Mr Neil Byron
Presiding Commissioner
Productivity Commissioner
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Shell submission to the *Review of the Prices Surveillance Act 1983*

Thank you for providing Shell with the opportunity to respond to the Productivity Commission's *Review of the Prices Surveillance Act 1983*.

Shell supports the Commission's recommendations that price controls should be a remedy of last resort and only apply in markets where competition is not strong. This is a logical progression as competition in all areas of the Australian economy becomes more intense.

The issue of price monitoring is more complex. In a rational policy making environment, Shell supports the Commission's view that price monitoring and public inquiries should only apply to industries where the market is of National significance and there is strong evidence of monopolistic pricing. Clearly as the Australian petroleum industry is one of the most competitive in the world, we would no longer be subject to monitoring or inquiries under the Commission's recommendations.

In an industry that is under intense public and political scrutiny, if the ACCC were no longer to monitor petroleum prices (or conduct public inquiries into the industry) the various state governments of Australia could step into this regulatory void.

As we have seen in Western Australia, South Australia and, to a lesser extent, ACT and Victoria, state governments have reacted to public pressure over high petroleum prices to make poor public policy decisions. These decisions have been made without any assessment of the costs or benefits, or without any type of rigorous analysis.

Therefore, in assessing the need for monitoring of our industry, Shell must:

- firstly balance the benefits and costs of such activities, and
- then assess if such activities did not exist, try and second-guess if potential state government intervention would be worse than the existing regime.

Although this 'broader' assessment prices surveillance options may sit outside the terms of reference of the Commission's inquiry, it is the reality Shell is currently faced with. Indeed the future of the Australia downstream petroleum industry is being put at risk by backward steps into re-regulation.

The following outlines Shell's views on the above. It concludes that although Shell supports the removal of price monitor and public inquiries into the petroleum industry, the danger of state-by-state re-regulation necessitates the continuation of price monitoring.

Where public perceptions do not reflect reality, there is a need to close this knowledge gap. Industry has a role to play here, but accurate, objective, timely and accountable monitoring by the ACCC can also help.

Shell believes this is best done by the interim step of requiring the ACCC to report annually on its monitoring activities, clearly stating the objectives and making an assessment of the benefits. The Productivity Commission should also periodically review the effectiveness of the ACCC's monitoring activities.

While acknowledging price monitoring at the Federal level is not mutually exclusive to poor state-based decisions, if the role of price monitoring also included education, this may go a long way to improving regulatory outcomes. Obviously Shell also has a role to play in explaining the nature of the petroleum market to governments and, most importantly, our customers.

Shell looks forward to expanding on the attached at your public hearings in June, and answering any additional questions you may have.

Yours sincerely

Peter Duncan
Chairman Shell Australia

Shell Australia submission to the Productivity Commission

Review of the Prices Surveillance Act 1983

The costs and benefits of price monitoring and inquiries

The downstream (from the refinery to the pump) petroleum industry has been the subject of more than 40 reviews and inquiries over the last decade. While prices are no longer set by the ACCC, it still plays a strong role in monitoring prices and reviewing the petroleum industry's activities.

To illustrate the scrutiny the petroleum industry has been placed under, the plethora of recently introduced regulation or inquiries over the last few months include:

- ALP petroleum inquiry.
- Soon to be announced Commonwealth inquiry into petroleum taxation.
- ACCC inquiry into price volatility.
- ACCC inquiry into Fuel Sales Grants Scheme implementation.
- Western Australia Select Committee into Petroleum Product Pricing.
- South Australia inquiries into fuel quality and petroleum prices.
- ACT inquiry into petroleum prices and recent temperature correction legislation.
- Victorian terminal gate pricing legislation.

Obviously this is evidence of the public concern over high petroleum prices, and the political reaction to this. However, the evidence of the competitive nature of the industry is plainly evident:

- Australia has the cheapest pre-tax petrol in the world.
- In all the markets in which Shell operates around the world, Australia has the lowest petroleum retail margins.

- There are no barriers to entry into the market and the only significant regulatory constraints are applied on the refiner-marketers. There is no evidence of profiteering or collusion, and return on assets have been low or negative over the last few years. In 2000 Shell's downstream business lost $63 million.

Shell shares the concerns of our customers over high prices. But given the forty or so inquiries over the last decade have found no evidence of collusion, monopolistic pricing and inappropriate behaviour, what has been the benefits to the community of such activities?

The role of price monitoring and the ACCC

Clearly the ACCC is well placed to monitor prices and, perhaps most importantly, its role in monitoring prices is crucial to the public perception of the petroleum industry. Therefore the key questions for the Shell are:

1. Should the ACCC continue to monitor and inquire into petroleum prices?
2. If so, what form should this take?
3. If not, who would fill the regulatory void?

Who will fill the regulatory void?

Somewhat perversely, Shell needs to answer (3) *who will fill the regulatory void*, before reaching a conclusion on the continuing role of the ACCC. While this is perhaps outside the terms of reference for the inquiry, it is fundamental to Shell's decision-making process.

On a first principles basis, Shell supports the Commission findings that prices monitoring and public inquiries should only apply to industries where the market is of National significance and there is strong evidence of monopolistic pricing.

Shell believes there is simply no evidence of the petroleum industry engaging in monopolistic pricing and therefore would not be a candidate for continued ACCC involvement.

However, if the ACCC were to longer involved in monitoring the industry, Shell is not confident that some state governments would not simply step into the void and continue to re-regulate the industry. Intervention by state governments is likely to be far more interventionist than the activities of the ACCC.

Take Western Australia for example. In the last few months the Western Australian Government have legislated:

- A fuel quality standard different to the rest of Australia and the region, that effectively precludes imports from both interstate and overseas. This effectively gives BP's Kwinnana refining a monopoly position in Western Australia. This has already added about one cent a litre to the price of petrol and puts the stability of fuel supplies in doubt if the BP refining were to unexpectedly close.
- Restricted the cornerstone of retail competition, by fixing daily pump prices. This will lead to higher daily average costs.
- Fixed the terminal gate or wholesale price <u>below</u> the cost of supply. If Shell is forced to sell at this price it will simply have to close down its WA terminal and wholesale operations.
- Introduced a bill that will enable Shell franchisees to buy half of their petrol of other wholesalers. This means Shell will be forced to change its franchise conditions and charge its franchisees higher fixed costs to make up for losing royalty revenues. This will lead to less discounting and higher pump prices.
- Is suggesting legislation that will fix pump prices to an arbitrary limit above the already artificially low wholesale price. If this limit were set too low, Shell would also have to withdraw from retail operations in Western Australia.

In the medium term (or perhaps even the short run) this will seriously undermine petrol supplies into Western Australia. This sort of regulation is far worse than prices monitoring.

While various state governments are toying with this sort of intervention claiming it enhances competition, they are in fact restricting the petroleum industry's ability to compete. As we have seen in Western Australia, South Australia and, to a lesser extent, ACT and Victoria, state governments have reacted to public pressure over high petroleum prices to make poor public policy decisions. These decisions have been made without any assessment of the costs or benefits, or without any type of rigorous analysis.

The sovereign risk this places on Shell's operations is considerable, and in the long run if it continues will lead to reductions in investment, or in the worst case withdrawal from the Australian market.

This is why Shell believes, in an arena that is leading to restrictions in competition and poor public policy in various states, price monitoring is preferable to re-regulation. Obviously the two are not mutually exclusive, and extensive price monitoring is not going to guarantee poor decisions are avoided in the various states. This leads us back to the role of the ACCC in providing information.

The role of price monitoring and the ACCC (MK II)

If price monitoring is the lesser evil to re-regulation, what form should it take? And perhaps more importantly what is the role of the ACCC in helping establish sound regulatory outcomes?

When it comes to price monitoring, Shell has nothing to hide. It is completely open in terms of price and margins, as well as publishing a vast array of pricing information at www.shell.com.au/petrolpricing.

But often debates over petroleum prices and market power become blurred and highly politicised. Recent petrol price increases on Anzac Day (in Sydney) and Easter Thursday were the subject of much debate and understandable consumer anger. This is despite the fact that Shell's margins on these days were less than average increases as part of the normal pricing cycle.

Shell was accused of collusion and being "un-Australian". In an ultra-competitive environment in which Shell's downstream business had just cut staff numbers by 350 to reduce costs, these types of comments were most concerning to all Shell employees. More importantly it added to our customers perception that they were not getting a good deal at the pump.

Where public perceptions do not reflect reality, there is a need to close this knowledge gap. Industry has a role to play here, but accurate, objective, timely and accountable monitoring by the ACCC can also help.

In the case of the petroleum industry Shell believes external monitoring can complement our own efforts to increase public understanding. For example:

- Shell's petrol pricing website [www.shell.com.au/petrolpricing] – this site provides prices for every suburb and town in Australia, a breakdown of how gets what from a litre of petrol, explanations for city country price differences and volatility, historical information on crude oil, refining margins, real petrol prices (and for other goods) as well a snapshot of industry profitability.
- Shell's work with the RACV to provide a breakdown of petrol prices in various Victorian locations for the *Royal Auto* publication.

Recent interventions by the ACCC have been unhelpful. Investigations into post-GST petrol prices and the Fuel Sales Grants Scheme were both unambiguous in their findings, despite the fact that consumers had benefited fully in both cases.

The key issue is how to improve the quality of monitoring in this area and help overcome information asymmetries. Shell suggests price monitoring needs:

- Clear objectives.
- To be apolitical.
- To be accountable.

Shell believes this is best done by the interim step of requiring the ACCC to report annually on its monitoring activities, clearly stating the objectives and making an assessment of the benefits. The Productivity Commission should periodically review the effectiveness of the ACCC's monitoring activities.

Shell supports the principles of best practice regulation as set out in Box B.1 *Suggested Principles of Best Practice Regulation*. These principles focus on more than simply monitoring, but developing a relationship between the regulator and industry, and how to best communicate a comprehensive set of information to consumers. Importantly, the regulator needs to be accountable and transparent in its dealings with stakeholders about objectives, processes, data and decisions.

Assessing the costs and benefits of prices monitoring

When assessing the costs and benefits of prices monitoring, Shell believes there is a role for more than monitoring industry behaviour for breaches of the Trade Practices Act. Surely there is a substantial benefit in actually disseminating information collected in the monitoring process.

Again on a first principles basis, if government intervention should be based on market failure, the only potential reason for government intervention in the petroleum market would be information asymmetry – or put more simply, to help explain the market to consumers.

Providing such information could actually benefit consumers in the market place. If consumers better understood the nature of the petroleum market they could take greater advantage of the discounting cycle and in the long run this could actually lead to less volatile pump prices, while retaining the full benefits of competition.

In the long run, once the true nature of the highly competitive petroleum industry became widely know and understood, this monitoring activity would obviously no longer be necessary.

If such monitoring by the ACCC is to maximise benefits, it must be accurate and objective. If it is not, the gap between public perceptions and reality is likely to widen not narrow. Where this gap becomes too wide, the risk is that policy makers will intervene in the pursuit of political objectives. This will more than likely be in a fashion that is detrimental to consumers and industry participants.

This is not suggesting the petroleum industry itself does not have a role in explaining the nature of the market, why prices change and issues such as city country price differences. Given the public perception of the oil industry is generally poor, Shell and others need to do a better job in explaining the way petrol pricing ‘works’. However, this is not helped when politics takes over the facts.