-06, this is equivalent to around $10 billion. Consumer prices would be adversely affected by around 0.4 per cent in 2006. Our modelling also shows that in 2006 higher petrol prices were also accompanied by higher interest rates and, of course, a larger current account deficit. Also, and not surprisingly, economic activity in the transport sector is calculated to be around one per cent lower than it otherwise would have been. The sustained increase in fuel costs, as forecast, will mean that the transport sector will never return to its previous growth trajectory.

I would like to reiterate that, while these findings are consistent with what we expected, they are preliminary findings and subject to further review. That said, I would also like to reiterate that sustained high petrol prices are bad news for the Australian economy and Australian motorists. Let me also say that our initial modelling of temporary price shock, whereby the price of oil declines over the longer term, is in many respects equally bad news for the Australian economy. According to the CIE, the pain of high petrol prices, whether temporary or permanent, is not just felt by the energy sector and motorists; the pain is felt by every sector of the economy and every region of Australia. Furthermore, the pain is significant.

It is for this reason that the NRMA is committed to examining the role that alternative fuels can play in Australia's future economic development. This is why we are holding an alternative fuels summit on 4 October, which will bring together a range of stakeholders, including governments, politicians of all persuasions, policymakers and leaders from the automotive, petroleum and alternative fuel industries, to examine what the potential is for the development of an alternative fuel industry in Australia.

CHAIR—Mr Evans, to me it seems that among the most important points you make is the proposition that the retail price of petrol in Australia has increased at a greater rate than the price of crude oil. From that, may I take it that you infer therefore that there is a degree of price gouging, profiteering or market manipulation—whatever expression you choose to use—which can be laid at the door of the oil majors? Is that basically what you are saying?

Mr Evans—Essentially, we do believe that there has been an opportunistic increase in margins taken up by the oil companies. Since January 2005, the price of Malaysian Tapis crude, which is our reference product for setting our parity pricing, has increased by around 24c per litre. Assuming that this cost was fully passed on to motorists and that there was additional GST levied—as there has to be—the average retail price of unleaded petrol in Sydney in June 2006 would have been around 123.4c per litre.

CHAIR—Indeed. I think we all understand that point. That is the point you seek to illustrate by figure 4.2 on page 17 of your submission.

Mr Evans—Yes. We say the margins have increased about 27.3 per cent over that period. So they have taken the opportunity to not only capture the price increase in crude but also to add additional margins. It is also true, from what we can gather looking at information from, say, the Western Australian Department of Consumer and Employment Protection, that they have seen a 2c to 3c increase per litre above the cost or price increase in retail fuel margins. And wholesalers have also increased by about 2.5c per litre above what we expected the margin to be.

CHAIR—I want to show you some other evidence the committee has received from witnesses from the Australian Institute of Petroleum, who appeared before us yesterday. You have their submission in front of you. I want to take you to the chart on page 19, figure 10. Although they disaggregate for more factors than you do, including tax, this is essentially their version of the same data which you treat in figure 4.2. You will see the lowest band is the mauve band, which is the Singapore refinery price. It seems to include the same period for which you chart; the last figures are taken on 28 June 2006, and yours also finish in June 2006. The top line, the dark blue line, is the retail price. Allowing for the fact that what you are charting is the metropolitan Sydney price and they are charting what they say is the Australian national average, you see the point I am getting at, don't you? If their data is right then your proposition is wrong, because the blue line at the top does seem to be almost—as far as the naked eye can see—congruent with the movements in the Singapore refinery price.

Mr Evans—It does, and this is part of the problem we all have: what are the actual figures? When they use a national average, do they factor back into the retail price of petrol the rebate that the Queensland government gives, for example, which would change it a bit?

CHAIR—Obviously it would be a barren exercise for me to say to you, 'There you are, your figures are wrong.' I am not saying that. What I am saying is that the assertion you make, which sounds to me to be perfectly logical, depends on which data series one chooses.

Mr Evans—Exactly.

CHAIR—If their data is right then your assertion is not maintainable, and I assume you would not make it if it was not. We need to get our data right; that is the point I make to you.

Mr Evans—Without knowing the composition of their data or the sources they have used, it is difficult for me to say at the moment. But I would welcome the opportunity for us to sit down with them and compare figures, and come back to the committee with our reviews as to whether our figures are right, theirs are right or what the differences are.

CHAIR—We might even ask the AIP about this by way of a written question, because I do not remember it being asked yesterday in relation to the elements in the calculation of the national average.

Mr Evans—Yes.

CHAIR—I have two other points. Going to your figure 4.2, while undoubtedly in the 2006 calendar year it does show a sharpening divergence between the crude oil price and the average metropolitan Sydney retail price, nevertheless you would agree with me, wouldn't you—the table speaks for itself—that that comes off the back in about February 2006, there being virtually no difference between what you chart as the crude price in the dotted line and what you chart as the retail price in the hard line.

Mr Evans—Yes.

CHAIR—I am sure that you would acknowledge that there are other factors as well as merely the crude price, including the freight costs. You said yourself that companies are entitled to make a profit so there are refiners' margins and wholesalers' margins in there. My point—and this is verified by some evidence we got from BP yesterday—is that at the points where the dotted line and the hard line tend to converge you would expect the oil companies to be making a loss, all things being equal, wouldn't you?

Mr Evans—Or making normal profits, depending on which point you start from. That is the issue we have with the oil companies. If you chart over a normal time—

CHAIR—I accept that this has to be averaged over time. In February 2006, which is the clearest illustration of the point I am making to you, there is virtually no difference between the price at which they resell and the price at which they acquire crude, so it gives them no allowance for freight and other costs. Do you acknowledge that?

Mr Evans—Yes.

CHAIR—So a movement from an apparently loss-making position over a five-month period in which the prices have diverged somewhat is at least as consistent with a company moving from a loss-making position into a more natural profit-making position than it is a continuing lack of congruence between the crude oil price and the retail price.

Mr Evans—There are two different axes in this chart of ours.

CHAIR—I see.

Mr Evans—The left-hand axes are the price per barrel.

CHAIR—I see.

Mr Evans—That is why I raised the issue. It depends on whether they are wanting to make a normal profit. This is why we used this graph; it demonstrates, if you look at the left-hand axes, what the price is and the margins. And you can see the margins increasing. That is why we have used those two axes in the chart.

CHAIR—I understand what you are saying to me. That explains it perfectly.

Mr Evans—That is why I made the point. On a normal profit when they come together you would think the world was in perfect harmony—they were tracking the increase in the price of a barrel of crude by the consequent comparable increase in the retail price of petrol—but as we can see there it fluctuates and the gap has grown quite a bit in the last few months.

CHAIR—This is my last point. I take you back to the Australian Institute of Petroleum's submission—and I ask you to turn to page 20, figure 12—where you will see one of the elements of cost. The AIP and BP took us through their version of how this is computed. One of the elements of cost that they said was built into the ultimate price—the retail price—was what they called the quality premium. That is the cost of refining to the now much tighter Australian standards. I am sure, Mr Evans, you would acknowledge that that is a legitimate element of cost.

Mr Evans—Exactly, but we also acknowledge that the federal government has provided significant support to the refiners to upgrade their plants, as well.

CHAIR—Sure, but that is a capital issue. I am talking about a product pricing issue.

Mr Evans—That is one of the things that we cannot examine—whether or not there are additional costs to the capital cost of improving the capability of the refineries to produce a higher quality.

CHAIR—They say it is a product pricing issue. And that is why I am taking you to figure 12.

Mr Evans—Yes.

CHAIR—Each time the Australian standard has gone up from E3 to E4 and whatever it was before that, the bottom line—the red line—which is a straight and flat line, shows a jump in cost.

Mr Evans—Yes. In their chart it certainly does.

CHAIR—So you would expect that to happen, as a matter of commonsense I dare say. The more fastidious the Australian quality standard becomes, and the greater cost of refining to it, it will build in an additional increment of cost into the base price, won't it?

Mr Evans—It will. But—I will go back—is that increase in cost due to recovery of the capital investment or is it a continuing cost because of additional refinery costs through the processing itself?

CHAIR—Yes, that is a fair point.

Mr Evans—That is what we do not know. We are not inside the oil companies to find out whether that is a real cost. To what extent are they offset? If it was capital cost purely, to what extent have they offset that by the fact that government has provided quite substantial subsidies? From our point of view we welcome the increase in standards.

CHAIR—Yes, I understood you did. It is entirely possible that we will take up the AIP's request to appear again to respond to some of these observations, so please expand on your critique as fully as you like.

Mr Evans—We welcome the opportunity, Senator. You can ask the questions that we have been dying to ask!

CHAIR—We have been trying to! One last point: you said the oil majors have market power. Of course, it is not against the law for a company to have market power; it is against the law for a company to, in defined circumstances, take advantage of that market power for a harmful purpose. Are you going so far as to say that they take advantage of that market power for a harmful purpose, or are you merely calling to our attention the belief, which I think we would all share, that, when you have four major players in a relatively small market like the Australian petroleum market, as a matter of commonsense each of them is likely to have market power?

Mr Evans—I think our concern now is that that market power is being concentrated. In our submission we looked at the extent of market power and how that compares with the ACCC's view of other industries and relevant market power. Our concern is even greater these days because of the further concentration of power in the two retail supermarkets, the Coles and Woolworths chains. We look at the experience in the UK, where there were similar events a number of years ago, preceding ours. Initially you see this increase in competition as they enter the market, capture market share and push the independents out, and then the prices come back up because they have market dominance.

CHAIR—This is what lawyers call 'the recoupment issue'.

Mr Evans—Yes. So we are watching with great interest what is happening here. Those two chains, in fact, now have 65 per cent of the retail market, and we are seeing a decline in the number of independents. From my discussions with independents, I have to say that essentially they have almost given up. They accept that the retail chains will be the dominant market players and, when that occurs, their ability to really compete in the marketplace is going to be reduced. It is further compounded by the supermarket chains having such a large share of the refinery output that, we understand, they get significant discounts off the wholesale price. There are two prices—and I have to confess that, until I got into this position and got pounded by my members about petrol prices, I did not understand that there was a wholesale price and a terminal gate price, and those two vary. The chains, we understand from our sources, are getting discounts in the order of 7c a litre because of the volume—

CHAIR—Although BP told us yesterday they only sell at terminal gate price. We have not heard from the other majors yet, but on the basis of some evidence we got from the Australian Institute of Petroleum I suspect that that is not the uniform industry practice and that you are right: more commonly, there is a difference between a terminal gate price and a wholesale price, which—as one would expect, I dare say—reflects discounts for bulk value, long-term supply contracts and so on.

Mr Evans—Yes. And that means the independents are going to struggle to be able to compete and to provide competition.

CHAIR—Well, does it? We have heard evidence from two independents so far in this inquiry—the biggest independent in Queensland, Matilda Fuel Supplies, and the biggest independent in Western Australia, Gull Petroleum. We actually took the inquiry to south-east Queensland, which is where Matilda operates, and Western Australia, where Gull operates, because we were aware that those were the two markets in which the independents are strongest. To paraphrase but, I hope, not oversimplify their evidence, they basically told us in their different words that they were doing okay—that they had good, profitable, growing businesses, albeit based on supply from the majors. The picture that started to emerge, at least for me, was that the independent chains, once they develop sufficient capital mass and critical size, are doing quite well in this market, but the mum-and-dad operators, if you like, who operate one or two service stations maybe, are not doing well. The point I would make to you, Mr Evans, is that, if the oil majors, whose customers independent chains are, were actually seeking to misuse their market power to eliminate competition, then as the suppliers to the independent chains they would be in a perfectly good position to do so. The fact that the independent chains are prospering, rather, suggests to me that that is not happening.

Mr Evans—We are not saying that it is solely the oil companies. If there is predation going on it may well be coming from those two chains who are engaged in the retail market, and they are not going to be captured by the new oil code. So they are at liberty and they are tough players.

CHAIR—Indeed, but we also saw some evidence that the independent chains, like Matilda in south-east Queensland, are the loss leaders in their particular markets, which again is not consistent with the oil majors, who, as their suppliers, potentially have them by the throat, trying to drive them out of business.

Mr Evans—Yes, that is true. It is interesting that you have a good independent chain operating in south-east Queensland and Western Australia but you do not have the same thing in New South Wales, which is the market we are primarily concerned with.

CHAIR—But I think there are historical reasons.

Mr Evans—There are historical reasons. We have actually tried to see if we could participate and take our two million members and say, ‘We are prepared to look at negotiating’—to gather independents together and negotiate with the companies. I have to say we have been unsuccessful to date. I would not back the NRMA’s shirt on the fact that we could compete in the market unless I could guarantee that we could compete. And we have not been able to get the guarantee of supply at a price from the other two companies. Caltex and Shell, you would understand, did not want to talk to us. We have not made any headway with BP and Mobil. We are still interested because we believe there needs to be more competition in the market, particularly in New South Wales. So it is interesting that they say they will supply, but when we said, ‘We’re prepared to provide the mechanism for an outlet for at least two million members plus all the other major clubs’ members who might be travelling through New South Wales,’ we just could not make any headway.

CHAIR—I suspect that if an independent chain were trying to enter the market now, it probably would not be able to. You seem to be agreeing, Mr Endres.

Mr Endres—Yes, and that is a concern: will there be competitive market entry in the future? If these market developments preclude that then that could be a danger to future competition.

CHAIR—Indeed, but given the capital intensivity of this market you would not expect entry into the market to be particularly easy. High barriers to entry—you are an economist; I am not, but correct me if I am wrong—are an inevitable feature of highly capital intensive markets, are they not?

Mr Endres—For sure, yes.

CHAIR—That is why I say it is an historical factor. In Western Australia you have the issue of greater proximity to Asian markets. I used to act for Matilda when I was a barrister and I have been familiar with this industry for a long time. In the 1990s there was a lot of surplus capacity in south-east Queensland markets so they basically built their business on spot cargoes. That does not happen any more, but because they have an established market presence and an established network they are through the barriers to entry stage and they can now compete in the existing market quite well. So the point I am at pains to make is that the absence of independents from the Sydney or Melbourne markets reflects as much the historic absence of the peculiar factors which, in years gone by, enabled independents to get established in the Western Australian or south-east Queensland markets. It does not, of itself, suggest that those markets are not competitive.

Mr Evans—No, but I will just go back. We were prepared to garner substantial financial resources—not only our own, but those of others, and we are a billion-dollar company these days—but the key was whether we could guarantee a supply of petrol at a level which allowed us to compete with the two chains. And the answer to that was no. So we then looked at other options. Could we import it? That was not our preferred model, but again we found a problem in storage capacity in New South Wales.

CHAIR—But that is barriers to entry issue.

Mr Evans—Absolutely, but again it was a barrier to entry in the lack of availability, not the financial resources. The financial resources could have been gathered; it was getting through the door in the first place.

CHAIR—What years are you speaking of, Mr Evans, when you were looking at that?

Mr Evans—Over the last two years.

CHAIR—Within the last couple of years?

Mr Evans—Yes. As I said, the price of petrol is probably the major issue that this organisation gets representations from its members on. Wherever I go back it is guaranteed to be on the agenda in questions from members: what are we doing, why is it et cetera? I did not realise you represented Matilda, but you would understand the complexity of the industry. Trying to explain that in simple terms, I have discovered, is not easy.

CHAIR—As it is not very easy to explain section 46 of the Trade Practices Act to some people. That is life. Why is it that when the price of petrol goes up everybody criticises the government but when the price of petrol goes down nobody congratulates the government?

Mr Evans—I am probably one of the more vocal critics. I think I have actually congratulated the government. Our concern is the issue of transparency. As we said in our submission, we believe there is a real need for greater transparency. Fuel is really an essential commodity these days. No-one on this committee would envisage life without petrol.

CHAIR—Of course. But at what point do you mean there needs to be transparency? There is transparency in the retail price. The barbecue stopper is the retail price of petrol. There is transparency at the terminal gate price and there is transparency of the Singapore approved price. So at what point in the chain is there an absence of transparency?

Mr Evans—The margins. They are not publicly available. The other issue, which again is a barbecue stopper, is the differentials between the Sydney retail price, for example, and the price out in country regions. It is impossible to explain.

CHAIR—That is a freight issue, isn’t it?

Mr Evans—No. It does not explain the differentials. As we said in our submission, even the oil companies themselves say 3c a litre would account for the freight cost. When you get differentials, as we had between Sydney and Wagga in the last week, of nearly 20c a litre—19c—that is very hard to explain. In fact, you had differentials of 14c between Wagga and Albury in the average price of fuel on the same day. You cannot explain it by freight.

CHAIR—True.

Mr Evans—Those are the sorts of things that people find difficult to comprehend. The oil companies say it is competition. You go to Wagga and you go to Albury, reasonably sized cities, with all of the chains there—Woolworths and Coles plus BP and Mobil—yet all of the stations at Wagga had an average price of 132c a litre and Albury had 118c a litre. There was a differential between Sydney and Albury, which we had not seen for some time. I have to say that the Albury residents were somewhat amazed that they were that close to the Sydney price. They had not seen that low a differential for some time. That was very hard. That is the sort of thing that people just cannot comprehend and then they start to look around to see who they can blame.

Senator O’BRIEN—In figure 10 on page 19 there is a box in the top left-hand corner with the term ‘wholesale price’ and then in brackets ‘TGP’, which I take it stands for ‘terminal gate price'. I understand you to be saying that those are not necessarily the same. Can you expand upon your understanding of the difference between a wholesale price and a terminal gate price?

Mr Evans—Again, this is not something I have ever seen the oil industry explain but we certainly get data that has the two. The wholesale price is that which they will sell to their bulk customers and the TGP is that which they will sell to you or I if we are running a service station and want a tanker load of fuel—and it has to be a tanker load. So there is a differential in the price. But you never see the wholesale price out in the public arena.

Senator O'BRIEN—So the wholesale price should be less than the terminal gate price.

Mr Evans—The data I see on a daily basis shows that to be the case.

Senator O'BRIEN—What sort of differential are you talking about on average?

Mr Evans—I have not got it with me but I can send to you the differential, as we understand it, for say today, between the wholesale price and the terminal gate price. Major bulk customers will then get a further discount off that wholesale price as well. I want to be factual and correct. I want to make sure I give you the data we get as of today and what those two prices would be.

Senator O'BRIEN—I would not want to misrepresent them, but Coles said yesterday that they purchase their fuel at terminal gate price, not lower.

Mr Evans—They purchase it? Yes, but did they also indicate that they get a discount?

Senator O'BRIEN—No, they said they did not get a discount.

CHAIR—They said they did not generally get a discount.

Senator O'BRIEN—Sorry, that is true. They said that there were some special arrangements which were not codified—

CHAIR—Codified in what?

Senator O'BRIEN—I am trying to find the correct word, if you will just give me the leeway. They were not mandated—I think that is probably a fair way of putting it—in the contract. It was somewhat discretionary; they could ask for assistance at times in the market from their wholesale supplier, Shell.

Mr Evans—And rebates?

Senator O'BRIEN—They indicated in their evidence that they were not getting rebates as a matter of course. They did say that other things such as the leasing of sites, maintenance of the forecourts and the pump systems, and intellectual property were the subject of commercial arrangements, but of course we do not know whether there is in fact a discount built into those commercial arrangements, as distinct from those built into the terminal gate price.

CHAIR—You might remember, Senator O'Brien, I asked them about that, and they basically said there was not.

Senator O'BRIEN—I did not understand them to be saying there was not—

CHAIR—That is what I took them to be saying.

Senator O'BRIEN—I think what they said was that they were normal commercial arrangements, but normal commercial arrangements often do—

CHAIR—I understand that.

Senator O'BRIEN—take into account an advantage. I do not think we can say from their evidence that there was not some commercial advantage obtained by Coles Express from Shell in those arrangements. I do not think that is something that we could see behind, from the evidence that we had.

CHAIR—Except, you will remember, I asked them whether there was some discounting implicit in those arrangements, and they were quick to deny that there was.

Mr Evans—And that is the problem we have and why I raised the issue of transparency. I have to say over the last two years I have probably had more discussions with oil companies than I would care to count, as they try to convince me that criticism of the pricing is unjustified or there are certain circumstances. Last year when we held the petrol summit we raised the issue in a communique—and there were 50-odd parties present—saying that the oil companies had not demonstrated that their cost increases justified the profit margins they were getting. One of the oil company CEOs said to me, 'Look, it's not about profit; it's about what the market will bear, so you're wrong.' But we have sources inside the companies saying that the real price that the two supermarket chains are getting varies: they get that 4c-a-litre discount and more from the oil companies on the price at which they are selling. The price at which they are purchasing then enables them to provide that level of discount and maybe make some profit. But we do not know. This is from sources. I cannot give you any evidence other than to say that our sources give us that information, which raises concerns because petroleum is such a key component of the economy.

Senator O'BRIEN—From the evidence that Coles Express gave yesterday, I took it that they did not get any such discount and that the 4c-a-litre and other discounts were built into almost a marketing budget, for want of a better term, for the Coles Myer group.

Mr Evans—That is what we originally believed and that was what was put forward by the chains. But when their market dominance started to increase—and it is now at 65 per cent of the retail market—that is when people on the inside started to raise with us that there were substantial discounts being provided. As I said, we do not know for sure; it is no more than rumour, I have to say, or nothing more than information that we cannot verify. But we would dearly like someone to verify it—to either say it does not occur and put it to bed or say it does occur and verify it. But, whilst this floats around in the ether, it raises the level of concern in the community about whether or not Australians are getting a fair deal on fuel. That is the problem.

The volatility in the market that occurs on a day-by-day, week-by-week basis just adds to it, I think.

Senator O'BRIEN—Perhaps we will come back to that. On page 8 of your submission, in table 3.1—regional movements in petrol prices, the New South Wales metro average is one of the higher figures in terms of the actual increase and the percentage increase in price. What does 'NSW average metro' mean? Is that the average of prices in Sydney, Wollongong, Canberra and Newcastle?

Mr Endres—It may be best if I answer that. My recollection is that it is Canberra, Wollongong, Newcastle and Sydney. This table shows just the price movements over two points in time. I have recently had a discussion with the Australian Automobile Association. They basically were saying—and our data shows this too—that at any particular point in time this will change. So it is a constant moving feast, I guess you can say.

Senator O'BRIEN—I guess it depends on which point in the cycle each of these markets is in as to the level of increase, although it is over a fairly significant period. Further to the issue of the capital cost for the refiners, I take it from your evidence that you do not have an in-depth understanding of the capital cost involved in meeting the new fuel standards as against the amount of subsidy.

Mr Evans—No. I have asked the oil companies if they would care to elaborate so that we are not being critical of the fact that they get subsidies. They have publicly claimed that they have had to increase the price because of the higher standards. I said, 'Tell me what your actual costs are, given that you've got a subsidy' and they have declined to. I think that is important. If there are real costs then I would not want to be in a position of criticising someone for passing those costs on. But I would really like to know what the real costs are.

Senator O'BRIEN—In your submission you also touch upon the issue of refiner margins. We had some evidence earlier this week from Mr Richards, a consultant from Economic and Energy Analysis Pty Ltd. That evidence showed details of the published Caltex profit result rising from $106 million in 2002 to $414 million in 2005, based on a growing refiner margin which, in the first half of 2003, was 3c a litre and now reported, in the first half of 2006, at 10.62c per litre. Do you understand that that is reflective of the growth in margins for oil refiners or is that an exemplary example?

Mr Evans—We do not know precisely but, given the nature of the industry, that it is very competitive and that we do not get any reporting in Australia of the other three, we would expect their margins to be the same. Certainly, again, in anecdotal evidence from people inside the industry, the margins are pretty comparable. The differentials in production costs are minimal. They are all very much concentrated in making sure that they are running as efficiently as possible. We know that last year, for example, in around August and September they actually had refinery margins of around 17c per a litre.

Senator O'BRIEN—On page 17 of the overhead from Warwick Richards there is a small chart in the right-hand bottom corner—I know you do not have it in front of you—showing a fluctuation in the refiner margin over the first half of the year. The margin is something in excess of 10c at the beginning of the year, falls to something around 1c or less at the beginning of

February, grows to somewhere around 18c per litre during June and at the end of the period appears to reach its highest point at around 18c per litre. What do you say about those sorts of margins, given that the average, on the evidence we have, is showing a more than trebling of the margin since the first half of 2003?

Mr Evans—That goes to the heart of one of our concerns—that there are these marked increases in the refinery margin which contribute to the profit of the refiners. I will publicly say it: we do not mind them making a profit; that is the nature of the market. It is whether it is a fair and reasonable profit given the nature of the commodity. When they have those sorts of margins the impact in the economy is quite significant. That is why we asked CIE to have a look at it. It was not just us representing the complaints of individual motorists. We were asking whether this had a deleterious effect on the economy and therefore was there a role for government to make sure they were not enabling a situation which had a deleterious effect on the economy when they might have been able to make sure it did not occur that way.

The refiners are not being good corporate citizens when they do that. I accept that they have to make a profit—and a reasonable profit—but not that they can make unreasonable profits or take advantage of situations. And they do. Last year, with Hurricane Katrina, I had many debates with oil company executives. Their argument was that they had to increase the refinery margin because if they did not sell it to Australia they could sell it in the US market. I asked each and every one of them, ‘Have you netted out the cost of freighting Australian refined product to the US if you are arguing that you can sell it in the US market?’ Not one of them said they had. Their view was: ‘That was the increase in the margin in the US, we will replicate it in Australia and we will not account for the fact that there will be freight costs if we have to ship it to the US to sell into that market because there is a shortage of supply.’ That is when they have trouble convincing the public that they are being reasonable corporate citizens.

Senator O’BRIEN—What do you say about the state of the market when, one could argue, it is possible that excessive profits are being generated at refinery level at the moment? Do you say that there is some failure in the market?

Mr Evans—We would say there is an apparent failure in the market, and a growing concern on our part that the market may well contract even further in the number of players. Having four dominant players in the market is okay if they are all competing in equal shares. We have two that are really dominant players and there are many rumours around the industry that one of the current players may well exit the market—that being Mobil. It is merely a rumour but it raises our concerns that we are then down to three and that really will make it difficult in the Australian market. If you look at the evidence in the UK, where the supermarket chains—Tesco and others—are in a dominant position, you will see the market went back up. So you have to be very careful. Australians are very dependent on fuel, not only for transport of goods but for personal transport as well.

Senator O’BRIEN—There is no doubt that demand has a limited impact on the volume of sales and the market has some. Coles Express told us that when prices went over $1.20 to $1.30 then to $1.40 there seemed to be a contraction in demand, but overall it is an essential, isn’t it?

Mr Evans—As we said in our submission, there has been a contraction in demand, but you are seeing it reflected in a change in the composition of the car park. I know from my former life in the government department of industry that this also would raise some concerns about the impact on the Australian vehicle manufacturing industry, which has not been taken into account in our work to date. Clearly the 22 per cent reduction in the sales of six-cylinder vehicles in the Australian market is going to have severe consequences for the Australian vehicle manufacturing industry. Motorists are voting with their pockets. They are saying, ‘Well, I will go to a more fuel efficient vehicle.’ One of my other roles in life is as chairman of a car rental company. We would not even contemplate buying a six-cylinder car because we know that its resale value is so small we could not make a profit, but four-cylinder vehicles are very valuable vehicles in the used car market. The more fuel efficient they are, the more valuable they are.

Senator O’BRIEN—In relation to your evidence about market power—for example, supermarket chains—you were asked some questions about the concept of taking advantage of market power. I am taking from your evidence that you would say—and correct me if I am wrong—that the increase in the refinery margin is an exercise in market power.

Mr Evans—Absolutely. But of more concern, because we do not know about the other three but we did know about Caltex because it is a company that reports in the public arena—

Senator O’BRIEN—I can tell you that I do not think BP disagrees with the concept that they are similarly experiencing profit growth compared to Caltex.

Mr Evans—That is the thing we find difficult to understand. In a truly competitive market, even with four, you would expect some greater competition and variations in the margin as one tried to capture more of the market than the other. When you talk about the domination of the retail chains with their shopper dockets and 4c a litre, and when you see the fluctuation in margins, you would think that if someone really wanted to capture the market they could reduce their refinery margin to make sure they were competitive in the field, but the similarity is just unreal. We know it does not meet the test of collusion but it is too coincidental for us to feel comfortable about.

CHAIR—Why isn’t it just price following? That is what it is, isn’t it? They see each other’s margins. There is a leader and they follow them up and follow them down. Isn’t that what happens?

Mr Evans—Yes, they do.

CHAIR—What is wrong with that? We had evidence from some economists the afternoon before last who said that that phenomenon is consistent with pure competition.

Mr Evans—It would not be my view of pure competition.

CHAIR—But you acknowledge yourself that this behaviour, which you acknowledge as price following, is not collusion. It could be. It could be that they are acting in such a purposive and mutual way that it would be collusion, but that has never been demonstrated and you are not asserting that to be the case.

Mr Evans—No, it is coincidental.

CHAIR—It is not coincidental either. In fact, it is the opposite of coincidental; it is causal. One of them will lead a price movement and the others will follow. The evidence we have on it—and I think it reflects common sense—is that, in a purely competitive market for a common uniform commodity, the tendency of the commodity to be sold at a competitive market price means that various players selling the same commodity in a purely competitive market wind up charging the same price.

Mr Evans—Except that it generally holds that that is when you reduce the price. What we see in this industry is that it occurs in the opposite direction.

CHAIR—It occurs in both directions.

Mr Evans—It occurs in both directions but pure competition means that you want to be the one who has the most advantage in the market, the greatest sales, that you want to be the market leader in terms of price, quality or the service you are providing. When you have a commodity like fuel, we find it rather strange that, yes, they may follow but they follow up as rapidly as they follow down. In a purely competitive market you would expect someone to say, 'I'm going to exercise a market advantage, because I'll keep my price down,' but they do not.

CHAIR—Why is it different from, for example, banks? The interest rates that banks charge tend to go up and down in the same way.

Mr Evans—I get into enough trouble over petrol. If I go into the banking area—

CHAIR—That is my point: when you have a totally uniform commodity, whether it be money or fuel—in other words, they are not competing on quality, on different characteristics of a commodity—there is a uniformity about it and, if you have four players in a market, then in a purely competitive market the price at which that commodity is sold will be the competitive price for any of them. If you have four of them, as I said before, they will all wind up charging much the same.

Mr Evans—A not dissimilar price—and the same is true for banking.

CHAIR—You acknowledge that.

Mr Evans—I can say that we have entered that market—and we got into that market without betting the farm on it. The NRMA used to be an organisation that provided loans for motor vehicles, and we have gone back into it. We are actually cheaper than any of the banks, and we are making a profit. We could do that because we could obtain funds, we could obtain the distribution services we have and we could compete. We cannot get into this industry because the one thing we cannot get is a guarantee of supply of product at a price—

CHAIR—This is back to the barriers to entry problems.

Mr Evans—Exactly.

CHAIR—Mr Endres, before I return the call to Senator O'Brien, speaking to you in your capacity as the economist, it is also true as a generalisation, is it not, that price volatility is a feature of competitive markets?

Mr Endres—Yes.

CHAIR—So that if the price were completely flat, you would be more suspicious of collusion than if the price was volatile?

Mr Endres—Yes, I do not disagree with that. I would like to say two things. One, you compared petrol to banking. Banking has a range of different products. They do not just compete on home loans and loans; they compete on savings accounts and things like that.

CHAIR—That is true, but that is what makes my point a fortiori, isn't it?

Mr Endres—Excuse me?

CHAIR—That makes my point even more strongly in relation to the oil company. The more uniform the product, the fewer features on which it competes, other than the pure uniform undifferentiated product itself, the more you would expect purely competitive principles would wind up with the same price being charged by different players in the same market.

Mr Endres—Yes, that is true. The other point I would like to make is the price cycle that you see in each of the states is very consistent. My question—and I do not have an answer to this—is: why don't you see some supermarkets or some petrol retailers putting down the price on a Thursday instead of a Tuesday? If they really wanted to capture market share, even just transitorily, they would cheat on the price cycle and reduce the price on a Thursday instead of a Tuesday because they know that their competitors are actually lifting prices on that day according to the price cycle. So why aren't there completely random price movements—that is what competition would suggest because you are always cheating on your competitors? However, what we see in petrol is this constant weekly cycle.

CHAIR—That is a fair point. I would respond by saying to you that you must be aware that there is a huge literature on parallel conduct and, in particular, the distinction drawn by some economists between conscious and unconscious parallelism. Are you familiar with that?

Mr Endres—Yes.

CHAIR—Sorry, Senator O'Brien, that was a little excursus but I thought it might have been helpful.

Senator O'BRIEN—Let me explore this concept of competition. Where there are price fluctuations in the wholesale market and dramatic price fluctuations in the retail market and everyone seems to follow one another up and then down, is it competition or could we call it price gaming? It seems to me that everyone is looking for a rate of return.

Mr Evans—Yes.

Senator O'BRIEN—In the first half of the year, if we look at the Caltex chart, the margins fluctuated from near zero to 18c a litre, leading to an average margin for Caltex declared at 10.62c a litre. If there were competition, if there were plenty of product in the market and everyone was trying to sell their product and thought that they might not be able to sell it if they did not offer it at a competitive price, wouldn't we have seen a lower price range? Wouldn't the fluctuation up to 18c have been almost impossible?

Mr Evans—Yes. If there was pure competition, you would not have seen that, but there is not.

Senator O'BRIEN—Is it likely then, because we are not producing enough refined petrol in this country to meet market demand, that competition is being strangled by limitations of supply?

Mr Evans—If I can expand on that: in terms of looking at the market, it is just not purely Australia. For the supply of crude and the refined product, it is in the region.

Senator O'BRIEN—We do bring it in.

Mr Evans—One of the concerns that we have in the future is that if there is not some management, then the price increases we are seeing now will be modest compared to what will happen then because of demand in two economies in particular: China and India. We are seeing it now in terms of the price of diesel. We have not seen the fluctuation in the price of diesel over the last few weeks that we have seen in unleaded petrol primarily because the demand for diesel in those countries is greater than it is in Australia. We are fairly constant users of diesel and so the diesel price in Australia stays relatively high.

No-one is investing—certainly not in Australia—in refinery capacity to the extent necessary to meet demand and that is a concern we have. We understand the significant cost of increasing capacity; we accept that and you have to get a return. What we are concerned about is that no-one is investing, and when you talk to the oil majors and ask, 'Why isn't someone investing?' they say, 'We overinvested in the eighties and early nineties and now we are getting a return that we are more than happy with and we don't want to go back into the area of investing again in case it drops.' I have to say that last year the oil companies were predicting prices in the range of $25 to $40 a barrel. Of course, it has gone up to $75. They are not saying that now, but last year they were arguing that it was not reasonable to think of investing in Australia because the price was going to go back down to that $25 to $40 range. What bothers us is that this industry and these people should know better than most what the likely costs and prices are, but they seem to get it wrong as well. We the motorists end up suffering.

Senator O'BRIEN—I am just interested in how you see the market and this alleged competition price cycle from the consumer's point of view. Indeed the gentleman from Matilda, the independent, was talking about parts of the cycle where there will be an attempt at a particular site to increase price to encourage others to move up as well and push up that margin. I would call it 'gaming'.

Mr Evans—That is probably not a bad word.

Senator O'BRIEN—It is an attempt to achieve a margin by floating the idea that perhaps the market is ready to raise the price, rather than the concept of taking an opportunistic price reduction to get volume, given that this has become more a volume industry.

Mr Evans—And getting a market advantage. That is what we have difficulty understanding. Again, the complexities of the industry are something that the average person does not understand. The fact that, even though it is not a company owned site, the oil company can advise the operator of that site the price they should be charging for fuel perplexes people. The average person would think it was an independently owned site, albeit branded, and should be able to determine at what price it sells. The answer is it cannot.

Sydney is a classic example. When you net out the differentials in the property prices, which one has to—it costs you more for a site in Vaucluse than it does for a site in Blacktown—but not any wage differentials, by the way—we have not been able to detect any real differentials in wages or the other costs—the variance across Sydney is quite significant. Typically the lowest price in Sydney is out in the western suburbs, certainly not in the eastern suburbs. And the difference can be anything between 14c to 15c across Sydney. Again, motorists cannot understand that.

Senator O'BRIEN—That might well be what the market can bear in those circumstances.

Mr Evans—It is certainly what the market can bear in those suburbs.

Senator O'BRIEN—It may be that demand for petrol for longer distance travel is less when you are closer to the centre of the city as well.

CHAIR—What about the rents? Wouldn't that be the reason?

Mr Evans—When you net that out. There is a differential in rents—there is absolutely no doubt about that—but when you net that out it does not explain the differences in prices.

Senator O'BRIEN—What about volume of sales?

Mr Evans—They are comparable.

CHAIR—I hope you are not suggesting, Senator O'Brien, that wealthy people should pay more for their petrol than less wealthy people?

Mr Evans—They do!

Senator O'BRIEN—I thought the evidence was that they were and I was wondering whether—

CHAIR—That is very ideological, Senator O'Brien—a true socialist line.

Senator O'BRIEN—I do not know that it was. I was suggesting that perhaps where you do not drive as far the sensitivity to price is less.

Mr Evans—It is interesting that the wealthier suburbs, when you net out the rent differentials, do actually pay more.

Senator O'BRIEN—It is probably good from an ideological point of view that those who can afford to pay more are paying more, but that is a different question.

CHAIR—Goodness me! Is that foreshadowing the policy of a future Labor government in which you would be a minister, Senator O'Brien? That would scare us all!

Mr Evans—As a motoring organisation, we do not have that ideology.

Senator O'BRIEN—I thought our tax scales were supposed to address that. So if the government has a different view, it would be interesting to hear it.

Mr Evans—But, again, that compounds the problem of motorists trying to understand petrol pricing, when you net that out. They ask us those questions. People from the eastern suburbs do raise them. Our view is that, apart from those key differentials of rent and freight, there should be some parity in the price of fuel across Sydney, and there is not. It is markedly different.

Senator O'BRIEN—Going back to that issue of taking advantage of market power, what is your view of this concept? We heard from Coles Myer yesterday that overall their sites operate profitably and they would hope that each site operates at a profit. But would it be fair to say, in your experience, that some larger volume sites—perhaps supermarket sites—would have the ability to operate for a period of time on very narrow margins which would have an impact on the ability of others to compete in the area?

Mr Evans—Yes. Certainly, from talking to the independents, that is a major concern they have; they see there are examples. You had independents in Canberra; you do not any more.

Senator O'BRIEN—Senator Stephens suggests that maybe that means price support. But what I am suggesting is that, rather than price support, it means moderation of the desired profitability of particular sites while volume is achieved, given that volume is a major driver in the industry at the moment. Is there any concern that, particularly given your evidence about the British experience, we are likely to see in the Sydney market the volume sites operating on low margins to drive further volume and having an impact on the ability of others to compete over an extended period?

Mr Evans—It is a concern of ours. Predatory pricing would be a concern. Our concern is also the rationalisation of sites. It creates a number of problems: firstly, that the availability of fuel is limited and that means some motorists will have to drive further to get to a site. You are seeing that even in Sydney, but also to some extent in the regions as well. If you go through, the number of sites has reduced markedly over the last decade and continues to reduce. Mobil, for example, are closing down a significant number of sites across the country. So that is less competition. The chains are buying up the bigger sites or they are suddenly becoming Caltex, Woolworths or Shell/Coles branded sites. And therefore you see an impact on the smaller sites, even around those suburbs. That is a major concern we have.

Senator O'BRIEN—Certainly, consumers might think that, whilst very low prices are being offered relative to others in a particular area, that is a good thing. Are you suggesting that, from your knowledge of the British experience, that can be transitory and that once competition—

Mr Evans—Certainly, the British experience tends to indicate it was. They moved in, they reduced the number of independents quite substantially, and then the prices started to climb, in not dissimilar ways to what we are arguing here: that the increase in the retail price of fuel did not match or did not parallel the increase in the price of crude.

Senator O'BRIEN—You use the term 'predatory pricing'.

Mr Evans—Yes.

Senator O'BRIEN—Is that how you see that behaviour?

Mr Evans—We certainly think there have been some examples of people coming to get dominance in a market and, if you look at the prices they were charging for fuel compared to others in a region, when the competition was removed then that price, which might have seemed lower than comparable sites in other areas, moved back up again.

CHAIR—This is one of these terms that gets thrown up by everyone and I think we should make sure we are all talking about the same thing. When you use the term 'predatory pricing', what do you mean by that?

Mr Evans—I mean someone moving to a market and selling at a price either below cost or at a very slim margin, such that those who were established there before cannot compete. They do not have the same advantage in terms of discounts or volume sales or whatever, because of their circumstances. But the focus is not on competing on a pure basis but rather on forcing them out of the market.

CHAIR—Is it an element of what you consider to be predatory pricing that the party engaged in that conduct must have the intention of driving the other party out of the market?

Mr Evans—You would have to, in my understanding of 'predatory'. That would be one of their objectives: to remove any competition from the area.

CHAIR—So, if it is just a consequence of a pricing strategy and the pricing strategy does not have the objective of eliminating competition, you would not consider that to be predatory pricing.

Mr Evans—No. If it is pure competition, we would welcome it.

CHAIR—It is interesting you say that, Mr Evans. What you say is pretty close to the way the law interprets section 46 at the moment.

Mr Evans—Yes. And we would not want it different from that.

Senator O'BRIEN—Let me put it to you this way: in an area, generally speaking, a certain volume of fuel is sold. If the intention is to take a much greater volume, it might be hard to demonstrate that you intended to take all of the volume of the competitor. If someone intends to take a significant part, how do you prove that there is intent to destabilise that business? That would be very difficult to prove under current law, wouldn't it?

Mr Evans—You cannot.

CHAIR—You can.

Mr Evans—You can if someone—

Senator O'BRIEN—If someone admits it.

Mr Evans—Yes.

CHAIR—No, that is not right, Mr Evans. I have done it. I know how to do it. You can. And it does not depend on there being a whistleblower. Subsection (7) of section 46 of the Trade Practices Act, unusually among Australian statutes, says you can arrive at that conclusion by inference alone in the absence of a single piece of direct evidence. People do not understand that when they toss section 46 around.

Mr Evans—I welcome that advice, Senator. I might go and pass it on to a couple of people. Unfortunately, you might not be in a position to represent them, but I will certainly pass it on to them! Most behaviour is unusual—I have to admit that at times—but most people are reasonably rational. They are not going to drive for a long period of time to save 4c a litre when they work out that they are going to use several litres of fuel to save 4c. The occasional person does, I admit, but most people are rational and do not. So, when there is a reduction in the number of stations in a region or location, they have no choice but to fill up there. And that, I think, explains part of the problem in some of the wealthier suburbs in Sydney.

Senator O'BRIEN—Can I characterise the NRMA's evidence as saying that they are not satisfied with the competitive model at refiner level and they are not satisfied with the competitive model at the retail level?

Mr Evans—That would be a fair summation of our view.

Senator O'BRIEN—And could I characterise your evidence as saying that, as a result of this unsatisfactory level of competition at both levels, motorists are paying more for their fuel than they might otherwise pay?

Mr Evans—Yes. I will take that a little further and say that we regularly survey our members. A bit over 12 months ago we picked the trend that is now apparent: the level of anger of motorists about the price of petrol. Indeed, we were trying to advise government at all levels that this was an issue which was arising. And it is going to be very difficult to placate that anger without some further ability to inform motorists of the real costs, the real profits, the real margins et cetera, and to satisfy them that the system is open and transparent and that there is a truly competitive model.

Senator O'BRIEN—We have had some interesting evidence about different markets. The evidence from the Commissioner for Fair Trading in Western Australia is that for all of 2005 and to date in 2006 the Perth market has been on average cheaper than the capital city markets east of Perth. The suggestion from the Commissioner for Fair Trading, and certainly the evidence was, that they cannot understand that difference in any way other than the impact of the FuelWatch system in Perth. The fact is that their market seems to have a price cycle which is longer, a range of fluctuations which are shorter and going through a smaller range and, generally speaking, a bottom of the cycle comparable to the bottom of the cycle in the eastern states' capitals.

Mr Evans—I have to say, I could not disagree with them. One of the pieces of information I get on a daily basis is FuelWatch. I think it is probably the most comprehensive information I have seen provided. And, of course, it comes from a government authority. I think the fact that it is a government body providing this information carries additional weight. And it is very detailed and good information for motorists as to the price of fuel and the reasons for that. It is giving them advance information. I do not know if you have looked at FuelWatch, but it says, 'We expect the price of fuel to be X tomorrow.' It gives people some advance—

Senator O'BRIEN—It is more than 'expect'; they say, 'From three o'clock it will be X.'

Mr Evans—Yes. Initially they were saying 'expect'; they now say 'will be'. I think the market is following them.

Senator O'BRIEN—It was interesting this morning to see on the *Today* show that prices in Perth are currently the lowest. They are about 4c-plus a litre lower than the lowest prices in Sydney.

Mr Evans—Yes, Senator. And I have a problem each day when I read FuelWatch to see that it is cheaper than Sydney. Sydney is the biggest market in Australia yet prices are lower in Perth.

Senator O'BRIEN—And in that market, the evidence we have from, I think, the RAC as well as the Commissioner for Fair Trading, is that independents, particularly the chain independent Gull, continue to operate successfully.

Mr Evans—Yes. And we see some local evidence, by the way. One example I often use is Bathurst and Orange. In Bathurst there are fewer independents and they are smaller operations. In Orange, there is a couple of reasonable-size independents. The price differential between Bathurst and Orange is noticeable—there is a 2c or 3c a litre difference—yet Orange is a little further down the track than Bathurst. Bathurst is a bigger city. One would expect greater competition there than in Orange, but Orange is almost without exception at a lower price than Bathurst.

Senator STEPHENS—Gentlemen, I want to pursue some of the discussion we had earlier this morning in relation to the refiner margins. I draw your attention to the ACCC's submission. On page 29 it appears that they regard the refiner margins as an artificial construct; they describe it as the difference between the Singapore Mogas 95 price and the Tapis crude price. Is that what you perceive the refiner margin to be?

Mr Evans—An artificial construct? I do not think we have ever seen it as an artificial construct. Certainly, the oil companies do not seem to regard it as an artificial construct; they see it as the key to their profits. I do not understand what the ACCC is getting at. I will have to go and look at it.

Senator STEPHENS—I do not want to verbal the ACCC, but it seems from my reading of the submission that they are basically suggesting that the difference between the Singapore Mogas 95 price and the Tapis crude price is variable. Therefore, for the oil companies to use that as a fixed point of difference is in fact, not to use the legal term, misleading as a starting position.

Mr Evans—Could I take that on notice and come back to you. One of our concerns is that the reference price for crude is Tapis crude, which is the margin between Tapis and the other crudes. Tapis is the most expensive crude on the market, so that starts to give the oil companies an advantage in terms of their base price. As we stated in our submission, if it is then 95 RON, not 91 RON, which again is the biggest selling fuel in Australia, there is another little margin. Margins creep in—for instance, the transport costs are based on 38,000-tonne tankers. There are not too many 38,000-tonne tankers plying their trade these days. So that gives them another margin. Can we come back to you with an answer in written form? We will take the question on notice, look at it and make sure that we give you a reasonable and responsible answer.

Senator STEPHENS—Certainly. I would appreciate that. Senator O'Brien talked about the Western Australian system. You reflected on its benefits for consumers. What do you think about the ACCC's petrol price cycle webpage in terms of the extent to which it injects transparency into the market?

Mr Evans—I do not want to be impolite, but not a great deal. We do not think it gives good information. Motorists want information about the price of fuel and also why it varies to the extent that it does. That is what they pursue us about. That is why we have set up our Petrol Watch, which receives millions of hits. We believe it has had some effect on price as well. Certainly, the stations which have the lowest prices are pretty consistent. They are the market leaders. You can almost guarantee when you go on FuelWatch to find that the cheapest petrol price will be amongst a handful of stations. They are very anxious to make sure that they always have the lowest price. It has not had that effect yet in the eastern or northern suburbs, but certainly that is the thing that motorists want. When we question our members about looking at the ACCC site, they say they do not find it informative at all.

Senator STEPHENS—That is helpful information as well. Going back to the situation of Mobil and certainly the continued speculation about Mobil's intentions, theoretically can you tell us what you think the effect would be on petrol pricing and supply in Australia if there were only three rather than four major oil companies?

Mr Evans—That is a difficult one, Senator. That is one of our concerns—that it takes a fourth one out of the market. BP are not linked with one of the chains. I guess there is probably a natural level of about 75 or 80 per cent of the market that the two chains could not go above because the sites would not be significant enough in size for them to acquire and run them. So there would still be a number, particularly in regional areas. If you take Mobil out, I would be quite afraid that we would see a continued increase in the price of petrol above and beyond the price of crude. So we think there would be higher costs for motorists and, as we said in our opening statement, quite deleterious effects on the Australian economy. These rumours that Mobil may be thinking of vacating the market are of concern to us, and we are looking at what options we might be able to pursue in concert with others to make sure that there is at least a fourth player in the market.

Senator STEPHENS—We have talked about the price cycle and the consumers' perspective of the price cycle. Do you have any speculative remarks to make about what is going to happen to petrol prices over the long weekend?

Mr Evans—If you were listening to Triple 6 this morning, you will know that it has happened—it has gone up by 10c.

Senator STEPHENS—Ten cents?

Mr Evans—Yes, a 10c increase in Canberra. I did not have a chance to look at what had happened in Sydney this morning, but I expect it to rise. We had the classic example a few months ago where there was a long weekend in the eastern states but it was not a long weekend in Western Australia. Of course, FuelWatch showed a jump of about 12c or 15c in the eastern states while the price in Western Australia stayed at the previous level, and afterwards it came back down again. One has to be cynical at times, Senator, I am afraid. But when I turned on the radio this morning and heard the debate on Triple 6 about a 10c jump in fuel, I did not have the heart to ring up and say, 'Looking at the data we get, yesterday there was actually a 0.5c per litre reduction in the seven-day rolling average price of fuel, so it should have gone down.'

Senator O'BRIEN—Senator Brandis would be displeased to hear that, according to the television reports this morning, the price in Brisbane is now higher than the price in Sydney at the lowest levels.

Senator STEPHENS—But our evidence from the industry yesterday was that there is no such thing as weekend hikes—that this is all a furphy—

CHAIR—That is not fair. The evidence was that there was no distinction between long weekend hikes and other weekend hikes.

Senator STEPHENS—That is right—with a graph to prove it.

Mr Evans—That might well be true. One thing we have noticed is that there was a window on the Tuesday, and we gave advice that Tuesday was generally the day in Sydney which had a lower price, but we have seen the window close. It usually ran from Monday afternoon to Wednesday morning. It is now from Tuesday morning to late Tuesday afternoon. So we have had to modify the advice we give to members.

Senator STEPHENS—Indeed.

CHAIR—Following on from Senator Stephens's questions about Mobil, are these rumours in the industry about Mobil possibly withdrawing from Australia given much credence?

Mr Evans—Initially they were not, but they are getting some momentum, and that is a worry.

CHAIR—They are the only one of the majors which is not appearing before this inquiry.

Mr Evans—To the extent that we are talking to people and asking, ‘Is there any potential for us to find a group of like-minded individuals with sufficient cash to crash through the barriers to entry to make sure that we do have some competition?’

CHAIR—Wouldn’t you think that if the Australian industry is super profitable there would not be rumours about one of the four players withdrawing? Doesn’t that tend to suggest the contrary? I am not saying the rumours are true, but doesn’t that tend to suggest that the industry is in fact so cutthroat that were this decision to be made—presumably by some board in the United States—it would be because they have decided their return on capital here is too low?

Mr Evans—Or that the return on capital elsewhere can be greater.

CHAIR—It is the same point.

Mr Evans—My experience in the industry over many years is that, for some industries, the size of the Australian market is so small that for it to get on the radar screen in a boardroom in New York is very difficult. The Australian market probably accounts for one per cent, at most, of Mobil-Exxon’s global market. As I said, my experience from my industry days was trying to get in the door and say, ‘We’re important; talk to us; think about us,’ and so on. We are a nonevent. So I would not be surprised that, in a boardroom, a market the size of Australia does not even rate or that someone might say: ‘We’re not making sufficient profit out of that. What’ll it cost to vacate the market?’ And that is the worry.

CHAIR—Were one of the players to withdraw, it would be quite powerful evidence that the industry is not particularly profitable in this country.

Mr Evans—I wish I had had Caltex shares.

CHAIR—That is a different question.

Mr Evans—Yes, but they are the ones we know.

CHAIR—But when participants in an industry—who I think we all agree have quite a lot of market power and have sunk an enormous amount of capital into a capital intensive industry—decide to withdraw, that to me tends to suggest a view that the industry is not all that profitable, as measured by return on capital.

Mr Evans—There are a whole range of factors that go into that. But it also may well be because, having seen the dominance of the two retail chains and the fact that those two retail chains dominate the retail market as well, the opportunity to link up with another player in the retail market and do a similar thing may not be possible, and that is also a worry. These interrelationships may well have an effect on how people view Australia.

CHAIR—Mr Endres, there were some questions from Senator O’Brien about the rationalisation of sites, and we know it is a given that the number of sites has fallen very substantially. The number of sites is not the indicator of competitiveness so much as the number of players. Is that right?

Mr Endres—It depends on what part of the industry you are looking at. If you are looking purely at the retail segment of the industry—and some of those sites are independents and therefore they represent another player—then the number of sites could be important. But I think, stepping back, at a higher level the number of players is an important thing.

CHAIR—That brings me to my next question to you, Mr Endres. Depending upon, among other things, the level of capital intensiveness of an industry, do you accept that if there is a rationalisation in which what have been described as the ‘mum and dad independents’—the families that might, for argument’s sake, operate one or possibly two petrol pumps from the front of the local shop—go out of the market, that rationalisation does not of itself suggest the market has become less competitive? In other words, is there a critical mass below which, in a perfectly competitive market with these characteristics, it is just not feasible to be an operator?

Mr Endres—I think that if you are looking across a state, or maybe just within a regional centre, with one ‘mum and dad’ site and one site that is a Caltex or another of the majors, and one of them goes out then that is a loss—that is significant.

CHAIR—But I do not think anybody would define the market as being so localised as to be, for example, one country town, would they? You would not say that, would you?

Mr Evans—There is another issue, which is that if there were pure competition in refining there could be an argument that the refiners would want to make sure that they had a significant presence across the country and across regions, because there is, to some extent, brand loyalty. Until the advent of the shopper dockets of the retailers, brand loyalty was quite common. It has decreased. From information from the two chains that do the shopper dockets, we know that last year, even in the northern suburbs and eastern suburbs of Sydney, there was a marked increase in the use of shopper dockets, which indicated that people had gone away from their traditional brands. There was a decline in sales at the non-shopper-docket sites.

CHAIR—I think that is a very fair point. My point was that merely the rationalisation by the reduction of sites at the margin—the one and two petrol pump operators—does not of itself suggest the market is not competitive, does it?

Mr Endres—It depends on how you define the market. If you define it at a very local regional level it may be, but if you define it differently it may not be.

CHAIR—Your qualification fact would only apply if you define the market very narrowly at a local level, wouldn’t it?

Mr Endres—Yes. The more narrow, the more significant it will be.

CHAIR—I am rather taken by the good people of my friend Mr Turnbull’s electorate paying 14c a litre more for petrol than people in Blacktown. Is that not entirely explicable by decisions by the retailers within that region of Sydney to think, ‘Well, we can charge these people 14c a litre more,’ and then price following within that region by the other retailers—in other words, pricing decisions driven at the retail level, not at the supply level?

Mr Evans—I think one has to say that from our experience it is the refiners more than the retailers that set the price.

CHAIR—That is not the evidence we heard yesterday.

Mr Evans—I have actually been in stations when they have received the call from the oil company saying, ‘This is the price you will set,’ including—

CHAIR—We have only heard from one of the oil companies so far, so we will ask the others the same question. Mr Evans, do you find among your members an awareness that Australian petrol is comparatively cheap?

Mr Evans—They are aware that it is cheaper than in Europe but they are also aware that it is dearer than in North America.

CHAIR—Are they aware that North America is the only region of the world in which petrol is cheaper than it is in Australia?

Mr Evans—They are, but they also compare themselves in terms of vehicle usage to North America more than they do to Europe.

CHAIR—Thank you, Mr Evans and Mr Endres. That was very helpful.

Proceedings suspended from 10.34 am to 10.47 am

COLLINS, Councillor Stanley Bruce, Mayor, Winton Shire; and Member, Remote Area Planning and Development Board

Evidence was taken via teleconference—

CHAIR—Good morning, Councillor Collins.

Councillor Collins—Good morning.

CHAIR—As you are aware, these are broadcast public proceedings. The committee has before it your submission, numbered 43, which has been lodged on behalf of the Remote Area Planning and Development Board. I invite you to speak to the submission briefly, and we will then proceed to questions.

Councillor Collins—Thank you. Broadly, I believe there are two major factors that affect the future of remote Australia, and by that I mean whether we face losing population, drifting away to the city as people have for years, or whether we are ever going to reverse that trend. These factors are the viability of industry and commerce in those areas and the cost of living—and it is a much higher cost of living. Fuel excise as it currently exists and has done for a number of years impacts negatively on both those factors. When I say ‘negatively’, I mean negatively from the point of view of those living out there.

It forces foreign producers and industry to operate with a higher cost base than their competitors closer to the coast and the capital cities. It produces a higher cost of living, which is a significant deterrent to families moving to remote Australia. The simple facts are that fuel excise adds to the transport cost and puts up the cost of all consumable items and food to residents of those areas. This includes all basic foodstuffs.

I often think about when the GST was being introduced a few years ago. There was much media hype, I suppose, and focus on GST on food and on the negotiations that took place to get GST off food. Yet the way that fuel excise impacts on rural Australia and particularly remote Australia is that it is a tax on food and everything that is transported. It is a simple fact of life that there are greater distances between centres in remote Australia than in other parts of Australia. As a result of that, there is a greater reliance on travel for those people living there simply because you need to travel between various centres and the distances are greater. I believe there is more non-discretionary travel in rural Australia. I cannot support that with facts and figures, but I have lived in remote Australia pretty well all of my life. Services are gradually—some might say rapidly—being withdrawn from various centres so, for simple health and education purposes that people in the capital cities take for granted, we have to travel quite large distances.

As an example of accessing education in this area, there is a school of distance education in Longreach, which is 180 kilometres away by sealed road. We believe that is relatively accessible to people at Winton. But most of the students enrolled in that school live on properties. I know one family that lives 230 kilometres west of Winton. The husband is a manager for a family company. He is not a property owner. His wife and he make frequent trips to Longreach to be involved in educational function days. There are all sorts of support activities that they believe they have to attend. They are also trying to engage or involve their children in sporting activities and social interaction. They told me earlier in the year when council was putting a submission together for the state inquiry—and I hope my memory serves me right—that they travelled in the order of 20,000 kilometres in one year for those purposes.

I should also say that less expensive alternative fuels such as LPG and biodiesel are not widely available in remote areas and therefore very few people access those options. In remote Australia road users pay a higher GST component on their fuel because it is levied at the bowser. Just as a matter of interest, this morning I looked up a website known as MotorMouth, of all names. The best bowser price in Brisbane this morning quoted for ULP is 106.9 and for diesel 120.5. The best bowser price in Winton this morning—and this is also Caltex—for ULP is $1.31, which is 24c more. The diesel is $1.36, which is 15.5c more. That is about all I wanted to say in my introduction, but I think it is evident that people in rural and remote areas suffer as a result of fuel excise.

CHAIR—Thank you very much indeed, Councillor Collins. On that last point about the difference between the price today in Longreach and in Brisbane, do you accept that, because of distance, there is going to be a freight component which will inevitably make fuel in remote Australia more expensive than in the capital cities?

Councillor Collins—Absolutely. That is a fact of life and we do accept that.

CHAIR—Are you aware or are people in your shire generally aware that the Commonwealth government froze excise in 2001 and that in the five or so years since then the excise has not increased and in fact, as a proportion of the cost of fuel, has effectively fallen? It has been frozen now for more than five years at 38c a litre.

Councillor Collins—I am aware of that and I think a proportion of people in the shire would be aware of it. I think a large number of people not only in this shire but probably across Australia would not be.

CHAIR—Yes. I am just thinking that if we say that inflation over the last five years has been running at roughly two per cent a year then there has been an effective 10 per cent reduction in the amount of excise.

Councillor Collins—That is welcome. However, I think the whole point of the RAPAD Board submission was about the inequity: as long as excise is levied, as it is, to raise general revenue and is not hypothecated to the areas in which it is raised then it becomes a regressive tax on people living in remote areas.

CHAIR—I understand that point. I cannot see anything in your submission specifically about ethanol, although you do mention alternative energy. From the point of view of your shire in western Queensland, are there prospects for the development of an ethanol industry in your part of Queensland?

Councillor Collins—I do not think so. This is a purely pastoral area. Unless there is some technology that suddenly surfaces that makes it cost effective and gives some cost advantage to utilising a native grass or some other pasture species that would be available to us, it could be difficult to imagine.

CHAIR—I expected you to say that, but the reason I wanted to draw that point out is that, because ethanol is made from sugar and grain in particular, it seems to me—I will make this observation and invite you to comment on it—that those who suggest that taxpayers' funds should be diverted to generating ethanol industries in the sugar- and grain-producing parts of Australia are really playing one part of the bush off against another. What do you say about that?

Councillor Collins—Yes, I would have mixed feelings about it. Not only I but everyone living in this part of Australia would be very keen to see cheaper, alternative energy developed. But if it consumes grain in particular it certainly impacts fairly heavily against the cattle feedlotting industry, and much of the cattle coming out of this area go into that industry. So while we might see cheaper energy we would probably also see dearer grain prices, which would impact against us in the long term.

CHAIR—All right then, Councillor Collins; that is good. Thank you.

Senator O'BRIEN—Councillor, the submission that you have given us charts the average price of unleaded petrol in Longreach. There is not a page number on it but it is the third page of the formal submission, not counting your letter. There is no substantial fluctuation in that price as compared to the average price of unleaded petrol in the chart on page 2. What does that indicate to you? Does that mean it is a function of a lack of competition, or is there another factor operating?

Councillor Collins—There is certainly a lack of competition and, in any particular fuel retail outlet, volumes are much lower in these remote parts than they are in the heavily populated parts of the country. So we recognise it is necessary for the retailer to have a higher cents per litre mark-up on his product in order to cover his overhead costs. But the bit that hurts is that price drops at the retail level seem to be far quicker in the cities than they are out here.

Senator O'BRIEN—Looking at that chart and thinking about the remote area fuel subsidies that have been paid, would you be able to describe to us the impact on fuel prices of those subsidies and comment on the question: are those subsidies passed on to the consumer or are they partially, substantially or totally taken by the retailer?

Councillor Collins—I really have no figures or data to substantiate what I say in this regard but, casting my mind back to when there were some operating, I am not sure that it was a major benefit. If I could raise a parallel issue, that would be the Queensland state subsidy. It was eight-point-something-or-other cents per litre. Primary producers usually have a bulk end user licence and, because of the bookkeeping required and the relatively small amount of on-road fuel—or the bookkeeping really—a lot of them do not bother to claim that 8c back.

Senator O'BRIEN—So those consumers who buy their fuel direct from the wholesaler, you are suggesting, sometimes or often do not claim that rebate?

Councillor Collins—That is correct. Those are people who are living out on properties some distance away. They do not have a high usage of bowser retail except when they are away from home, so they often do not claim. I know a lot of people who do not because they think the paperwork and the bookkeeping required do not make it worthwhile.

Senator O'BRIEN—They do not get enough benefit to justify the exercise; is that what you are saying?

Councillor Collins—That is correct.

Senator O'BRIEN—In terms of the chart about Longreach, do you know how many retail outlets for unleaded petrol there are in Longreach?

Councillor Collins—That is something I have not even attempted to track, but I can readily think of about six. Because I live in Winton I know there are only two in Winton.

Senator O'BRIEN—Okay. Has that number changed? Were there more in the past?

Councillor Collins—Good question. I cannot really answer it. I might be a little under, at six; it could easily be up to eight, but I do not think there would be many more than that.

Senator O'BRIEN—You talk about the average price of diesel declining between May and, I think, 6 August, according to the chart on the third page of your submission. What do you put that decline down to?

Councillor Collins—I could only suggest a link to overseas diesel prices. I do not really know. We have observed that diesel and ULP do not always mirror each other's rises and falls. It must have something to do with the international market, and if that is not the case then I would be at odds to—

Senator O'BRIEN—I am not asking you to attribute a cause if you are not aware of a cause. What do you know, if anything, about the cost of transporting fuel—for example, from Brisbane to Longreach?

Councillor Collins—What I can say is that a type 1 road train, which is two trailers—I think I have said this somewhere in my submission—would normally use an average of 0.9 litres per kilometre on a round trip, loaded one way and empty the other. To the best of my knowledge, almost all the fuel in Winton, Longreach and the whole of the central west area is now transported by road; 20 years ago a large amount, if not all, came by rail but that does not happen any longer. The transport costs certainly impact on the bowser price.

Senator O'BRIEN—I am trying to see whether we can attribute some actual cost per litre—that is why I am asking the question—given that the margin between Brisbane and Winton, for example, on 6 August was 24c a litre for diesel and 9c a litre for unleaded petrol. Do you have any idea how much per litre it would have cost to transport the fuel?

Councillor Collins—I would have to sit down and do those sums, and I am not really in a position to do that. I would need to draw on the expertise of a road transport operator. They transport a large amount of fuel in an operation like that. It should not be anywhere near those differences.

Senator O'BRIEN—But you are not aware of any actual costs?

Councillor Collins—I could not tell you that, I am afraid.

Senator STEPHENS—I am from New South Wales and I was quite taken by the regional perspective of your submission, given that most of the submissions that we have received so far are from industry or consumer groups, so this is a very useful submission for us. I will ask a few things. All the figures that are in your submissions about the cost of fuel include the 8.4c per litre subsidy from the Queensland government, don't they?

Councillor Collins—If we are talking bowser price, yes.

Senator STEPHENS—If you add that 8.4c a litre it is quite a significant difference for people in western Queensland—the real price of petrol in western Queensland is significantly higher. Regardless of that subsidy, one of the things about it is that the subsidy is not zoned. Do you think that that should be the case—that the subsidy is zoned?

Councillor Collins—I am not familiar with the argument. I think if that was the case it really would depend on how that zoning was done and what it was designed to try and achieve.

Senator STEPHENS—Has Woolworths or Coles entered any of the towns in your region? If so, what has the effect been on petrol prices?

Councillor Collins—Woolworths and Coles do not operate in the area of the RAPAD Board submission. Certainly, they are both in Mount Isa. There is a Woolworths in Cloncurry. Both of those places are to the north-west. And there is Emerald to the east. But they are not in our area.

Senator STEPHENS—I presume that the consumption levels are not there for those supermarkets to consider that they have an opportunity in your communities. That is very interesting. Going now to your comments about the cost of fuel and its impact on living costs in outback regions, are the regions that your organisation represents experiencing a population decline?

Councillor Collins—Slowly, yes.

Senator STEPHENS—To what extent would you attribute that to higher fuel costs?

Councillor Collins—That is a very difficult call. It is a range of things that contribute to the population decline. We have a skills shortage out here. It is very difficult to get people with those skills to come and take up those positions. They probably look at all the services available and all sorts of issues. The cost of living is one of the things that helps firm up their decision. So, as far as the price of fuel goes, it is very difficult to say that it has a finite effect. But a big point of view is that it really does have to have an effect because, as I have said, it impacts on not only the cost of living but also the commercial sustainability of business in the area.

Senator STEPHENS—You make the point about the tourism industry that high fuel costs are having a negative impact on that industry sector in particular. Are you able to provide us with any data on tourism trends in the region?

Councillor Collins—Total visitor numbers have been declining in what we call the outback region, which actually runs, outside of the RAPAD Board area, from the New South Wales border at Cunnamulla in the west, north to Mount Isa and Richmond and Hughenden. The outback region covers about two-thirds of Queensland. In that area there has been a general decline—I think it is in the order of about three or four per cent a year for the last four or five years.

Senator STEPHENS—Yesterday we heard from the industry association called the Australian Institute of Petroleum. They addressed the issue of regional differences in the retail petrol price. On page 44 of their submission there are some comments about the difference between city and country prices. The difference, they say:

... is due to a number of factors in addition to market structure factors noted above:

These include:

- Retail margins are typically higher in the country compared with major capital cities, due to lower fuel volumes and shop sales over which to spread service station operating costs.
- The general absence of discounting to attract incremental volume in country areas also means that country prices appear to be higher than fully discounted or average city prices.
- Freight is typically 1.5 cents to 3 cents per litre greater for country than city delivery.
- Distribution costs may be significant for some country areas where fuel must be stored in depots and double-handled, rather than being delivered directly from coastal terminals. Most service stations in country areas are operated by distributors and dealers (branded and unbranded independents).

Going on from there, they make the following argument:

In regional areas, however, returns to individual service station owners and operators may be more reasonable. This is because, among other things, discounting in regional areas is less common and land values are lower - for both service stations and wholesalers. Regional consumers therefore do not subsidise city motorists, as is often claimed.

I just wondered if you had any comment to make about that observation from the industry and whether or not your organisation has had any opportunity to provide the kind of information and perspective to the petrol industry that you have provided to us in the inquiry. So there are two questions.

Councillor Collins—I will answer the last question first. We have not made any contact with the fuel industry in that regard directly. They make a number of observations there. It is difficult for me, especially without facts and any research, to argue with some of what they say or most of what they say. I think that some of what they are saying is correct. The distributors that we have are a BP outlet and a Caltex outlet. They are both operated by coastal based distributors but they are fairly big operators. I think they have a wide presence through the area. I really could not comment on what they are saying.

I do not think that the claims have ever come from this region that we are cross-subsidising or subsidising city consumers or that fuel companies are jacking the price up out here to put a lower than cost price in the cities. But they find it very easy because of the lack of competition just to take an undue time to drop their prices here. Their margins are pretty good out in these areas because of that.

Senator STEPHENS—As to your submission presented to the committee, dated 6 August, can you tell me whether the petrol price for unleaded petrol has gone beyond the price in the graph entitled ‘Average price of unleaded petrol in Longreach’, which is on page 5 of your submission? Has it gone any higher than that in the last month and a half?

Councillor Collins—It certainly did. It did go up and it continued to go up until probably early September. It has been retreating since then. I am not sure what the price is in Longreach today, but, as I said, the lowest ULP price in Winton today is 131c. So Longreach is probably around 1c cheaper—around 130c, I imagine.

Senator STEPHENS—In your submission it had gone to 140c.

Councillor Collins—It would have gone higher than that. I think it would have got up to about 145c at the end of August. I drive a diesel car, so I was not really looking at ULP prices. I drove to Toowoomba for a local government conference, and prices were very high at that time.

Senator STEPHENS—At the end of August?

Councillor Collins—At the end of August to early September.

Senator STEPHENS—Thank you very much; your evidence has been very interesting.

CHAIR—Councillor Collins, thank you very much indeed for taking the trouble to appear before us by teleconference. A transcript of your evidence will be available on the committee’s website if you would like to review it.

Proceedings suspended from 11.21 am to 11.47 am

BROWN, Mr Colin, Manager, Costing and Quantitative Analysis Unit, Tax Analysis Division, Australian Treasury

CHISHOLM, Mr James Donald, Senior Adviser, Australian Treasury

COLMER, Mr Patrick, General Manager, Indirect Tax Division, Australian Treasury

FRENCH, Mr Stephen Reginald, General Manager, Competition and Consumer Policy Division, Australian Treasury

HOLDAWAY, Ms Hae-Kyong, Manager, Competition Policy Framework Unit, Australian Treasury

KENNEDY, Mr Steven, General Manager, Domestic Economy Division, Australian Treasury

MURPHY, Mr James Andrew, Executive Director, Markets Group, Australian Treasury

THOMAS, Mr Andrew, Manager, Domestic Economy Division, Australian Treasury

TURVEY, Mr David Robert, Manager, International Outlook Unit, International Economy Division, Australian Treasury

CHAIR—Welcome. I might start with those from the markets group. Does that deal with competition policy issues?

Mr Murphy—Yes.

CHAIR—I suspect you have been following the evidence that this committee has received. Let me ask you this question in general. There have been assertions—it seems to me not particularly verified by hard data—that the oil majors behave in this economy in an anticompetitive fashion. Those assertions have been loose allegations of predatory pricing—whatever that means; the term has meant different things to the people who have been using it—and of price gouging—whatever that means. From your point of view, do you consider the conduct of the oil majors in this economy to be consistent with the conduct of players in a competitive market? To put it even more simply, how competitive do you consider this market to be?

Mr Murphy—We think it is. We would say that it is a competitive market and that the ACCC has extensive powers to investigate alleged breaches of the Trade Practices Act—that is, breaches of market conduct. It has powers to obtain information and documents as evidence. It also has the power to conduct informal price monitoring, and it has conducted that. When I say that it is a competitive market, I would point to the investigations and prosecutions of individuals in the retail market in Geelong, Ballarat and Brisbane as examples of enforcement of a competitive market.

CHAIR—I might interrupt you, Mr Murphy, to point out—something that is lost on some, I think—that the ACCC's proceedings in the Brisbane market were not against an oil major but against an independent.

Mr Murphy—Yes, that is right. But I think it is an example of the principle of a competitive and efficient market being upheld by the ACCC. Also, there is significant public scrutiny of oil prices, and that is putting pressure on the providers of petrol, the majors. There is a lot of political noise around petrol prices. I might leave it there.

Mr French—Senator, you mentioned the issue of price gouging, profiteering. From our perspective, the Trade Practices Act is much more focused on ensuring that there are competitive markets.

CHAIR—That is a very important point, because I think some have made the mistake of assuming that what is alleged to be price gouging is a species of anticompetitive conduct, whereas it is not necessarily, is it? You can have price gouging in competitive markets, can't you?

Mr French—You might see conduct which some describe as price gouging, but I suspect that in any market you will see other competitors operating to undercut that sort of behaviour or you will see other competitors entering into the market where markets are uncompetitive. From our perspective, we focus on ensuring that the market is competitive, and the law is focused on that rather than on those sorts of effects that you might see from time to time.

CHAIR—Are you aware of, or can you point to, any evidence of price gouging?

Mr French—No, we are not. I think the ACCC gave some evidence at their hearing. I do not think they were pointing to any such conduct either.

CHAIR—I am not quite sure who the right people are—again, it is probably the market people—to answer this question about microeconomics. Is it generally true to say that price transparency is a feature of competitive markets?

Mr French—You would expect that a competitive market is generally one that is well informed and has a number of players. The proposition is that a very well-informed market is probably going to be a well-functioning one.

CHAIR—If we were looking for the indicia of a competitive market, price transparency would be one of the indicia for which we would look. Is that right?

Mr French—We would.

CHAIR—If we were looking for the indicia of a competitive market, is price volatility one of the indicia for which we would look?

Mr French—In this particular market you certainly do see price volatility. You see it from day to day even, daily changes in prices. The sort of conduct that you see in the petrol industry is an indicator of strong and intense competition. You will see petrol stations moving into the market, perhaps one discounts the price. That is then followed by competitors, maybe down the street or across the road. They will generally seek to match that discounting. That is another strong indicator of competition in action.

CHAIR—Conversely, if in a market like this we saw prices remain uniform and flat across time, would that raise a suspicion that the market was not competitive or not as competitive as it should be?

Mr French—There may be markets where prices are reasonably stable. Those markets may still have a strong degree of competition. In this particular market it is certainly not the case that prices are not volatile.

Mr Murphy—If you are looking at the competitiveness of the market, a major influence is international factors—the international price of crude. We cannot just look at domestic factors when we are looking at competition. The boundaries of competition are set by the international factors.

CHAIR—Indeed, but I think so much of the discussion in this market is focused on that margin at the pump, the retail level of a few cents up or down. Is it right to say from an economic point of view that price following or parallel behaviour, in which—to use your example, Mr French—one sees prices on one side of the street following prices on the opposite side of the street, is consistent with and indeed a feature of a competitive market, in particular a price competitive market?

Mr French—It would be an indicator. Some may say that it is an indicator of some participants in the market colluding as well. You would expect that the concept of parallel pricing is something that you would see in a competitive market, yes.

CHAIR—I think this is fairly elementary but let me put it out there anyway. Price following and collusion are not the same thing, are they?

Mr French—No, they are not.

CHAIR—Nor are parallel pricing and collusion the same thing, are they?

Mr French—No.

CHAIR—Finally, when we are dealing with a uniform commodity like petrol in which there is really little or nothing to compete on other than price, and there are, let us say, four major players in the market for this uniform commodity, is the fact that the prices at which each of the four sells to the ultimate consumer tend to be approximately the same at any given time not what one would expect in an economically efficient, purely competitive model for the sale of a uniform commodity in which one only competes on price?

Mr French—It is a reasonable proposition. I think that, as you have said, this is a sector where the product is quite uniform. You will see competition principally reflected in the players in the market trying to match or better the prices of their competitors.

CHAIR—In a perfectly competitive market defined by that characteristic, you would expect the prices that they can offer to be much the same?

Mr French—It would not be a surprising outcome. It may vary from time to time.

CHAIR—Of course, but I am assuming a given point in time.

Mr French—Yes. It certainly is one possible outcome of the market.

CHAIR—To use a rather pedestrian comparison, a grocer might say, ‘I’ve got better apples than the grocer across the road.’ You can compete on quality or, in a service delivery aspect of the economy, you can compete on quality of service. There is a variety of bases upon which one can compete. But, when one is dealing with a standard, commoditised product that is delivered in the same manner—that is, through a petrol bowser—everywhere in the country, largely they can only compete on price, can’t they?

Mr French—Some of the companies will seek to establish a brand and compete on those terms as well.

CHAIR—And then there are the convenience stores, which are another relatively new element that have been introduced into petrol service stations.

Mr French—Indeed, but it is probably likely that consumers would not be swayed too much by brand loyalty in this particular market if the price they can get is lower at another outlet.

CHAIR—For example, Shell, which does not have a refinery in Brisbane but takes its supply from a BP refinery, sells its petrol from Shell petrol stations in Brisbane. It can hardly say, ‘We have better petrol than BP.’ They are not competing on quality, in other words.

Mr French—Largely, no.

CHAIR—So, in a market characterised by that feature or those features, would you expect the prices, in a pure competition model, to tend to be somewhat similar?

Mr French—As I have said, they may vary from time to time. But you will see competitors seeking to match or better the prices of the other players in the market. That is a normal part of the effect of the operation of a competitive market.

CHAIR—That is what I am getting at. You would expect to see, as a feature of the phenomena you have described, price convergence?

Mr French—It certainly can happen, yes.

CHAIR—Would you expect to see it?

Mr French—It may not happen. My local video stores have price differentials and they are just around the corner. But it is certainly an outcome that you could expect. It would not be an indicator that the market is noncompetitive.

CHAIR—Thank you.

Senator O'BRIEN—Would it be fairer to say that competition in the retail fuel market is a factor of both volume and price—that is, volume of sales by site and the price at which it is sold?

Mr French—I am not quite sure what you mean.

Senator O'BRIEN—What I am saying is that, if you have a site that is selling 30,000 litres every couple of days and another site that is selling 10,000 litres, the site that is selling 30,000 litres has a propensity to charge less and still make more profit. Isn't that a factor—I think that is what the evidence is saying—in how this market operates at the moment?

Mr Murphy—It may be. Just in general notice, you observe that uncompetitive sites have closed up. Over the years, the number of service stations around the place—

Senator O'BRIEN—I think we have received evidence that volumes are a very important factor in this market. I am going back to the question Senator Brandis asked about the price being a key competition factor in the market and suggesting that price and volume together are the key factors in this market at a retail level.

Mr Murphy—Yes, you are probably right. But there are other aspects of this competition argument. The emergence of alternative fuels—I know it is only very small at the present time—is seen as a competition issue. And also there seems to be a considerable success of shopper docket programs. That has been going only a couple of years, but I think they now have over 50 per cent of the market. So you wonder whether competition is not entering through those alternative windows. Yes, volume is very important. I do not know if we have something on this in the submission, but it has always been said that the owners of sites have great difficulty. Margins are very tight. That is what you hear about. Anyone running a—

Senator O'BRIEN—Depending on which day of the week you are buying your petrol, of course. The average margin—

Mr Murphy—But I think that overall it is not a profitable business, especially for an independent—the owner of his own site. But, yes, volume must be, obviously, very important.

Senator O'BRIEN—Yes. If your margins are squeezed, you make more money by selling more fuel. That is pretty self-evident, isn't it?

Mr Murphy—Yes.

Senator O'BRIEN—And the volume is being sold through the supermarket sites, according to the Australian Institute of Petroleum submission, for their member sites. Forty per cent of fuel is sold through the supermarket sites, on the figures that they have.

Mr Murphy—I thought it was a little bit higher, but it is significant.

Senator O'BRIEN—It might be higher, but that is what their submission says. When you talk about the emergence of alternative fuels, substitution is limited, isn't it? You cannot get into a car that is not converted to gas. You cannot put diesel in a car that is a ULP car. There is, perhaps, the opportunity to buy an ethanol blend, if your car is suitable, if there is price competition at that point. But, otherwise, substitution is pretty limited, isn't it?

Mr Murphy—At this point in time, yes. But you wonder about the capacity of people to pay and whether there will be an increased demand for alternative fuels.

Senator O'BRIEN—That is right. The future may be different. We do not know yet. I am asking what we know about the current market in the context of your comments about the emergence of alternative fuels. Do you think that the average price of fuel in a section of the market relative to other sections of the market is an indication of the effectiveness of competition in that section of the market? Can we simply pick a location, look at what the average price is, look at what the average price is somewhere else and make a judgement as to whether competition is more or less effective in that section of the market?

Mr Murphy—I do not think and I would not say that you can do it strictly on the price. There could be other factors.

Senator O'BRIEN—Let's remove freight by saying it is a relatively common component.

Mr French—I think this is a market where local conditions might well be quite important. There may be differing local demand considerations. But I think that some of the most significant reasons for some of those differentials are the things you have mentioned, which would be transportation and freight costs between, for example, the city and the country.

Senator O'BRIEN—Let's take a metropolitan area, given what we are talking about in terms of volume and price being drivers of competition. If you could point to a location where, compared to similar locations, the average price is lower, would not that be an indication that the competitive forces in that section of the market are stronger? Isn't that what competition should dictate—that where there is the strongest competition you should get lower average prices, if we have a pure competition model?

Mr French—That would tend to be the case, but some of these differentials might depend on a whole range of factors like where they might have sourced the fuel. I am not sure if you have got a particular situation in mind.

Senator O'BRIEN—There are examples. The NRMA submission gives us some details on average prices in various parts of the market and outlines that, for example, prices went up in an 18-month period in Bathurst by 46c per litre and in Dubbo by 43c, in a period when one would have thought that the difference in transport costs would not be 3c a litre between those points.

Mr French—Well, we would want to look at those figures and examine them a bit more closely, Senator.

Senator O'BRIEN—The other example is the Perth market, where with a different competition framework—there they have the FuelWatch system—the Commissioner for Fair Trading in Western Australia provided evidence that in 2005 and all of the year to date average prices in the Perth market have been lower than each of the capital cities east of Perth on average. My proposition is that on the face of it that would seem to indicate that the competition model in Perth is more efficient for the Perth market, because they are achieving lower than average prices.

Mr French—This is something that we have not really analysed in a great deal of detail. We are aware that the ACCC has looked at those sorts of issues much more closely than we have, so I think we would want to look at some of those figures more closely before we made more detailed comments.

Mr Murphy—It is interesting that where there has been action taken by the ACCC—other than the Brisbane case—it has been in regional markets, and you wonder whether in a regional area the market can possibly be confined and there would be less competition than there would be in the metropolitan areas.

Senator O'BRIEN—The ACCC can only take action where it has some indication that there may have been a breach of the law.

Mr Murphy—In their submission they would have said that on their price monitoring they are visiting 50 per cent of the sites. That is over 3,000 sites that they monitor, so that is pretty comprehensive.

Senator O'BRIEN—Most of those sites would go through multiple price variations on a daily basis in metropolitan areas—perhaps not so in regional areas. It would be pretty hard to get a snapshot of their operations with all of the fluctuations that are taking place, potentially, every day of the year. It would be very hard for the ACCC to really get a snapshot of the market in a particular area in that circumstance, given their source is a one-price-per-day figure, isn't it?

Mr Murphy—Yes, but they would be looking at trends. As you have pointed out yourself, there are differences in certain markets as to price, so I would suggest the ACCC would be looking at significant trends where you can, through the data, see that there is a potential there that there has been some price fixing. If you are looking at things on a day-to-day basis, no; but once you start getting data over a period of time I think that would alert you to the fact that there could be price fixing, if there was.

Senator O'BRIEN—We had some evidence that there are examples in overseas legislation of potential actions that can be taken against players who dominate a market, to prevent them from taking excessive advantage of that market domination. We do not have similar provisions here, do we?

Mr Murphy—Yes, we do. That would be under Trade Practices Act general provisions.

Senator O'BRIEN—Which provisions do you say would give us the equivalent of the European provisions, for example?

Mr Murphy—General competition law—not specifically in relation to petrol, but general competition law.

Ms Holdaway—Certainly it is under the general competition law under the Trade Practices Act. Section 46, for example, deals with misuse of market powers. That would actually cover the sorts of situations that you have touched on.

Mr French—There are different approaches to, say, merger tests in some other jurisdictions. The tests that we apply here relate to the substantial lessening of competition rather than dominance. I think we have recently reviewed the approach to that through the Dawson report. That approach has been confirmed, at least as it applies to the mergers test under section 50.

Senator O'BRIEN—In Australia we do not have any legislation which deals with the concept of price gouging. We took some evidence on Tuesday afternoon that, for example, European law, based on articles 81 and 82 of the Treaty of Rome, has powers that we do not have here. Do you agree with that?

Mr Murphy—I do not have that in front of me. We do not, in the Trade Practices Act, refer to price gouging. But it is part of the general competition provisions.

Mr French—We have looked at some international law in this area and we have not been able to find comparable provisions. But that particular reference is something that we could follow up.

Senator O'BRIEN—I have not looked at those provisions directly. I am relying on evidence that we received on Tuesday. It is on pages 49 and 50 in particular of the *Hansard*. If you wanted to respond to that or agree with that, that might be useful to the inquiry. The submission that you presented to the inquiry talks about excise duty or customs duty on imported petrol. Are you able to tell the committee the levels of collection of those duties over the last two years, broken down by month?

Mr Colmer—I have the budget paper here.

Mr Brown—In terms of collections in dollars in 2005-06, it is $7.28 billion for petrol. Are you interested in diesel and other fuels?

Senator O'BRIEN—Yes.

Mr Brown—Diesel is $6.24 billion and other fuel is $220 million. So you have a total excise of $13.74 billion.

Mr Colmer—There is some additional duty raised from customs, but it is not disaggregated into fuel and so forth. The majority of fuel in the past has come through the customs system without paying duty and has gone straight into the excise duty. But there would be a little more in there.

Senator O'BRIEN—So it is $13.74 billion?

Mr Murphy—That is correct.

Senator O'BRIEN—That was in 2005-06?

Mr Brown—Yes.

CHAIR—You said that you were reading from a budget paper. Is that an estimate for 2005-06 or is it an actual?

Mr Brown—That is the estimate at this stage. This is from the current budget paper.

Senator O'BRIEN—Could you, perhaps on notice, tell us what the actual figure was?

CHAIR—Would it be available yet for 2005-06?

Mr Brown—It may be. The information comes through with a lag.

Mr Murphy—What was it in the previous year?

Mr Brown—I will give you the equivalent numbers for 2004-05. For petrol the excise revenue was $7.33 billion, for diesel it was $6.131 billion and for other fuel it was $147 million. The total was $13.608 billion.

CHAIR—Is that an actual?

Mr Brown—That is an actual.

Senator O'BRIEN—For the goods and services tax will there be an ad valorem rate? Can you give us the collection statistics in relation to those fuels as well?

Mr Brown—The goods and services tax collected on the fuel is not identified. It is one-eleventh of the price of the fuel that is sold by service stations but the actual amount that is remitted by companies is not disaggregated into fuel or other supplies. It is not separated out from other things that are sold in service stations. The other issue with the goods and services tax is that you also need to net off the input tax credits that businesses claim for business use of fuel. So the gross amount of GST collected on fuel is perhaps not that meaningful a measure in terms of the total tax.

Senator O'BRIEN—Are you saying that there is no estimate made of that amount?

Mr Brown—There are no separate statistics showing how much GST is levied on particular commodities. It is not just fuel.

Senator O'BRIEN—Statistics are one thing. Is there an estimate made?

Mr Brown—You can estimate the amount from total fuel sales but, again, the number, because, as I say, you have to take off business use, is not something which you can meaningfully disaggregate.

Senator O'BRIEN—Your submission says in the executive summary:

Wholesale and retail costs and margins are another component of the price of petrol and have remained relatively stable over time.

That is not true of refiner margins, is it?

Mr French—No.

Senator O'BRIEN—Are you saying refiner margins are not contained in the description of wholesale and retail costs and margins?

Ms Holdaway—No. For the purposes of the presentation we have divided them up. We refer you to page 3 of our submission, where we provide you with an approximation of what different components of the price of petrol may contain, and in it we keep the refiner margin separate to the wholesale and retail costs and margins. What we are referring to there in terms of the stable trend over time of the margins is the wholesale and retail costs and margins without the refiner margins.

Senator O'BRIEN—That is a lot clearer than the depiction earlier. I accept your explanation. I think chart 8 on page 12 refers to movements in refiner margins.

Ms Holdaway—Yes, that is correct.

Senator O'BRIEN—You are depicting that, while there are periods of perhaps negative movement in refiner margins, over the period since September 2002 we are seeing some very significant peaks and extended, relatively high refiner margins. Does that indicate that refiner margins are taking a greater percentage of the consumers' dollar in terms of what they are spending on petrol? I would have thought it does.

Mr Turvey—Senator, I would say two things about that chart. One is that you can see in the period from about the late nineties through to early 2002 that refiner margins were very low. So you have to take into account that these things do move around and that over the long run refiners have to cover their costs.

CHAIR—I am sorry, Mr Turvey, but what chart are you talking about?

Mr Turvey—The chart on page 12. There is a section of the chart from around 1999 through to 2002, where those margins are quite low. So you have to look at these things in a longer term context. Secondly, this is just simply the gross difference between the Tapis price and the Mogas price. So this does not allow for differences in costs. So, while that margin might have been increasing, we cannot say anything about what costs of production were doing in that period.

CHAIR—Are those in nominal or adjusted prices?

Mr Turvey—That is nominal.

CHAIR—There is a point I made yesterday: towards the right-hand end of the chart, after a period of some 13 years, you would expect the amplitude of movement to be greater.

Mr Turvey—In absolute terms, yes.

Ms Holdaway—You mentioned the contribution of the refiner margin to the price of petrol. I guess the other factor is that the biggest component of the price of petrol is the crude oil. So, to the extent that that is going up, the percentage of what the refiner margin is presenting, in terms of the price of petrol, may not change all that greatly. Having not done the analysis, it is difficult to say. But that is something that we need to bear in mind—that it is the international crude oil prices that are driving the price.

Senator O'BRIEN—My attention has been drawn to this issue by some material presented to the committee by Mr Richards on Tuesday. He presented some evidence. Firstly, he charted Singapore refining complex margins. At some points going back to that period of 1999 to 2002 it was as low as approximately US60c per barrel, going up to a high in 2004 of about $US3.50; and then he is forecasting a reduction.

But, according to the same submission, the Caltex refiner margin in the first half of 2003 averaged $US3 per barrel and rose to the point where, in the first half of this year, it was $US10.62 per barrel, which was more than treble the refiner margin and significantly in excess of refining margins projected in that submission. Does that not indicate that margins to Caltex, and in all likelihood to other Australian based refiners, are historically very high? Is that not particularly so when the same evidence says that in the first half of 2006 the refiner margin fluctuated up to as high as about $US18 per barrel? What does it tell us about the state of competition in the Australian market if a margin can be attained that is quite different from the sorts of margins apparently being achieved in the Singapore refining complex?

Mr Turvey—I am not sure that it tells you all that much, Senator. I refer you back to our chart on page 12. These things are very volatile. As Senator Brandis pointed out, as the nominal price rises, you have to take the absolute dollar value of the margin into context with the nominal price as well. So you would need to make a comparison based on proportions rather than on absolute levels.

Senator O'BRIEN—With respect to the Caltex profit result over that period, in 2002 it was $106 million; in 2003 it was $200 million; in 2004 it was $350 million; and in 2005 it was $414 million. It would appear that they have achieved a dramatic increase in profitability at the same time as the refiner margin has moved. BP told us yesterday that their profitability was not dissimilar. What does that tell us about the market?

Ms Holdaway—I think what that really leads to is the interaction between demand and supply. Certainly, within the refined product market, which once again is international, to the extent that we are really talking about an international commodity here, we know that there have been some constraints on the supply side. There have been issues with the adequacy of refining sites, for example, world wide. That will certainly drive the prices up, as you can imagine. At the same time we know that the demand side has also quite significantly increased. So when we talk about what it actually says about competitiveness, it is difficult to say, because prices are determined by the interaction between demand and supply. We do know that in the refined market sector there have definitely been constraints on supply. Also, future risks have been built in, and demand has increased.

Senator O'BRIEN—Do you mean demand has increased internationally?

Ms Holdaway—Which actually flows on to the impacts for Australian refiners as well, who are obviously one of the players in that international market.

Senator O'BRIEN—So because the demand has increased internationally, there is less fuel available that might flow into the Australian market. Is that what you are saying?

Ms Holdaway—The price is actually determined in the broader market, the international market. That is what I am referring to.

Senator O'BRIEN—You would think that that would have an effect on refiner margins, wouldn't it?

Ms Holdaway—Which is basically calculated by looking at what the prices are for the refined products and what the prices are for the crude oil before refinement.

Senator O'BRIEN—It seems pretty clear that as an amount of the price of fuel the refiner is taking more. That is what those figures would tell us, wouldn't they?

Ms Holdaway—The trends certainly show that it is going up; you are quite right, Senator.

Senator O'BRIEN—The NRMA gave evidence this morning. Without trying to verbal them, they were prepared to say that they thought there was inadequate competition in the refiner sector and they were not satisfied with competition in the retailing sector either. Given the ability to attract such high refiner margins, isn't their view, that there is inadequate competition in the refiner market at the moment, borne out by the facts?

Mr Kennedy—Do you mean the global market, Senator?

Senator O'BRIEN—No, the local market, given that their margins are higher than, for example, Singapore's.

Ms Holdaway—We have to rely on the ACCC to look into issues like that, which they do as part of their responsibilities under the Trade Practices Act. At this stage we cannot really give you any more than just—

Senator O'BRIEN—Are you talking about their price monitoring power?

Ms Holdaway—Their general responsibilities under the Trade Practices Act. If what you are saying is correct and it is actually anticompetitive as such then the ACCC have the powers to be able to investigate those issues further.

Mr Kennedy—There is a discipline imposed by the fact that, as Ms Holdaway pointed out, refined petrol is still an internationally traded good as well, so if people are going to import it more cheaply then obviously—

Senator O'BRIEN—If it is available—

Mr Kennedy—If it is available.

Senator O'BRIEN—that is, if there is excess capacity—and I understand there isn't any significant excess capacity at the moment for the fuels which our standards require us to use.

Mr Kennedy—That is why I guess it is important to distinguish between whether this is a global phenomenon or a domestic phenomenon. I do not know the details—Mr Turvey may be able to comment on this—but I think there is international evidence of tightness around refinery capacity worldwide. That is the sense in which demand has run ahead of our ability, if you like, to supply refined petrol. Like in any market, we would expect some lags in supplies if we have got a bit surprised on the demand side by the emergence of someone like China, for example, before new capacity could be built.

Senator O'BRIEN—What sort of lags should we expect? Is Treasury looking at what factors are out there in the international market that might moderate this possible deficiency in the competitiveness of the Australian refining market?

Mr Turvey—I cannot comment on the Australian market, but certainly in the international market there is evidence that there is some increase in investment both in production and in refining capacity, which is what you would expect with prices so high. I believe in the refining sector the lags are around three to five years between the commencement of construction of a new refinery and its operation.

Senator O'BRIEN—When are the new refineries coming on stream that are going to have an impact?

Mr Turvey—Presumably some time in the next three to five years.

Mr Murphy—The issue of refining is addressed on page 16 in the ACCC's submission. Their analysis is that our refineries are old by international standards and we do lack capacity. How that impacts on the margins they are charging I will not comment on, but it may be that our refining capacity is a flaw in the whole process.

Senator O'BRIEN—Concurrent with the increase in their margin is a dramatic rise in their profit. That tells us, doesn't it, that they are taking advantage of the current state of supply to increase their margin, despite whatever the limitations of their plant and equipment might be?

Mr Turvey—It is exactly those prices that will trigger the new entrants into the market and add to supply.

Senator O'BRIEN—In the Australian market?

Mr Turvey—Quite possibly, yes.

Senator O'BRIEN—Who is going to invest in a new refinery? No-one has been able to suggest to us that there is even a remote possibility that someone is going to build a new refinery in Australia.

Mr Kennedy—It is an internationally traded good, so we can import more of this good if we need to and export more of other goods, wherever we find our comparative advantage. Wherever there are supply problems, be they, for example, in bananas or whatever good, you would expect the price to rise and there to be a production response. Obviously there are big lags in a market like this. And the global demand increase has been dramatic, as we talked about before, particularly coming out of countries such as China—they have significantly added to global demand for these products. It is a substantial adjustment, there is no doubt about that.

Senator O'BRIEN—How much of this increase in capacity is directed towards what seems to be a continuing expansion of the Chinese market and perhaps the Indian market? And does that mean that when we get that extra capacity online it will only be meeting demand as it has expanded at that time? That is the other question, isn't it?

Mr Turvey—Are you referring to the crude sector or the refining sector?

Senator O'BRIEN—The refining sector.

Mr Turvey—My understanding is that projections for demand and supply growth are relatively even.

Senator O'BRIEN—So we are going to be the same in three to five years as we are now?

Mr Turvey—On the information that I have, the trends are similar. I cannot say exactly that growth in demand and in supply will be exactly equal, but they are certainly—

Senator O'BRIEN—Looks like it would be a pretty good market for the Australian refiners if the current environment allows them to have a margin which seems to be fairly historically high and is generating fairly generous profits at the moment. On what you are saying, there does not appear to be any light at the end of the tunnel with more capacity if demand continues to grow.

Mr Turvey—Most people are projecting that, over the longer term, the price will fall in the crude oil market from the levels that it is currently at.

Senator O'BRIEN—ABARE have said that, but they have been completely and utterly wrong in their predictions. They would be very brave people predicting falls in the price of crude, I would have thought, over the longer term.

Mr Turvey—Over the longer term—this is my point. The whole point about where we are at now is that there was probably underinvestment in the sector during the 1990s and that over the last few years, when demand growth did ramp up, producers have been caught short. They are now investing more in order to supply more. One would expect that, as that supply comes online, it will put downward pressures on prices. We cannot forecast whether the demand will be stronger than we are currently expecting. But, given the extra investment that has gone into the sector and all else being equal, we would expect that there would be some downward pressures on prices.

Senator O'BRIEN—The availability of volumes of crude will put a cap on the expansion of refining capacity, won't it? People are not going to produce refining capacity for a resource that is not available. That is a natural cap on any expansion.

Mr Turvey—Certainly.

Senator O'BRIEN—From what you have said to us, it would seem that the current state of the market is not likely to change. Would that be a fair assumption?

Mr Turvey—No—

Senator O'BRIEN—In the longer term. No doubt there will be short-term fluctuations in the market, but the current state of the market is not likely to change in the longer term, given that supply and demand for the product, as you have indicated, grows at the same rate.

Mr Kennedy—It is very hard to forecast where these things are going to come out. It is pretty hard to forecast it in the very near term, let alone the medium to longer term. There will be a range of other economic responses such as the operation of motor vehicle volumes—which is primarily driven by fuel—which has fallen in Australia. People will start to substitute away, and those responses are hard to predict. To say what this is going to be in five to six years is very difficult.

Senator O'BRIEN—I would agree with that. The point that I would make is that to talk about things moderating in five to six years is a bit of a bridge too far at the moment as well. You are saying that you cannot really predict the general trends in the market. What I am saying is that you cannot predict that things will get better. Nor can you say that they will get worse.

Mr Kennedy—It is not just a question of oil either. It is also a question of what the global economy will be doing in four to five years and the extent of any other shock that is played out. While we can say, 'If demand did this and if supply did that,' it is predicated on a whole range of other things falling out as well.

Senator O'BRIEN—We will not get into what our balance of payments will be if—

CHAIR—I do not think Mr Kennedy or anyone else should assume that whatever this committee writes as a result of this inquiry will be based upon conjecture about what might happen with prices over the next few years.

Senator O'BRIEN—I am sure that it will not be, although there necessarily needs to be some conjecture on the future.

CHAIR—I will leave the conjecture to you, Senator O'Brien.

Senator STEPHENS—On page 5 of your submission, you say that between 2000 and 2006, households spent 2.7 per cent of their nominal total expenditure on fuel. Do you think that that proportion is likely to change significantly once higher prices for petrol are embedded in the cost of the goods and services that are included in that calculation?

Mr Kennedy—On the latest data, people are spending about 3.1 per cent of total household final consumption expenditure on fuel, which reflects higher prices and lower volumes. We do not expect it to rise significantly above that, but of course if oil prices and petrol prices rose more then it would rise. I would not expect it to rise much beyond where it is at the moment.

Senator STEPHENS—That 3.1 per cent was as of when?

Mr Kennedy—As of the June 2006 national accounts.

Senator STEPHENS—Following on from your conversation with Senator O'Brien, if imported crude oil is to be used as refinery input—and that does not attract a tax or tariff, does it?—

Mr Colmer—No.

Senator STEPHENS—does that then lead to an incentive for refiners to use imported crude over Australian crude because the latter does attract PRRT and royalties taxes?

Mr Colmer—The PRRT is a tax on the profit. In terms of the input to the refinery, crude oil carries no tax until such time as it comes out of the refinery. So it makes no difference to the tax position whether it is imported or domestic in that sense: they are both tax free on entry to the refinery and taxed on exit, through the excise system.

Senator STEPHENS—So that would not be why Australia exports most of its crude oil?

Mr Colmer—Certainly the tax would not make any difference to that. My understanding—and there may be somebody else who is more familiar with this—is that it is a question of the characteristics of the different sorts of crude oils and the sorts of products that you are trying to make as to whether or not it is best to use Australian crude or an imported crude.

Senator STEPHENS—We heard in the roundtable that Australia's oil is what is described as 'light and sweet' crude and is therefore more valuable than the heavier crude. Coming back to the submission, have you modelled the effect of sustained high petrol prices on the Australian economy? Has any modelling been done about that?

Mr Kennedy—We consider a range of shocks to the economy, so we would think about the macroeconomic effects of higher fuel prices. They are actually in the data at the moment, and the increases that we have seen over the recent period are dramatic, so that gives us some idea of how these things may play out in the macro economy. We also have macroeconomic models which allow us to think about what some of these effects might mean, plus we can do direct calculations such as: if fuel rises by X per cent and there are no other changes in consumption of other goods, what does that mean for consumers? Those types of calculations are all thought through.

Senator STEPHENS—Is any of that modelling, in terms of scenarios, available to the committee?

Mr Kennedy—I cannot recall—I will have to take it on notice—that we have done a particular scenario of higher fuel prices. We have certainly thought carefully about what higher commodity prices mean for the economy in general and the higher terms of trade associated with that. Some of our thinking around that was published in budget statement 4 this year. On the specific question of higher oil prices, I will have to take that on notice.

Senator STEPHENS—If you could do that, that would be great, thank you. Also in your submission you make the point that growth in demand has been an important factor behind the recent rise in crude oil prices. Are there any signs that the high prices are dampening that demand in any respect?

Mr Kennedy—In the domestic economy, demand has fallen by about four to five per cent, I think, for the operation of motor vehicles—as I said, a large component of that is fuel in the national accounts. On the global side, I will let Mr Turvey comment.

Mr Turvey—Certainly, in terms of consumer behaviour, the trend we discussed earlier of switching away from larger vehicles to smaller ones is something that has been evident. But, in aggregate, the global economy has continued to grow very strongly. That is one of the things about this period of high oil prices that is quite different from previous oil price shocks, that it is demand driven rather than supply driven necessarily. So the global economy has continued to grow strongly and we expect only very minor moderation in global economic growth over the new few years.

Senator STEPHENS—Given Australia's particular circumstances and the rapid growth in the trucking/transport industry, is that a scenario that you have modelled in terms of the cost of fuel prices for our domestic transport industry and the impacts that that might have?

Mr Kennedy—Not specifically, no.

CHAIR—Thank you very much, Ms Holdaway and gentlemen.

Proceedings suspended from 12.51 pm to 1.49 pm

CAPLAN, Mr Russell, Chairman, Shell Company of Australia

McGREGOR, Mr Grant, Sales and Operations Manager, Shell Company of Australia

MIDGLEY, Mr Chris, General Manager, Supply and Marine, Shell Company of Australia

CHAIR—This hearing is resumed. I welcome to the table representatives of the Shell Company of Australia. We have your submission, No. 45, before us. Can I indicate to you that the committee does have the capacity to receive evidence in camera. If there are any questions about which you feel that, for a sufficient response, it would be more comfortable for that response to be received in camera, you might indicate that and we will consider doing so. Do you wish to speak to your submission at all?

Mr Caplan—Thank you. I really think that, having made the submission and having augmented it with a short commercial-in-confidence submission, it would probably be more helpful to the committee if we just went to your questions.

CHAIR—That is fine. Forgive me if some of these questions canvass matters that are raised in your written submission, but it is probably useful for the purposes of the discussion to go into them in the question-and-answer session. Mr Caplan, when did your company's arrangement with Coles Myer begin?

Mr Caplan—In July of 2003.

CHAIR—Am I right in understanding that the Shell Company now does not operate any sites; those sites that had been operated by you either directly or indirectly are now all operated by Coles Myer?

Mr Caplan—That is almost correct.

CHAIR—To the extent to which there is a qualification, can you tell me what it is?

Mr Caplan—We have in largely rural Australia about 60 CVROs, as we call them—commercial vehicle refuelling outlets. They look like the picture I am holding up. They are usually out at the front of a terminal of ours up-country. They are mostly supplying trucks, but they do have petrol available. In almost every case they are operated by the terminal. At those outlets we set the price. So for the sake of completeness I need to refer to the fact that they exist. They sell minimum quantities of product and they do not really affect the issues discussed, in my view, by this committee. But 600 or so of our 1,000-plus sites we converted over to our arrangements with Coles Myer. Then we have between 300 and 400 sites outside that arrangement. They are owned and operated by independent parties. We have supply agreements with them and they carry the Shell brand.

CHAIR—Do you supply to any branded independents?

Mr Caplan—Not Shell branded independents other than the ones that I mentioned to you, but we sell significant amounts of fuel to major independents who sell that fuel under their own brand.

CHAIR—That is what I was trying to get at. Perhaps I put the question wrongly. What I want to get a handle on is this: by volume, what percentage of the fuel that you sell in Australia goes through the sites which are covered by your relationship with Coles Myer; what percentage goes through sites that are operated by Shell branded independents; what percentage goes through sites operated by independents which are not Shell branded independents; and what percentage has a different destination?

Mr Caplan—I think approximately 10 per cent to 15 per cent of the fuel that we sell goes to unbranded independents.

CHAIR—By ‘unbranded independents’ you mean independents not branded with the Shell brand?

Mr Caplan—That is correct.

CHAIR—And that would include independents that resell it under their own brand?

Mr Caplan—Correct.

CHAIR—Righto. Go on.

Mr Caplan—Of the remaining 85 per cent, somewhere around 75 to 80 per cent is through Coles Myer—is that right, Grant?

Mr McGregor—Closer to 90.

Mr Caplan—Closer to 90. And the balance is through those individually owned—largely individually owned—Shell branded sites in the market.

CHAIR—How many of the individually owned, Shell branded sites are there in Australia?

Mr Caplan—About 350, give or take.

CHAIR—But they are all pretty small sites, presumably.

Mr Caplan—Not all of them, but many of them.

CHAIR—Do those sites only take supply from Shell, or do they take supply from the other majors as well?

Mr Caplan—I think they are all Shell supplied, but it may be possible that some take from more than one supplier. In the main they are Shell supplied.

CHAIR—We heard some evidence from Coles Myer's representatives yesterday about the arrangement they have with you. I asked them a question which I will ask you as well and which I suspect you will want to take on notice, but if you want to answer it immediately please feel free to do so. My question is: if Coles Myer, your contracting party, were to consent, would Shell be prepared to supply to the committee in camera a copy of its contract with Coles Myer?

Mr Caplan—I would like to take that on notice.

CHAIR—I thought you would, and I asked them the equivalent question yesterday. Nevertheless, I am sure Senator O'Brien and I will want to ask you some broader questions about your arrangements with Coles Myer. How is the price at which you supply petrol to Coles Myer established?

Mr Caplan—The arrangements that we have with Coles Myer contain pricing and other elements, which, if it is agreeable to you, I would be prepared to discuss in camera but which I would not be comfortable discussing in open session because they do contain commercially sensitive elements which I would not really want to disclose.

CHAIR—Okay. We will suspend the hearing for a moment while Senator O'Brien and I discuss this in a private meeting.

Proceedings suspended from 1.57 pm to 1.58 pm

CHAIR—We have agreed to accede to that request, Mr Caplan. What happens now is this: we will exclude from the room everyone other than members of the committee, the committee secretariat, yourselves, obviously, and the Hansard people. For as long as this is in camera, of course nothing will be broadcast from this room. As well, in a moment I will pause so that Hansard can change the tape, and they have a set of arrangements whereby when evidence is taken in camera they put it onto a different tape, the security of which is protected. All right?

Mr Caplan—Thank you.

Evidence was then taken in camera but later resumed in public—

Proceedings suspended from 1.59 pm to 3.03 pm

CHAIR—This is a continuation of evidence on behalf of the Shell Company of Australia, following the conclusion of the in camera session.

Senator O'BRIEN—I want to raise with you some evidence that the committee received on Tuesday from Mr Richards, detailing material which he says is in the public domain, about the Caltex profit result and the Caltex refiner margin. The overheads—I know they are not before you, but I can relate them to you—on page 17 of his submission show that, in the first half of 2003, the refiner margin was $US3 per barrel. That grew to $10.62 in the first half of the current financial year. Without being able to give you a precise dollar figure, the margin fluctuated from somewhere between $10 and $11 a barrel at the start of the year down to somewhere in the vicinity of $1 or less per barrel. It then charted back up to something in the vicinity of $18 per barrel. This led to an overall result for Caltex of $10.62 per barrel in the first half of the current financial year.

The same submission detailed the Caltex profit result rising from $106 million in 2002 through to $414 million in 2005. It seems to be indicating that, on average, we have been going through a period of growing refiner margins. Currently in Australia, refiner margins are significantly higher on average than they are in, for example, Singapore. I want to get a response to that on the record. I have raised the issue with a number of other witnesses, and you are obviously one of the major refiners.

Mr Caplan—I have not seen the information; but, from my own knowledge, I can say two things. First, refiner margins vary, and it is unarguable that refiner margins in recent times have been high. I am sure that the committee has had a lot of evidence as to why they are high, but it principally relates to demand outstripping supply, exacerbated by some natural phenomena in the United States and some apprehension about affairs in the Middle East. You understand that.

Senator O'BRIEN—Are Australian margins high compared with, say, those of Singapore? That is one of the propositions.

Mr Caplan—The second thing that I want to say is that it is too simple to compare average Australian margins with average Singapore margins, because you need to take into account the different configuration of every refinery and the different product qualities that we have in Australia.

Senator O'BRIEN—Singapore has a similar quality standard.

Mr Caplan—There are all sorts of refineries in Singapore. There are quite complex refineries in Australia. Without going into details that I do not have in front of me, let me say only one more thing: six or eight refineries are currently under construction in this part of the world, totalling about two million barrels, and there are 70 or so projects at varying stages of detail for further refinery construction. You have probably heard that the refining business is a cyclic business. It has happened often in the past that the high margins have brought additional capacity, which has destroyed the margins. You would think that people would learn but, in fact, we are in the process of seeing that happen again. Shell's expectation is that refinery margins will come off out of refineries that are currently under construction, let alone those that are—

Senator O'BRIEN—Is that a three to five year proposition?

Mr Caplan—I would say by the end of the decade, yes.

CHAIR—When you speak of 'the region', does that include China?

Mr Caplan—Yes, it does.

CHAIR—Does it include India?

Mr Caplan—Yes, it does. And it includes the Middle East.

Senator O'BRIEN—A question arose from your public submission about the cost of upgrading new refinery to meet the federal government's clean fuel specifications. You nominated a figure of $340 million.

Mr Caplan—Yes.

Senator O'BRIEN—Wasn't there a Commonwealth government subsidy? Assuming that Shell received some of that, is the figure of $340 million the total cost, or is it the cost less the subsidy?

Mr Caplan—Let me take that on notice. I do not know the answer to that.

Mr Midgley—I assume, though, that you are referring to the duty discount associated with producing early low sulfur diesel.

Senator O'BRIEN—Yes.

Mr Midgley—Effectively, there was an incentive for the oil companies to invest early in order to produce cleaner fuels at an earlier stage. We chose to invest early. Clearly, that was a considerable investment to bring up-front. So much of that duty benefit was really around offsetting the capital cost of investing early in order to bring clean fuels into the marketplace early and on time.

Senator O'BRIEN—How much of a subsidy was involved?

Mr Caplan—That is why I say that we do not know.

Mr Midgley—The duty discount?

Senator O'BRIEN—What is the value? I am just trying to find out whether the net costs of enabling—

Mr Caplan—I would have to do a calculation of the per litre duty discount and apply it to that. So I would have to take that on notice.

Senator O'BRIEN—And that is the cost for both refineries?

Mr Caplan—Yes, it is.

Senator O'BRIEN—And you have additional costs that you detail for the Geelong refinery which you describe as requirements of the regulatory licence and expectations of local stakeholders on environmental performance. Could you tell us what that really means?

Mr Caplan—Australia—and as an Australian I am pleased—has stringent environmental regulations. Refineries require continual investment in order to enable them to meet those stringent conditions, whether it is for the production of fuel or the emission of pollutants to air, water or soil. We have made, as I am sure others have made, hundreds of millions, if not billions, of dollars of investment over the last five years in order to continue to ensure that we operate within what the community expects of us. In return for that, we have not produced one additional litre. In fact, the production of more stringently specified products requires us to operate the refineries in a more severe fashion, which results in reduction of capacity for refineries. So the investment I would characterise as running hard to stand still. That is important, because any one of the six or eight refineries that I described to you earlier that are being constructed in the region are multiple times the size of any of the refineries in Australia. Competing with them is a difficult task. Keeping on adding the capital burden of doing that makes the task more difficult. I am not asking anybody to weep for me, but Australia has a group of undersized refineries that find it difficult to compete in an increasingly competitive world.

Senator O'BRIEN—None of the new capacity is proposed to be sited in Australia, is it?

Mr Caplan—No. I personally would doubt that we will see another refinery built in Australia because it costs more to build a refinery in Australia. If you look at some of those refineries that are being built in Korea or India, a single refinery has a capacity larger than the total Australian capacity put together.

CHAIR—Good lord!

Mr Caplan—So we have a very significantly changing refining environment around us. Those are refineries either in existence or currently under construction, so we can see what is in the pipeline.

Senator O'BRIEN—Does that mean that the smaller refineries are less likely to continue to operate given their scale and cost of production against these new, more efficient, larger-scale refineries?

Mr Caplan—That is basic economics. It is very important that those refineries operate perfectly in order to maximise what they can do in a very competitive world or that they produce some niche products which are higher margin or higher value products—maybe like lubricants or bitumen or one or other of those products—that can give a greater return for the cost of production. But it is really difficult for little refineries to compete in an ugly world.

Senator O'BRIEN—Perhaps you could, on notice, give us an idea of how the price has gone for bitumen, as one of the by-products of refining in Australia, given it is a very important component of a major infrastructure need of the country. I would be interested to see how that has been affected in comparison to the price of petrol.

Mr Caplan—We can do that.

Senator O'BRIEN—I have one other question. I have been given an understanding that when we look at refiner margin, the dollars per barrel figure roughly translates into a cents per litre value. Is that right?

Mr Caplan—Yes, roughly.

Senator STEPHENS—We heard yesterday from the Australian Institute of Petroleum and we have received a significant submission from the ACCC. I want to ask you to comment on the

ACCC submission where they appear to regard the refiner margin as something of an artificial construct, being the difference between the Singapore Mogas 95 price and the Tapis crude price. First of all, would you see it that way?

Mr Caplan—That is not how I would define refiner margin. The refiner margin, as I know it, is the difference between the crude price and wholesale price of the products made from the crude. The two major indicator crudes that would be relevant for calculation of the refiner margin in Singapore and in Australia are, say, Tapis and Minas; and so, by combination of those, you get a crude price. Of course, as you may understand, Senator, refineries do not set their refiner margin. Refineries are victims of the refiner margin—that is, the refiner margin is an outcome of two available numbers. Sometimes, when crude prices are high and product prices are low, a refiner margin is lousy or negative—often it is negative.

CHAIR—But that is only brief: there will be a lag period, but—and we know this from the various charts we have seen—when crude price goes up it is not very long before the product price goes up.

Mr Caplan—Well, they are often driven by different things, Senator. And I can assure you, having been in the industry for a lot longer than I care to remember, there have been times when, for protracted periods, the refiner margin has been negative and there have been losses associated with being in the refining business.

CHAIR—But if you took any fairly long period of time it has been in positive territory, hasn't it?

Mr Caplan—You are talking in 10- and 20-year periods. I mentioned to you that our return on capital demonstrates periods over the last 10 years which are either driven by poor refiner margin—and you will have had input from other witnesses that there have been periods in this country when refineries have really suffered—or else we are so grossly inefficient, and I do not discount that, that others are making money and we are not. That is also a possibility, I suppose. People would not be in refineries if, structurally and forever, they did not make money. But there have been years during which refiner margins have been zero or negative.

CHAIR—I am just putting in front of you the Australian Institute of Petroleum's submission: figure 8 on page 15, the gross Singapore petrol refiner margin—

Mr Caplan—That is for petrol, one product of a refinery.

CHAIR—Sure. That is the product we are concerned with, though.

Mr Caplan—It might be, but when a refinery makes petrol it also makes, inescapably, other products. So the refinery margin for petrol is one element in describing the whole refiner margin—and only one element.

CHAIR—I accept that. But is typically the refiner margin for petrol roughly equivalent to the overall refiner margin?

Mr Caplan—Not necessarily. It depends on—

CHAIR—I appreciate it may not be, but typically is it?

Mr Caplan—No, often it is not. It depends on the configuration of the refinery, and the refinery may well be a refinery that is heavily weighted towards making diesel rather than petrol or it may be a refinery that has got limited upgrading capacity. So while refiner margin is a helpful notion in average, it is a distinctly unhelpful notion when people take elements of it and try and extrapolate from it.

CHAIR—Sure. You say that this is too limited an exercise, though the AIP did not seem to think so. Figure 8 in their submission shows that, with the exception of a couple of days at the end of 2004 and perhaps more than a month at the end of 2005, the gross Singapore petrol refiner margin has been in the black and that over that two-year period charted in their table it has averaged about 4c per litre.

Mr Caplan—That is what the chart says, Senator, and I would agree with you. I thought you were talking about long term. This is a relatively short period in the life of a refinery. So if you went back two years beyond that—

CHAIR—So you think that is better than it was in the previous two years?

Mr Caplan—Absolutely. Significantly better.

CHAIR—Did you want to add anything? I do not want to cut you off.

Mr Midgley—The driver of refinery margins is gasoline, the high-value product. So the chart on figure 8 is going to give you the highest, what we say is the crack, value difference between crude and finished product of any of the product differentials.

CHAIR—I see. So the answer to my earlier question to Mr Caplan—that is: to what extent would the petrol margin be typical of the overall margin?—is no, and in fact this would show us the highest margin?

Mr Midgley—That is correct. This will show the driver to try to maximise your yield of gasoline versus other products. So a simple refinery will only make 25 per cent gasoline versus a complex refinery, maybe 40 or 45 per cent gasoline.

CHAIR—Thanks, Mr Midgley. As there are no further questions, gentlemen, you are excused. Thank you very much indeed. Can you respond, please, Mr Caplan, to those questions you have taken on notice and those matters you have undertaken to consider.

Mr Caplan—Thank you. We will.

[3.26 pm]

HARWOOD, Ms Mary, First Assistant Secretary, Environment Quality Division, Department of the Environment and Heritage

WARD, Mr Michael, Acting Director, Clean Fuels and Vehicles Section, Department of the Environment and Heritage

CHAIR—I welcome to the table Ms Harwood and Mr Ward from the Department of the Environment and Heritage. Thank you for making yourselves available to answer questions that the committee may have for you. We have heard evidence from a number of witnesses, both industry witnesses and independent experts, about the effect on domestic fuel prices in Australia of the higher fuel standards which apply in this country. Members of the industry have used the expression 'quality premium' to describe that element in the calculation of the ultimate retail cost of petrol represented by the cost of adhering to the higher fuel standards. I am putting before you the submission to this inquiry from the Australian Institute of Petroleum, which is the peak industry group of the oil companies. I direct your attention to figure 12 on page 20. You will see that there are two cost elements other than product cost which are charted in figure 12—that is, the red line which is the quality premium, and the mauve line, which is the shipping, to give an aggregate total of those two components of cost. You will note that the red line is quite flat but stepped, reflecting the points in time at which the specification changed. Do you accept that the domestic cost of Australian petrol did increase in the manner indicated in that figure directly as a result of the movement to the new fuel standards?

Ms Harwood—I have a very brief opening statement that sets the context for how the standards came in and the decisions around them at the time they were introduced. Could I make that?

CHAIR—It is not my custom to ask Public Service witnesses to make statements because I think they are here basically to assist the committee by responding to any inquiries senators might have, but if you want to make that statement, Ms Harwood, you should. But before you do, perhaps you could answer my question.

Ms Harwood—Certainly. In essence, yes, at the time that the government made the decision to upgrade Australia's fuel standards to meet requirements, for a number of reasons that I can go through, but to meet international standards, it was acknowledged that that would add a cost—that is, there would be a cost to the oil suppliers of meeting those standards.

CHAIR—Which would flow through ultimately to the market.

Ms Harwood—Which would flow through, but a conscious whole-of-government decision was made at the time to proceed with adopting the fuel standards, not least because significant health benefits were identified at the time—that is, by introducing the standards progressively, through the period 2000 to 2019, the net health benefit would be at least $3.4 billion.

CHAIR—The costs reflected in the red line to which I have drawn your attention are essentially production costs, aren't they? One would not expect them to abate over time; they are just an additional cost at the stage of production at which the fuel is refined to the specification.

Ms Harwood—The industry would be much better placed to characterise where and how the costs arise, but some of the costs relate to investment in additional equipment in refineries which would be amortised through time—that is, that is not a continuing cost. I do not think characterising them as stable, ongoing costs necessarily captures the essence of that investment that has been made already by the industry in upgrades to the refineries.

CHAIR—When these more stringent fuel standards were introduced I take it there was a period of consultation with the industry?

Ms Harwood—There was very extensive consultation with a very wide array of stakeholders.

CHAIR—Limiting yourself for the moment to the four major oil companies, the refiner marketers, there was consultation, I assume, with each of the four of them?

Ms Harwood—I will clarify that but I have no doubt that they would all have been actively engaged in the process.

CHAIR—If you don't know the answer, perhaps you could take that on notice and confirm your understanding.

Ms Harwood—Yes. We may have with us a list of all the stakeholders who were consulted at the time that the act was being developed.

CHAIR—Can either of you tell us what was the attitude of the four major refiner marketers to the new fuel standards? Were they supportive? Were they reluctant? Were they neutral? What did they say?

Ms Harwood—Neither of us was in this role at the time that the act was brought into being, so I would—

CHAIR—Could you check that and come back to us in writing?

Ms Harwood—I am happy to do that.

CHAIR—Can I explain to you the reason I ask that question. It was put to some witnesses—I forget which ones—by one of our colleagues, Senator Joyce, that the high fuel standards represented a non-tariff barrier and that, as I understood him, he was suggesting that it was very much in the interests of the four majors to have this non-tariff barrier so as to make it more difficult for there to be competition with them from other sources. Whatever you think of that argument, it would bear upon it to know whether or not the four major refiner marketers supported or opposed this measure. We have heard from one of them that they supported it.

Mr Ward—The general process for setting fuel quality standards is for public submissions such as would be made by the oil majors to be placed on record and we would place them on our internet site, so they may well still be posted.

CHAIR—If you could check that for me, that would be good. Ms Harwood, you wanted to make some observations, so let me give you the opportunity to do that now.

Ms Harwood—Thank you. I just wanted to give the context of the decision-making process that led to the way Australia currently establishes its standards. Transport is the most significant contributor to ambient air pollution in urban Australia, with vehicles estimated to contribute up to 70 per cent of total urban air pollution. It is also one of the largest contributors to national greenhouse emissions.

In Australia, three interrelated strategies are being implemented to clean up vehicle emissions. Vehicles are required to meet effective emission standards when they first enter the market, through mandatory vehicle emission standards established as Australian design rules under the Motor Vehicle Standards Act 1989. Vehicles will be required to continue to meet effective emission standards while they are in use and they will be provided with the cleanest economically viable fuels on which to operate. New vehicle emission standards harmonising Australian standards with international vehicle emission standards were gazetted in December 1999. The quality of fuel in Australia was a key constraint to the introduction of new vehicle emission standards. Emerging vehicle engine and emission control technologies needed to meet new standards and help achieve reductions in fuel consumption are affected by the quality of the fuel used. In essence, clean vehicles need clean fuels.

The government made a number of policy decisions that have a direct bearing on the management of fuel quality. The Measures for a Better Environment package, announced by the Prime Minister in May 1999, included a commitment to reduce sulfur content levels in diesel fuel and foreshadowed sulfur content and octane changes to the composition of petrol. The Downstream Petroleum Products Action Agenda, approved by cabinet and released in November 1999, advised of the government’s intention to have fuel specifications implemented on a national basis. In December 1999 cabinet directed the Minister for the Environment and Heritage to develop Commonwealth legislation to implement national fuel standards. The Fuel Quality Standards Act 2000 was enacted after lengthy consultation with a wide array of stakeholders and detailed economic analysis.

As I said before, from 2000 to 2019 the avoided health costs through improved fuel quality and lower vehicle emissions will amount to greater than $3.4 billion. Prior to the introduction of fuel quality standards, the average level of sulfur in Australian diesel was up around 1,300 parts per million, equivalent to Third World diesel. In 2002 the sulfur limit was capped at 500 parts per million and then reduced to 50 parts per million in January this year. The limit for sulfur will again drop, to 10 parts per million, in 2009, making Australia’s diesel among the cleanest in the world.

Petrol has been progressively cleaned up since the introduction of the quality standards as well. Lead was banned in petrol in 2002, sulfur levels have been progressively reduced and in January this year benzine was capped at one per cent. The Fuel Quality Standards Act has provided the means to reduce pollutants and emissions arising from the use of fuel that may cause environmental, greenhouse and health problems, to facilitate the adoption of better engine and emission control technologies and to allow more effective operation of engines. Thank you.

CHAIR—Thank you. Mr Ward, do you have anything to add?

Mr Ward—No.

Senator O'BRIEN—What was the government's estimate of the impact on the price of fuel of these fuel standards?

Ms Harwood—I understand there was a regulatory impact statement done at the time that the standards were being mooted and it was estimated at that time that the effect on diesel would be approximately 1.5c per litre and on petrol, 1.1c per litre.

Senator O'BRIEN—That is from the whole suite of measures?

Ms Harwood—Yes, that is taking it through the sequential series of standards improvements.

Mr Ward—That was through to 2006. The original tranche of quality standards went through to 2006.

Senator O'BRIEN—The Australian Institute of Petroleum have ascribed in excess of 2c per litre from the beginning of 2006 as the quality premium. Your qualification was that the costs were estimated up to 2006. What does that mean—is it unknown after that?

Mr Ward—I note from their submission that it is also to 2006. The post-2006 standards have subsequently been introduced and gazetted.

Senator O'BRIEN—These quality premiums can only apply to that which exists now. AIP told the committee that it is a cent a litre higher than what the government's regulatory impact statement estimated, despite assistance from the government to the refineries for the cost of implementing the new standards measures. Have you any idea of how much has been paid to the refineries?

Ms Harwood—I am not aware of the basis on which the industry's calculation of the premium was made.

Senator O'BRIEN—I understand that it is their figure, not yours.

Ms Harwood—Yes. On the second question, there were tax incentives essentially to come into early conformance with the new standards. Basically, from two to three years before a standard was to come into place, there was an incentive to meet the standard early. The estimate of the extent to which companies took advantage of that incentive would be a matter for Treasury or the ATO.

Senator O'BRIEN—Do you know whether the incentive was capped in dollar terms?

Ms Harwood—It was a cents per litre incentive.

Senator O'BRIEN—So it wasn't capped?

Ms Harwood—It is really not our area, so I do not feel comfortable saying yes or no to that.

Senator O'BRIEN—The AIP submission also talked about the regulatory outlook for the Asia-Pacific region. It said that Australia is going to Euro 4 for petrol at some time in 2008 and that it has gone as at the beginning of this year or it will go at some time this year to Euro 4 for diesel.

Mr Ward—That is correct. I can explain what that means in terms of fuel quality, if you wish. The sulfur level for diesel dropped from 500 parts per million to 50 parts per million. The sulfur level for PULP, premium unleaded petrol, will drop to 50 parts per million in 2008 from its current level of 150 parts per million.

Senator O'BRIEN—Do you know whether any cost estimate has been arrived at for the premium impact of the 10 parts per million sulfur level standard projected to apply to diesel from 2009?

Mr Ward—There are regulation impact statements prepared for all the fuel standards and proposed changes. The estimate for the increase in the cost for diesel is about 0.7 c per litre.

Senator O'BRIEN—Is that based on costs in other jurisdictions? Obviously other jurisdictions have already gone to Euro 4.

Mr Ward—That would be costed—

Senator O'BRIEN—Sorry, 10 parts per million.

Mr Ward—I expect that would be costed on the cost of Australian refiners investing in capital to produce the lower sulfur.

Senator STEPHENS—On that point, you said that an impact statement was developed in relation to the move to E4 for diesel. What was the estimated impact on the price of premium unleaded petrol?

Mr Ward—The cost of decreasing sulfur in premium unleaded petrol from 150 to 50 parts per million was estimated at 1c per litre.

Senator STEPHENS—We had evidence in Queensland that this shift would mean that unleaded petrol, as we currently know it, will disappear and that premium unleaded fuel will become the standard grade of fuel. Is that right?

Mr Ward—Essentially it is, but it will not be regulated out of the market. Leaded petrol was regulated out of the market. In 1986, only unleaded petrol vehicles were allowed into the market, but it was not until 2002 that leaded fuel was essentially banned. Lead replacement fuel was offered as an alternative, and that is now receding from the market, simply because vehicles are no longer purchasing it. So, over time, as more and more vehicles are introduced to the market that require premium unleaded petrol—fuel with an octane rating greater than 95 RON—just through natural attrition of the fleet, there will be a smaller and smaller remnant that will require 91 RON petrol. So in 15 or 20—I don’t know how many—years, you would expect unleaded petrol to become scarcer and scarcer.

Senator STEPHENS—We also received evidence in Queensland that their expectation was that there would not be a 1c a litre difference but that it would be more likely to be 5c. Do you have any comment to make on that?

Mr Ward—The price of petrol is exactly what you are investigating, but it is a market decision. It is not something we can really comment on.

CHAIR—Thank you very much indeed, Ms Harwood and Mr Ward. If you could provide the answers to those questions on notice to the secretariat, that would be appreciated. This hearing is now adjourned until 9 am on Friday, 13 October.

Committee adjourned at 3.46 pm