Petrol Prices: Fair or Not?

COLIN WATSON

If petrol becomes more expensive, prices go up. Is this surprising?

There has been a lot of recent media coverage regarding petrol price rises. The Melbourne Herald Sun banner headline of 6 August 1999 declared 'Petrol fury'. A headline in the Sydney Morning herald pronounced 'Motorists urged to do in petrol cheats'. Nothing seems to stir the community to anger quite like a jump in petrol prices, except maybe hikes in bank fees and charges.

For decades, oil companies have been on the receiving end of bad publicity and miserable press coverage. Some of this is more than justified.

It all started with the original evil oil company that captured a virtual monopoly over the American oil refining industry, the Standard Oil Company, headed by John D. Rockefeller. The Standard Oil Company was eventually broken up by court order after legal action was initiated by antitrust authorities in the United States. Indeed, three out of the four oil refining companies in Australia today can trace back at least some part of their lineage to the Standard Oil Company.

Oil companies have developed a tense relationship with antitrust authorities throughout most of the world. Australia is no exception. The Australian Competition and Consumer Commission, and its predecessor, the Trade Practices Commission, have litigated numerous cases in the oil industry, with mixed success, for breaches of the Trade Practices Act, in particular price-fixing and resale price maintenance.

Are claims that petrol prices are too high correct? Do popular stereotypes—that oil companies are ripping off the public through petrol price rises—ring true? Do the oil companies behave like a cartel?

Petrol prices in Australia at the time of writing are hovering between 70 and 80 cents a litre in most of the capital cities and are often much higher in country areas.

The largest component in the price of petrol at the bowser is tax. Commonwealth excise on unleaded petrol is currently just over 43 cents a litre. A round 8.2 cents of this goes back to State and Territory governments, some of which use it to subsidise and reduce the cost of petrol by some amount. In Victoria, for example, 11.1 cents is returned to motorists in the form of lower petrol prices; in Queensland the entire amount is used to reduce the price.

A further major component in the price of petrol is the cost of crude oil. Crude oil is the main ingredient in the oil refining process from which all petroleum-based products are made. Although Australia does produce and export some crude oil of its own, more than 50 per cent of the crude oil used in Australian refineries comes from overseas. This makes Australian petrol prices heavily dependent on the international price of crude oil. The price of crude oil is generally denoted in barrels, which are equal to roughly 159 litres. The price of Malaysian Tapis crude oil, the benchmark crude oil in the Asian region, had risen from US$10.95 a barrel last December, to US$11.50 a barrel in February. The largest component in the price of petrol at the bowser is tax. Commonwealth excise on unleaded petrol is currently just over 43 cents a litre. A round 8.2 cents of this goes back to State and Territory governments, some of which use it to subsidise and reduce the cost of petrol by some amount. In Victoria, for example, 11.1 cents is returned to motorists in the form of lower petrol prices; in Queensland the entire amount is used to reduce the price.

Australian petrol prices are heavily dependent on the international price of crude oil.
If Mr Watkins had managed to get himself a copy of the ACCC’s 1996 report on the retail petrol market (Inquiry into the Petroleum Products Declaration) he might have discovered some of the answers. A side from higher transport costs, the ACCC identified a number of other reasons for petrol prices being much higher in the country than in the city.

The ACCC found that there were far too many service stations selling low volumes of petrol, requiring much higher retail margins than required in the cities just to remain viable. In other words, too many retail outlets chasing a limited amount of business.

It also found that there was a general lack of competition in country retail petrol markets, with retailers much preferring to accommodate the opposition rather than compete against it. The ACCC did not, however, absolve the oil companies from blame altogether, finding that there was some evidence to suggest that oil companies extracted higher fees and royalty payments from country service station franchisees.

The President of the NRMA, the largest motoring organisation in the country, Mr Nick Whilliam, has called on the ACCC to launch an inquiry into petrol prices. There have been 40 inquiries into the oil industry since the 1970s. During the 1990s, there have been five State and Territory-based inquiries, as well as two Federal inquiries. No other industry could claim this level of scrutiny and examination.

Never one to miss a media opportunity, the Chairman of the ACCC, Professor Allan Fels, has also weighed in on the issue. He was questioned on the ABC’s 7.30 Report about price boards at service stations and how this allows the major oil companies to find out their rivals’ price.

In responding to a question on whether this amounted to illegal tacit price collusion, Professor Fels replied: ‘On the whole, we have thought that means of signalling to one another is just inside the law, just safe, but it’s fairly close.’

When making this observation, Professor Fels obviously forgot about recommendation 9 from the ACCC’s 1996 report that states: ‘The State and Territory Governments give consideration to the mandatory display of price boards at service stations.’ What was suggested as a good idea by the ACCC in 1996 to promote competition has undergone a transformation to tacit price collusion by 1999.

The Federal Labor Opposition has been blaming the Government’s deregulation package for recent petrol price rises. Shadow Assistant Treasurer Kelvin Thompson said that the reason for recent price rises was ‘the Government’s abandonment of wholesale price maximums and price monitoring by the ACCC in August last year.’

Up until August last year, petrol prices had been subject to some form of price regulation since the beginning of the Second World War. The most recent manifestation of this was the maximum endorsed wholesale price which was set daily by the ACCC. It was based on the imported price of petrol from Singapore, at the closest major refining centre to Australia. The ACCC in its 1996 report found that: ‘The major oil companies in Australia are not directly subject to legislation that restricts the number of retail outlets that they can directly own and operate—the Petroleum Marketing Retail Sites Act 1980 (Sites Act).’

In its report, the ACCC concluded that: ‘Retail price levels in Australia appear relatively low by international standards, despite the high concentration of companies and the relatively low level of demand, and apparently profitability is not excessive.’

The ACCC also hinted at possible competition for the ongoing problem of high petrol prices. It was based on the imported price of petrol from Singapore, at the closest major refining centre to Australia. The ACCC in its 1996 report recommended that the maximum endorsed wholesale price should be scrapped. It found that it was not a constraint on pricing in metropolitan areas, noting that it may even have acted as a target price at the end of a discount cycle. Even the ACCC in its 1996 report recommended that petrol price controls should be removed.

Given recent increases in the international price of crude oil, it is extremely doubtful that continued price regulation would have done anything to prevent recent petrol price rises, contrary to Mr Thompson’s assertion.

A further cause of complaint amongst motorists in the capital cities is the massive price fluctuations that are observed. The ACCC in its 1996 report found that: ‘it appears that petrol price cycles in some capital cities are generally linked to weekly fluctuations in demand, continuing excess product at refineries, the threat of or land imports, the presence of independent chains and competition for sale share.’

The ACCC also hinted at the possibility that they are often portrayed to be by politicians and the media. With the lethal combination of the media and politicians on the warpath over petrol prices at the moment, the latest ‘regulatory solution’ to the ongoing problem of high petrol prices cannot be too far away. Maybe it is about time we had a little less regulation in the petrol industry. This is a novel solution that could actually make the price at the bowser far more palatable.

Colin Watson is a public policy analyst based in Melbourne.