



SUBMISSION

TO

SENATE STANDING COMMITTEE ON ECONOMICS

Inquiry into National FuelWatch (Empowering Consumers) Bill 2008
and the
National FuelWatch (Empowering Consumers) (Consequential Amendments)
Bill 2008

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RACQ submission to the Senate Standing Committee on Economics - the proposed national FuelWatch scheme

1 Introduction

This submission addresses the proposed national FuelWatch scheme and considers its likely impact on fuel prices and consumers. RACQ comments with regard to Fuel Watch are set out according to the published Senate Standing Committee Inquiry Terms of Reference.

The RACQ acknowledges that there is an opportunity for greater price transparency at the fuel retail level, but questions whether FuelWatch is the most appropriate mechanism by which to achieve this. Under a national FuelWatch scheme, the marginal benefits of price transparency and decreased consumer search costs, will come at the risk of higher petrol prices (especially for the most price sensitive motorists) and reduced competition.

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

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

2 Scope of the RACQ submission

The Federal Government announced that FuelWatch will be mandatory only in metropolitan areas. The scope of RACQ's assessment is therefore limited to south-east Queensland. Similarly, most discussion in this submission is centred on petrol prices, as opposed to diesel or LPG, because petrol makes up the bulk of our members' fuel purchases.

It is also worth noting that much of RACQ's comment is based on the observed impact of FuelWatch in Western Australia. We acknowledge that specific market factors mean that the Western Australian experience cannot be automatically extrapolated to south-east Queensland. It is a limitation of this submission that more informed comment could not be provided. To provide the level of detailed analysis required, petrol price data needs to be analysed on a volumetric bases, not simply using daily average fuel price movements. Unfortunately, the Australian Competition and Consumer Commission (ACCC) has not yet made this information available.

3 Senate Standing Committee on Economics Inquiry Terms of Reference

Term of Reference A

The impact of the proposed FuelWatch scheme on the price consumers will pay for motor fuel (including unleaded petrol, diesel and LPG) in metropolitan areas, regional centres and rural Australia.

FuelWatch is likely to raise petrol prices for many motorists. Under the proposed national FuelWatch scheme, the price of fuel will be fixed for 24 hours. Price fixing makes retailers cautious, introduces 'stickiness' into the market and can lead to lengthened petrol price cycles. The change to price cycles, for example from a one-week to a two-week cycle, impacts on motorists in two ways:

1. They have fewer opportunities to buy 'cheap' petrol at the low point of the petrol price cycle, because the cycle has fewer troughs.
2. When a price cycle lengthens, the amplitude often decreases and prices do not sink as low at the trough. This results in higher prices for motorists who seek out cheaper prices at the bottom of the petrol cycle.

In south-east Queensland, two-thirds of motorists purchase petrol on 'cheaper' days, at the trough of the price cycle. These motorists will pay more for petrol under FuelWatch.

Term of Reference B

The economic benefits and costs of the proposed FuelWatch scheme to consumers in metropolitan areas, regional centres and rural Australia.

It is clear that Fuel Watch will reduce the information imbalance between petrol retailers and consumers. However, it is not apparent that this is the best possible scheme to achieve this, or whether it comes at the lowest possible cost to taxpayers and motorists.

Economic costs from the proposed scheme include:

- Federal Government costs of \$20.9 million over four years;
- Ongoing compliance and administrative costs for petrol retailers; and
- Higher fuel prices as a result of lessened competition and extended petrol price cycles.

The proposed national FuelWatch scheme has a relatively narrow scope, and the following benefits will be realised only by metropolitan motorists:

- reduced daily price volatility; and
- greater price transparency and decreased consumer search costs.

At an individual level, the value of these benefits, versus the potential costs of the scheme will vary. For many motorists, the opportunity costs of FuelWatch are high and it is likely they would be prepared to accept fluctuating daily petrol prices in return for the ability to buy petrol at lower than average prices one or two days each week.

At a national level, the benefits of FuelWatch are marginal, and do not adequately offset the implementation and recurrent costs associated with operating the proposed national scheme.

Term of Reference C

Other economic costs of the proposed FuelWatch scheme, including the compliance costs of the scheme for industry, particularly independent retailers.

The compliance costs faced by individual service stations under a national FuelWatch scheme have not been confirmed. If FuelWatch imposes significant additional costs on retailers, then it will place undue pressure on small, independent service stations because they are less equipped to absorb increased overheads than large retail chains.

Other economic costs result from a reduced imperative for competition under FuelWatch. The proposed scheme will allow large multi-site retail chains to coordinate their pricing, which in turn will hurt small independent retailers and reduce competition in the market. It also becomes relatively more costly under FuelWatch for retailers to increase and decrease prices too much, in case they find they can't sustain their announced prices over 24 hours. This understandably results in conservative pricing and less vigorous competition.

Term of Reference D

The impact of the proposed FuelWatch scheme on competition between motor fuel retailers and the operation and viability of independent motor fuel retailers.

The proposed national FuelWatch scheme benefits large fuel retail chains, most likely to the detriment of independent retailing and competition.

Errors in picking the 'right' price, in terms of the market price for the next day, are likely to occur among petrol retailers. Large retail chains have an inherently greater capacity than smaller, independent chains or single site operators to take a hit to their margins, or lose business for an entire day. Independent service stations will be able to absorb far fewer pricing errors than oil company or major supermarket chain-operated sites before going out of business.

Multi-site franchises will find it much easier to use the FuelWatch scheme due to their advantage of market coverage. Large petrol retailers can subsidise incorrect or uncompetitive pricing at one location through alternate locations or discount prices at two or three sites, to ensure their brand is displayed on fuel price lists as the cheapest. This was acknowledged in the ACCC Petrol Price Inquiry Report as a strategy of 'rolling price leaders'. It is possible that such tactics could be employed to eliminate, over time, competition from independent operators in a given area.

Before FuelWatch was introduced in Western Australia, there were 200 independent retailers operating in the State. Seven years on, there are just 17. It is unclear to what extent FuelWatch contributed to this decline and there are conflicting opinions.

Term of Reference E

Intraday price volatility in the retail market, established price cycles in each state and territory, and consumer awareness of price cycles.

The retail petrol cycle in south-east Queensland is generally characterised by a sharp and significant rise in prices each Wednesday, followed by a period of gradual price decline to a low on Tuesday, before the next rise. The RACQ website and other media outlets facilitate consumer understanding of petrol price volatility and the resulting cycle. In Brisbane there is a high degree of awareness about when prices are 'cheapest'. This results in two-thirds of weekly petrol volumes being sold on the lowest priced days of the petrol cycle.

While some consumers may find the price cycles frustrating, the price variability gives the most price sensitive consumers an opportunity to buy at the lowest price of the cycle, often at or near wholesale price.

Term of Reference F

The impact of FuelWatch on discounting, as well as the amplitude and duration of price cycles, including any penalties that will apply to motor fuel retailers for not fixing prices for 24 hour periods.

Under FuelWatch, intra-day discounting will disappear and weekly discounting will lessen. It is reasonable to expect that this will cause petrol price cycles to lengthen, thus significantly disadvantaging price sensitive consumers.

Perth petrol cycles have altered considerably since FuelWatch was introduced seven years ago. The amplitude of price cycles has narrowed, reducing the range between the highest price and the lowest price in a cycle. In most Australian cities the difference between the peak and trough of a petrol cycle is a 10-cent margin, however, in Perth it is half this amount. Perth also has a two-week petrol price cycle most of the time. It is unclear whether the extended cycle is directly related to the introduction of FuelWatch, however the RACQ considers it likely that without FuelWatch, a two-week petrol cycle would not have emerged in Perth.

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

Term of Reference G

The potential use under the FuelWatch scheme of sophisticated pricing strategies by motor fuel retailers who have more than one retail outlet, and how they may take advantage of the 24 hour rule.

As noted under Term of Reference D, FuelWatch will allow large retail chains to utilise a strategy of 'rolling price leaders' and ensure their brand is always displayed on price lists as the cheapest. In markets where this occurs, small independent retailers will have no way to effectively compete, because they cannot cross-subsidise one low-margin site with higher margins at other sites. In addition, small independent retailers will be prevented from lowering their prices during the day to match the competition.

Term of Reference H

Independent analysis of the overall economic benefits and costs of the proposed FuelWatch scheme.

There has been no comprehensive assessment of the value of a national FuelWatch scheme. Neither the Federal Government or the ACCC have presented a clear case for the benefits associated with FuelWatch; nor have concerns regarding the associated risks of implementation been addressed. In its 2007 Petrol Inquiry Report, the ACCC concluded that there were potential benefits and potential costs of implementing a national FuelWatch scheme. The Commission said that a detailed evaluation, addressing various issues, would have to be made before the Government could confidently take FuelWatch further. If this detailed assessment has been undertaken, it is yet to be made public.

In March 2008, the Australian Automobile Association (AAA) commissioned FUELtrac to provide an independent review of FuelWatch. After analysing the impact of FuelWatch in Western Australia, FUELtrac concluded that the only real decrease in Perth petrol prices occurred after the entry of supermarkets in the Perth metropolitan area, and not as a result of the introduction of FuelWatch.

Term of Reference I

Independent analysis of the differences in motor fuel prices between Western Australia and other Australian states and territories, with particular reference to volumetric or consumption-weighted prices.

Analysis of average daily prices from Informed Sources shows that Perth is not the cheapest city for fuel, however, it is difficult for RACQ to draw conclusive findings from these comparative average price movements between Perth and other capital cities. Consumer purchasing patterns must be considered before the price impact from FuelWatch can be fully assessed.

Both the Government and the ACCC have focussed on how *average* petrol prices will change under FuelWatch. This is misleading and distorts the effect that FuelWatch will have in Brisbane and other eastern capitals, where a majority of motorists purchase fuel at below average prices each week. Actual sale prices of petrol in Brisbane are cheaper than the average of daily published prices. This is because a greater volume of fuel (65%) is purchased on 'cheaper days', at the trough of the price cycle. To determine the impact of FuelWatch, petrol sales need to be analysed on a volumetric basis. Nonetheless, data from two price monitoring organisations, Informed Sources and FUELtrac, suggests that FuelWatch had very little impact on petrol prices when introduced into Western Australia. Both organisations conclude that it was the entry of Coles into the Perth retail petrol market in 2004 that caused average prices to fall.

Term of Reference J

The legal basis for the legislation.

The RACQ declines to comment.

4 Conclusion

The RACQ does not believe that the proposed national FuelWatch scheme will benefit motorists in south-east Queensland. No clear evidence exists to show that FuelWatch will lower petrol prices. It is, conversely, more likely that under FuelWatch prices will rise and competition will decrease, leaving low-income consumers ultimately worse off.

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

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