Burning off the petrol price myths

Tim Wilson

It's hard to imagine a retail product as closely scrutinised as petrol. Consumers watch it, hawk-like, as prices rise and fall and Governments respond to the slightest fluctuations with a new inquiry.

In June, the Federal Treasurer, Peter Costello, directed the Australian Competition and Consumer Commission (ACCC) to hold an inquiry into the price of unleaded petrol in Australia. The last major inquiry into petrol pricing was held in 1996. Since then, numerous smaller parliamentary, government and regulatory inquiries have been held into every facet of the industry. No aspect has been left unexamined—from the introduction of the shopper docket discount scheme to changes in prices around a single weekend.

The current inquiry will assess the structure of the industry, competition in the market, prices, and barriers to efficiency in the industry. It is due to report to the Federal Treasurer by mid-December.

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In recent years, there have been major shifts in the industry. Partnerships emerged between Caltex and Shell and the supermarket chains Safeway (Woolworths nationally) and Coles. The refiners have increasingly handed their retail trade to the supermarket chains, and then coupled petrol sales with aggressive convenience store marketing.

Most importantly, the supermarkets are offering loyalty through their shopper docket petrol discount schemes. The shopper docket scheme works by providing discounts to shoppers who buy their groceries at the supermarket chain allied to the service station outlet. After spending a certain amount, consumers are given a docket that entitles them to a discount on their petrol bill.

A 2003 ACCC investigation into the proposed shopper docket petrol discount schemes reported that they were likely to reduce prices for petrol, increase non-price competition and, most importantly, encourage a culture of discounting.

But these supermarket–petrol retailer partnerships have upset many within the industry. A vocal contributor to the current inquiry is the Service Station Association that represents non-chain service stations throughout Australia. Its Chief Executive, Ron Bowden, has come out with his bat swinging, attacking the schemes by arguing that they are a duplicitous way of securing market share. Bowden claims that the partnerships are aggressively discounting petrol and recouping profits through higher grocery prices.

Bowden is not the only one making this point. Chief Executive of the National Association of Retail Grocers, Ken Henrick, also argues that supermarkets are hiking prices so that they can offer petrol discounts. During inquiry hearings, Henrick was asked to substantiate his claims with evidence. Not surprisingly, he couldn't, but simply referred to grocery prices going up.

Of course Bowden and Henrick may be right—higher grocery prices may be covering for reduced petrol prices. However, such a practice is hardly news and similar practice has been used throughout the industry for years.

Figure 1: Average petrol prices in Melbourne in June 2006 (cents/L)

	Week prior Queen's Birthday	Week of Queen's Birthday	Week after Queen's Birthday
Monday	131.90	137.30	No data collected
Tuesday	131.40	135.30	132.50
Wednesday	131.00	133.90	132.30
Thursday	142.00	143.40	144.20
Friday	140.00	140.60	141.90
Saturday	139.60	139.10	139.70
Sunday	138.10	136.80	137.30

Source: RACV Submission to the Senate Economics Legislation Committee Inquiry into the Price of Petrol in Australia, July 2006.

Independent service stations have traditionally had convenience stores attached to them which sell products with much higher profit margins than petrol. Retailers have to make a profit somewhere and using competitive petrol prices lures customers into buying profit maximising chocolate bars and drinks. And it is not just the independent chains that see a convenience store as part of their business model. In its submission to the 2007 ACCC inquiry, BP stated that convenience-store sales make up half of its service station revenue.

Ultimately it doesn't matter if service stations are using petrol as a lead-in product. If consumers want to reduce their petrol bill, they only need resist that chocolate bar.

Pricey petrol?

The attack on loyalty programmes, the shopper docket scheme and the necessity to draw incomes from more profitable consumer goods demonstrate one essential point—retail petrol operates in a competitive market and retailers are compelled to be creative to attract consumers.

Unleaded petrol is a generic product whose price is widely known and attracts little or no brand loyalty. Of a typical tank of petrol, roughly 41 per cent of the total cost is tax, 53 per cent is production costs and 6 per cent is profit for the retailer. Across the entire supply chain the total profit is only around 10 per cent—a comparatively low profit ratio for a retail product. Fortunately, petrol is a high turn-over good, so low returns are offset by high consumption.

Australia's petrol is amongst the cheapest in the world. We extract and refine the vast majority of it domestically and import only 15–20 per cent. A high level of domestic production does not make us immune from the world price, however. Australian petrol is priced against world prices to remove enticements to export to other markets which could cause a domestic shortfall.

Petrol prices fluctuate primarily around the world price sourced from the Asia-Pacific's major petrol trading market and source of our imports—Singapore. As a commodity traded in US dollars, we are also affected by changes in the Australian/US dollar exchange rate.

Despite the occasional blip, there is a very strong correlation between the Singapore price and the price at the bowser. Shifts in the world price take up to two weeks to flow on to Australian consumers because of the time it takes to transport petrol and for stations to replenish stocks. Similarly, because smaller country service stations have lower turnover and less frequent replenishment rates, the flow on of higher or lower prices can take longer in the bush.

Round and round we go

Exchange rates and the world price are not the only contributors to the price of petrol. The least understood component of petrol pricing is the price cycle. The factors contributing to the price cycle are numerous and poorly understood. But there is one factor that is universally understood to be the most important—demand.

The price cycle is famously blamed for peaks just before and on weekends and public holidays. Yet the evidence points to something different. The price cycle follows a largely predictable pattern. Current trend data from Melbourne show that peaks in price generally occur on Wednesdays and Thursdays and then prices decline until a trough starting on Monday or Tuesday. As a result, service stations are heavily dependent on the average takings of the entire week, not just a one- or two-day peak. If the price cycle is an effort to gouge the public for higher prices, retailers should be a little less transparent.

And public holidays are no different. Following the June 2006 Queen's Birthday weekend, the Senate Economics Legislation Committee held an inquiry into alleged increases in prices. Yet for all the hoopla made by politicians, it was up to the motorist's lobby, the Royal Automobile Club of Victoria (RACV), to hose down the hype. In its submission, the RACV provided data

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from Melbourne showing surprising stability in the market at the time and no abnormal price hikes. (See Table 1)

And all the criticism of the price cycle presumes that consumers are being exploited. The ACCC, petrol companies, petrol retailers and the RACV all beg to differ. Data collected by the ACCC show that a majority (roughly 60 per cent) of petrol is sold below the average of the price in the price cycle, not above.

The Senate Inquiry following the Queen's Birthday weekend demonstrates the biggest enemy of low petrol prices—politicians.

When petrol hovered around a dollar a litre, the biggest slice was taken by the Government through the fuel excise and GST. Following political pressure from the Opposition, backbench Liberal MPs and the public at large, the Government's fuel excise take was capped at 38 cents per litre. GST is added on after excise and all other costs and contributes 10 per cent of the final price—currently between 10 and 15 cents. Because of the cap on excise, the current take by Government is only around a third of the final price, but still a significant contributor to the price at the pump.

The Federal Government has regulations that also add costs for imported petrol. As an example, in 2001 the Federal Government introduced requirements limiting the content of benzene to less than 1 per cent, thereby adding additional refinement costs on already imported refined petrol.

But the Federal Government is not the only one to blame. In Western Australia, regulations exist that stop petrol companies from changing discounts and prices throughout the day. Service stations in WA have actually been fined for reducing their price of petrol. The aim of the regulations is to stop peaks in a price cycle, but their effect is to encourage retailers to set prices cautiously higher in order to manage the risk of undercharging and losing out.

Consumers beware

Despite inquiry after inquiry giving oil companies the all-clear, it hasn't stopped Government interference. In March of this year, the Government introduced a new set of regulations—Oilcode. Oilcode is designed to regulate, and increase the transparency of, petrol pricing. Its centrepiece is the introduction of Terminal Gate Pricing that primarily requires wholesalers to advertise the price per litre of product to buyers and the public at large.

And it's unlikely that Government interference will end there. When burnt, petrol is an emitter of carbon dioxide. With the 'threat' of catastrophic climate change on the political agenda, consumers should not expect a reprieve in prices. Caltex has already modelled how carbon price signals will impact on petrol prices. A carbon price signal could contribute anywhere from 2.4–12 cents per litre. If the Government wants to stop petrol price rises, perhaps it should conduct an in-depth review of the science supporting climate change.