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COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from Australia

-- Session I --

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COMPETITION AND COMMODITY PRICE VOLATILITY

-- Australia --

1. Introduction

1. Within Australia, commodity prices are generally set by markets rather than regulated by government. Australia considers markets that are competitive, so that prices are free to move in response to changes in market conditions, produce more efficient and productive outcomes for businesses and consumers.

2. Competition in markets creates incentives for businesses to be more efficient, innovative and productive. Furthermore, competitive pressure on businesses acts to ensure that prices closely reflect costs of provision, to the benefit of consumers.

3. Government intervention, in particular through regulation or other interventions intended to affect the price of goods or services, is generally not preferred. Such regulation should only be relied upon in the event of a demonstrable market failure. Government intervention, in the form of the economic regulation of prices, is invariably difficult and is an imperfect substitute for genuine competition. Economic regulation is very time and resource intensive and the derivation of an efficient price is difficult. Accordingly, it is important that price regulation is used judiciously and only applied to areas where market failures are clearly demonstrated.

4. Where there are ongoing concerns about the volatility of commodity prices, it is important to understand the underlying cause of the instability before introducing measures to address them.

5. If the volatility is a result of structural barriers to competition, it is important to understand what the structural barriers are and implement measures appropriate to address them.

- Where the cause appears to be the result of anti-competitive conduct, the Australian Competition and Consumer Commission (ACCC) is able to investigate the conduct and take action under the anti-competitive conduct provisions of the *Competition and Consumer Act 2010 (CCA)* (formally the *Trade Practices Act 1974*).
- Where instability is a result of insufficient competitive pressures necessary to achieve efficient prices and protect consumers, price surveillance powers are available under the CCA. These powers allow the Government to direct the ACCC to undertake a range of monitoring and reporting activities.

6. Each of these tools will be discussed in more detail in the main body of this submission.

7. However, competitive markets do not necessarily mean that prices in commodity markets will be less volatile. Equally, price volatility does not necessarily reflect a lack of competition in local markets. Price volatility may reflect a range of global and regional factors, including movements in international commodity prices, changes in demand and the availability of supply.

8. As a feature of certain markets in Australia, price volatility can be a sensitive issue and a source of public concern. Unstable prices can create uncertainty for businesses and consumers. Further, price volatility is often viewed as a result of a lack of competition, as the public may perceive price increases to be the result of collusive behaviour between businesses. In some cases, a lack of public information on the operation of markets can contribute to these perceptions.

9. Consumer concern regarding prices in the fuel and food sectors has often resulted in calls for action to be taken by governments and for competition authorities to investigate the sectors for anti-competitive conduct and/or to regulate prices in the industry.

10. As a key example, the ACCC currently conducts formal monitoring of retail petrol prices to ensure that prices are being set efficiently in the market and also to inform consumers of the underlying influences on retail fuel prices. Further information on mechanisms to address concerns about price volatility in Australia, including the role of the ACCC in enforcing compliance with competition laws, is outlined in the following discussion.

2. The role of government and competition agencies

11. Public concerns about unstable prices may generally be addressed through government policy to promote competitive markets. The Government may promote competition through a number of mechanisms, including reducing structural barriers to competition such as barriers to entry, addressing anti-competitive conduct through the investigation and enforcement role of the ACCC or monitoring prices to ensure that the market is working efficiently.

2.1 Addressing structural barriers to competition

12. Successive Australian Governments have pursued structural reform on a systemic and/or structural basis. Governments play an important role in ensuring that unnecessary regulations do not impede competition or prevent new businesses from entering a market. The ACCC also plays an important role in monitoring competition in markets and providing advice to government where issues arise.

2.1.1 National Competition Policy

13. In recent decades, Australia has undertaken significant reforms intended to improve the operation of markets. Australia has benefited from increased competition in a range of industries. In part, this is attributed to the economic reforms that Australia implemented from the 1980s onwards, including the opening of the capital account, floating of the exchange rate and the National Competition Policy reforms.

14. In 1995 all Australian governments (both state and Federal) agreed to implement a range of competition reforms under the National Competition Policy (NCP) framework. The aim of NCP was to improve Australia's economic performance by promoting competition in previously restricted markets. A range of economy wide reforms were undertaken, including extension of the anti-competitive conduct provisions in the TPA to unincorporated enterprises and government businesses. In addition, a number of sector specific reforms were undertaken in industries such as electricity, gas, water and communications, which were traditionally seen as natural monopolies.

15. NCP has resulted in significant benefits for Australia. Australia's Productivity Commission estimated that the National Competition Policy reforms directly contributed to productivity growth and price reductions in key infrastructure sectors.¹

¹ Productivity Commission, *Review of National Competition Policy Reforms*, Report no. 33, February 2005

2.1.2 *Lowering barriers to entry for grocery supply*

16. In January 2008, in response to community concerns around cost of living pressures, the Government directed the ACCC to undertake a formal inquiry into the competitiveness of retail prices for standard groceries using its prices surveillance powers.²

17. The ACCC's Grocery Inquiry found that, overall, supermarket retailing is workably competitive but there some specific factors that limited the level of price competition in Australia. These included barriers to the entry and expansion of competitors and limited price competition from independent supermarkets. In particular the ACCC noted the impact of restrictive covenants in leases, and of planning and zoning laws.

18. The ACCC identified over 700 supermarket leases with clauses that were potentially restrictive, and pursued a program of having the restrictive covenants removed. In 2009, Coles, Woolworths and other leading Australian supermarkets (ALDI, Franklins, SPAR, Foodworks and Metcash/IGA) agreed to court enforceable undertakings to remove restrictive provisions from supermarket leases. In May 2011, another Australian supermarket, Supabarn, agreed not to enter into new restrictive provisions in lease agreements, which concluded the ACCC's program on restrictive leases.

19. The ACCC also recommended changes to Australian state and local government planning laws to have regard to the potential for competition between supermarkets and to prevent major supermarkets from blocking the entry and expansion of competitors.

20. Following the ACCC's report, the Government introduced a range of measures to promote more competition in the grocery retailing industry and reduce barriers to entry, including:

- changes in the foreign investment policy to extend the timeframe for the development of vacant commercial land from 12 months to five years;
- clarifying predatory pricing and misuse of market power provisions in the CCA;
- providing information about the Australian retail grocery industry in international trade forums to attract new entrants into the Australian market; and
- introducing a mandatory, nationally-consistent unit pricing regime.

21. The Government also referred the potentially anti-competitive impacts of state and local zoning and planning laws to the Council of Australian Governments (COAG). In 2009, COAG agreed that planning laws should not unjustifiably restrict competition in grocery retailing. COAG also agreed that the Productivity Commission would undertake a review of planning and zoning systems. The final report of the Productivity Commission was released on 16 May 2011.³ In addition, a number of Australian state governments have made changes to their planning laws or are reviewing them.

22. All of these measures were designed to increase opportunities for entry into the industry and encourage more competition for the benefit of all consumers. The ACCC considered that ensuring competitors can enter the market and expand would be important to maintaining competitive pressure on the major supermarket chains. Notably, Aldi and Costco have expanded their presence in the Australian

² Australian Competition & Consumer Commission, *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*, July 2008.

³ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments Research report*, May 2011.

market in recent years, with Aldi having opened over 250 stores and Costco about to open its fourth store. The ACCC found in its Grocery Inquiry report that prices are usually lower at major supermarket chains in areas where a competitor such as Aldi is present.

2.2 Addressing anti-competitive conduct

23. As indicated previously, rather than seeking to directly regulate market outcomes, Australia has developed a strong competition policy framework, which is underpinned by Australia's Competition and Consumer laws. Specifically, Part IV of the CCA prohibits certain kinds of anti-competitive conduct. Broadly speaking, the kind of conduct prohibited under the CCA includes: cartel conduct, agreements that substantially lessen competition, misuse of market power, supply or acquisition of goods or services on certain restrictive conditions, resale price maintenance, and mergers that would have the effect of lessening competition.

24. Australia's competition regime is continually being improved to further promote competitive markets. Consistent with reforms in many other OECD countries, Australia has recently introduced criminal penalties for serious cartel conduct where previously only civil penalties were available. Additionally, in 2012 legislation will come into force to clarify Australia's merger provisions with respect to creeping acquisition and to ban anti-competitive price signalling and information disclosures in the banking sector.

25. The ACCC is the primary body for enforcement and compliance of the competition elements of the CCA. The ACCC can seek various remedies for breaches of the law, including criminal sanctions, financial penalties, disqualification from managing a corporation, injunctions to stop breaches or potential breaches of the competition law, compensation for loss or damage suffered by affected parties, adverse publicity orders, non-punitive orders and divestiture of assets. The ACCC can also accept court enforceable undertakings when a corporation has breached the law.

26. Consumers and businesses affected by the anti-competitive conduct may also seek remedies including injunctions, compensatory orders and damages through private litigation.

27. Australia considers that a comprehensive and effective competition law is vital to facilitating competitive markets across the economy, to the ultimate benefit of consumers, in the form of lower prices and greater choice.

2.3 Monitoring prices and educating the public

28. Where there are ongoing consumer and government concerns about unstable or volatile prices, it is open to the Australian Government to direct the formal monitoring of prices to ensure that prices are being efficiently set by the market. Price monitoring reports can also educate the public about the underlying causes of price volatility. Currently, the ACCC monitors prices in a number of sectors. Perhaps the most high profile price monitoring currently being undertaken by the ACCC is the monitoring of retail fuel prices in Australia. The ACCC provides and publishes regular reports which inform the Government and the public of the major underlying influences on retail fuel prices.

2.3.1 ACCC monitoring of fuel prices

29. In Australia, fuel prices were regulated to varying degrees at a state level since the 1940s. The Commonwealth government became more involved in petrol price regulation with the first oil shock in the 1970s when it began to regulate wholesale prices. From 1998, in line with government policy, fuel prices in Australia were deregulated and wholesalers were free to set their own prices according to market conditions.

30. To observe fuel price movements after deregulation, the ACCC conducted informal monitoring of fuel prices through to 2007. During this time, the ACCC observed that retail petrol prices had diverged from movements in international benchmark prices.

31. The Government subsequently directed the ACCC to conduct an inquiry into the price of unleaded petrol taking into account the structure of the industry, the extent of competition across the supply chain, the determination of prices across the supply chain and whether there were any impediments to efficient petrol pricing. In focusing on pricing and competition, the ACCC also sought to identify and address any potential anti-competitive activity in the industry after it had taken court action against petrol retailers in 2005 and 2007 for price fixing.⁴

32. While the ACCC's 2007 inquiry⁵ found the supply and wholesale fuel sectors had a relatively high degree of market concentration, it also found that there was a significant degree of price competition at the retail level. It further identified at the time that there was a significant level of vertical integration that influenced retail pricing and that the main influence on Australian retail petrol prices was the price of the international benchmark (the price for refined petrol in Singapore – Mogas 95). It also commented that there was a significant amount of misinformation in the reporting of petrol prices, which was not supported by evidence. In conclusion, the ACCC highlighted the need for reliable and objective information to be made available to consumers.

33. In response to the ACCC's findings, the Government directed the ACCC to undertake formal monitoring of the prices, costs and profits of unleaded petrol for a period of three years until the end of 2010. This was later extended until the end of 2012. This monitoring role is in addition to the ACCC's responsibility to enforce anti-competitive conduct and consumer protection laws across Australia, including in the fuel industry.

34. In performing its monitoring functions, the ACCC collects and examines retail prices of petrol, diesel and automotive LPG in all Australian capital cities and in around 150 regional locations. It reviews these prices and compares them with the respective international benchmarks. It also obtains cost and profit information from the petrol companies and uses this to compare Australian prices, costs and profits against international benchmarks.

35. If ACCC analysis indicates there are factors impairing competition in fuel markets, it can alert the government and community. As a requirement of the ministerial direction to monitor prices, the ACCC provides detailed reports of its findings to the Government which are also made available to the Australian public.⁶

36. The key findings of the ACCC's 2011 Monitoring Report include:

- Australian consumers pay a price for petrol that is, on average, reflective of the relevant international benchmark prices.
- Australian pre-tax petrol prices reflect international prices and thus are very similar to prices paid by consumers in other countries.

⁴ Ballarat price fixing, 2005 - *ACCC v Leahy Petroleum* (No. 2) [2005] FCA 254 & *ACCC v Leahy Petroleum* (No. 3) [2005] FCA 265. Brisbane price fixing, 2007 - *Australian Competition and Consumer Commission v Gullyside Pty Ltd* [2005] FCA 1727. Geelong price fixing, 2007 - *Australian Competition and Consumer Commission v Leahy Petroleum Pty Ltd* [2007] FCA 794.

⁵ Petrol prices and Australian consumers: Report of the ACCC inquiry into the price of unleaded petrol, December 2007.

⁶ Monitoring of the Australian petroleum industry: Report of the ACCC into the prices, costs and profits of unleaded petrol in Australia, December 2011.

- ACCC analysis has found that in Australia, as in most developed countries, petrol prices reflect international market prices and the local currency's value relative to the US dollar.
- Overall, the ACCC has not found evidence of excessive profits in the Australian downstream petrol industry, with rates of return in most sectors comparable to other manufacturing industries and petrol industries in other countries.

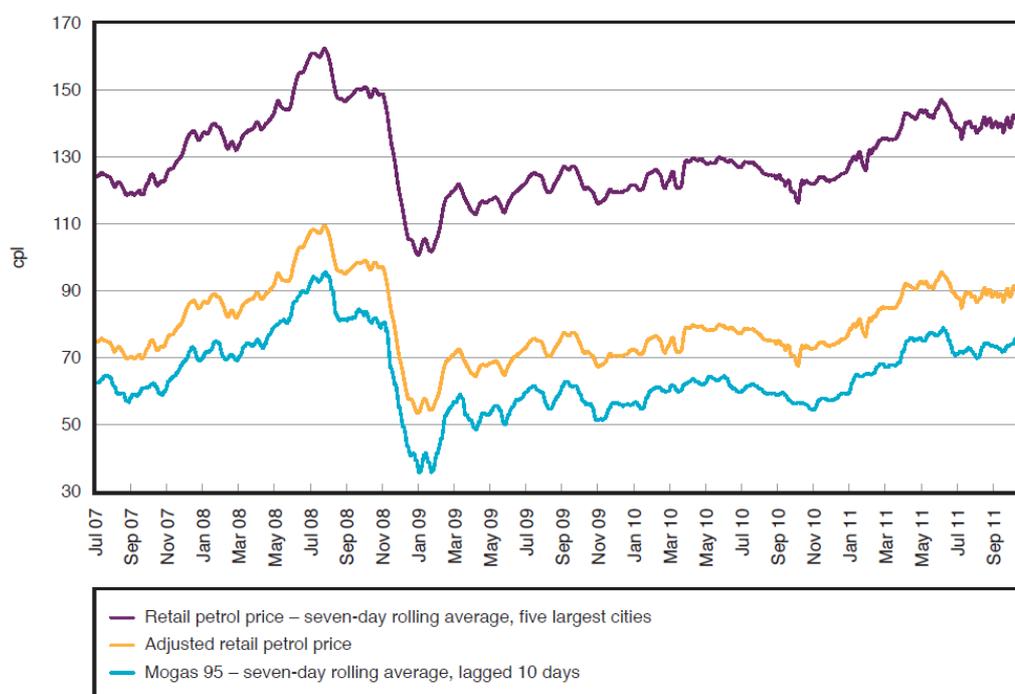
37. When prices increase, competition agencies often come under pressure to “do something” about prices. This is particularly the case with a high frequency, high profile purchase such as fuel. Calculating the contribution of different factors to retail petrol prices is complicated and not widely understood by the average Australian consumer. The key role that international prices plays in influencing retail petrol prices in Australia has been a key message that the ACCC has attempted to deliver to the public.

38. While local petrol companies are free to set prices in the market, fuel is an internationally traded commodity and a significant quantity of Australia's fuel is supplied by imports. As a result, local market prices are primarily influenced by the international price of refined petrol (the import parity price) and tax (excise and GST), which are both outside the control of the local petrol companies. Accordingly, the key drivers of fuel price changes in Australia are changes in international benchmark prices and the exchange rate.

39. Where price rises are not a result of unlawful practices but reflect increases in commodity prices set by international markets, the ACCC does not have the authority, and nor would it be appropriate, for it to intervene.

40. The ACCC has made it clear that changes in the international price of refined fuels and crude oil have been overwhelmingly responsible for movements in retail petrol prices. The components of fuel prices attributable to excise and GST and the pricing decisions of local petrol retailers have been relatively stable.

Daily retail petrol prices, adjusted retail prices and Mogas 95 prices: 1 July 2007 to 30 September 2011



Source: ACCC calculations based on Informed Sources, Platts and Reserve Bank of Australia data

41. As the chart above illustrates, ACCC analysis has shown that petrol prices have generally been in line with the underlying costs of supply and international benchmarks.

42. By making comparisons with the retail prices in other countries, which show very similar movements in prices, it can be shown that changes in prices are driven by international price movements, not generally by local competition issues.

43. This may reduce the likelihood that community concern over volatile prices results in competition and regulatory authorities becoming involved in what is in reality the efficient operation of the price mechanism.

3. Conclusion

44. Australia considers that a robust competition policy framework is a vital tool for ensuring the efficient and effective operation of markets, including commodity markets. Such a framework includes: the evaluation of markets to ascertain whether structural barriers exist, a robust and effective competition law and other policy tools to address impediments to the effective and transparent operation of markets. Such a framework will minimise the need for economic regulation and other tools for monitoring behaviour in specific markets.

45. In Australia, public concerns about price volatility particularly within the retail fuel market, can translate into calls for new regulations or changes to competition laws. Although unstable prices do not necessarily reflect a competition problem, a lack of public information about the underlying causes of price volatility can create such perceptions.

46. In addressing public concerns about unstable prices, Australia works to ensure that markets are generally efficient through a range of mechanisms to encourage competition. To this end, the ACCC plays a critical role in promoting competition and protecting consumers from anti-competitive behaviour.

47. Where price movements in a market largely reflect international factors rather than a lack of local competition, Australia considers that it is important to educate consumers of these factors in order to promote confidence that the market is working effectively.