COUNTRY PETROL PRICING: EVIDENCE AND RECOMMENDATIONS

Greg Walker
Regional Economic Research Unit, Charles Sturt University - Mitchell, Bathurst, NSW, Australia

Tom Murphy
Regional Economic Research Unit, Charles Sturt University - Mitchell, Bathurst, NSW, Australia

John Hicks[1]
Regional Economic Research Unit, Charles Sturt University - Mitchell, Bathurst, NSW, Australia

ABSTRACT This paper examines the evidence presented at three recent inquiries into petrol pricing. The paper argues that, contrary to some claims, the country - metropolitan petrol price differential is both significant and potentially damaging to country economic development. The causes of this price differential are examined and the implications for country Australia of the recent ACCC recommendations for reform of this essential industry are considered.

1. INTRODUCTION

Country petrol prices have received considerable attention in recent years with the conduct of several major inquiries into the petroleum products industry. Foremost amongst these have been the Industry Commission Inquiry (IC, 1994) and the Australian Competition and Consumer Commission Inquiry (ACCC, 1996). In addition to these two national inquiries, which had a broad national industry focus, the NSW Government commissioned an inquiry specifically directed at rural petrol prices in NSW (Parry, 1995). Although both the extent to which higher petrol prices exist in country areas and the economic factors responsible have been considered by each of these inquiries, some of the interpretations and conclusions drawn are questioned in this paper. It is also suggested that the importance of these issues for regional development have not been fully understood by many of the participants in the debate generated by

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these inquiries. In addition to the effect that higher fuel prices may have on the actual operating costs of regionally located businesses, the impact on prospective investors in regional areas may be of considerable importance for regional development. If the cause of higher petrol prices is seen as being related to problems within the regional economies themselves, an image of a backward local economy, beset with inefficiency and lacking in competition, could act as a positive disincentive for business to invest outside metropolitan Australia.

2. THE MAGNITUDE OF THE COUNTRY PETROL PRICE PROBLEM

A clear indication of the extent of the country price differential is provided in the survey data reported in IC (1994) which was also used by ACCC (1996). Table 1 extracts survey prices for a number of metropolitan areas compared with several large country cities in NSW. Each of these country cities has, by country NSW standards, a relatively large population base, a vibrant local economy and a major highway location with volume passing traffic. Hence cost and demand structures are more likely to approach those in metropolitan areas. The retail price differential in the third column is the difference between the average retail price for the city or town and the average metropolitan price. The fifth column measures the notional retail margin by subtracting the ACCC maximum endorsed wholesale price (MEWP), including the allowable freight differential and State franchise fee, from the surveyed retail price.

It is important to recognise that the MEWP in Table 1 measures the regulated maximum and not the actual wholesale price. Instances of negative notional retail margins highlight the fact that some retail locations are, on average, charged less than the maximum wholesale price.

Table 1 reveals considerable variation in average prices and margins between non-metropolitan locations but little variation between metropolitan locations. This is not to be confused with price volatility which has been demonstrated (Parry, 1995) to be significantly different between metropolitan and non-metropolitan locations. Metropolitan prices are quite volatile and display a cyclical pattern which is not evident in non-metropolitan prices; a factor not captured by the average price level data in Table 1.

In order to highlight the variation in average price levels, the country locations are divided into two groups. Group A comprises country cities that have similar pricing structures. Group B comprises four country locations with a history of lower than average country retail prices. The latter group provides examples of exceptions to the average country experience that should not be allowed to distort comparisons of average country and metropolitan prices.

Prices in each of the four locations in Group B reflect peculiar local market conditions. Lismore prices are influenced by Lismore's proximity to Queensland and a consequent exemption from the State franchise fee. This is evidenced by the ACCC (PSA) maximum wholesale price for Lismore being significantly lower than that for the country cities in Group A. Similarly Coffs Harbour enjoys a 40 per cent reduction in the State franchise fee. Prices in Maitland and Nowra are

Table 1. Average NSW Petrol Prices, Oct 93 to Jan 94[a]

City or Town	Average Retail	Retail Price Differential	Average MEWP[b]	Notional Margin
Metropolitan				
Sydney	67.30	-0.83	67.53	-0.23
Gosford	68.91	0.78	68.33	0.58
Newcastle	69.84	1.71	67.53	2.31
Wollongong	66.48	-1.65	67.53	-1.05
Average Metro	**68.13**	-	**67.73**	**0.40**
Country A				
Armidale	77.75	9.62	68.52	9.23
Bathurst	75.92	7.79	69.13	6.79
Dubbo	77.60	11.50	67.10	10.50
Orange	78.07	9.94	69.53	8.54
Tamworth	76.91	8.78	69.43	7.48
Wagga Wagga	78.34	10.21	70.13	8.21
Average Country A	**77.43**	**9.64**	**68.97**	**8.46**
Country B				
Coffs Harbour	73.82	5.69	67.82	5.99
Lismore	71.89	3.76	63.40	8.49
Maitland	69.87	1.74	67.93	1.94
Nowra	65.30	-0.80	65.40	-0.10
Average Country B	**70.22**	**2.6**	**66.14**	**4.08**
Average Country A+B	**74.55**	**6.82**	**67.84**	**6.71**

Notes: (a) All data in cents per litre

(b) The maximum endorsed wholesale price for fuel delivered at locations throughout Australia includes State franchise fees and allowances for freight charges (the freight differentials). The four major oil companies are required to notify the ACCC of intended price increases. The ACCC will endorse these price increases if they are below the indicator price level calculated by the ACCC and based on international parity prices.

Source: NRMA Submission to *Industry Commission Inquiry* for period 4 October 1993 to 31 December 1993. For Dubbo and Nowra, source is NSW LGSA submission to *Industry Commission Inquiry* for period 14 December 1993 to 21 January 1994. Retail price differential is based on average metropolitan prices for each survey period.

influenced by their proximity to the competitive metropolitan markets of Newcastle and Wollongong. For country cities in Group A, however, the average retail price is a significant 9.64 cents per litre, or 14.1 per cent, higher than average metropolitan retail prices.

Crucial to an appreciation of the data is the distinction pointed to by the *Industry Commission* between notional retail margins (and prices) in the densely populated coastal region (Sydney, Newcastle and Wollongong, and nearby centres such as Maitland, Gosford and Nowra) and that in the rest of NSW. Restricting the focus to regions outside the populated coastal region provides a much clearer picture of the country price problem. It is with respect to regions such as these that the *Industry Commission* commented " ... petrol prices ... seem unreasonably high ...” and the notional retail margin (the average retail price - maximum wholesale price gap), “ ... exceeded what could be considered to be a reasonable retail margin.” (Industry Commission, 1994, p. F.5).

Parry (1995) did not draw this country - greater metropolitan distinction in his analysis and subsequently concluded that the extent of the country prices problem was exaggerated. It has been argued elsewhere (Murphy *et al.*, 1996) that, in addition to this classification distortion, Parry’s analysis was also biased by placing undue emphasis on selective examples of relatively high price city outlets, and overly relying on data analysis drawn from charge card data which will understate normal country prices to the extent that it includes fuel card data.

The ACCC, in addition to examining the survey data presented to the Industry Commission Inquiry, noted a similar effect with Victorian country petrol prices. Based on survey evidence it presented to the ACCC, the Shell Oil Company argued that “country prices are not out of line with city prices” (ACCC, 1996b p. 82). However the ACCC found that, if the price data for Geelong were removed from the country classified group, then the price differential increased markedly (from 4.3 to 7.3 cents per litre). The ACCC therefore concluded that, “... there are often substantial differences between retail petrol prices in major cities and those in country areas,” and that whereas country consumers may expect to pay higher prices based on justifiable freight costs, “ ... as freight differentials do not generally exceed 3.0 cpl, a substantial residual amount is often left unexplained” (ACCC, 1996, p. 93).

It is therefore considered that the evidence supports the claim of a significant country petrol price differential, and a consideration of the factors responsible for this price differential is now examined. Here the crucial point is whether or not the causal factors reside with structural deficiencies within the local country economies or the wider industry itself.

3. CAUSES OF THE COUNTRY PRICE DIFFERENTIAL

Discussion on the causes of the country prices differential focuses on “local factors”. The local factors explanation includes a number of local industry deficiencies: (i) country communities have too many service stations and therefore existing retailers lack access to economies of scale; (ii) there is insufficient investment in the industry resulting in country distribution networks that are inefficient, (iii) country service stations have less ancillary operations such as shops and car washes that subsidise revenues from city petrol sales; (iv) for some country markets, the pricing pattern is also claimed to be indicative of tacit collusion and a lack of vigorous competition. In essence these factors suggest both that cost inefficiencies and local competition deficiencies are to blame.

The Parry and Industry Commission Inquiries supported the local factors explanation. The ACCC extended this explanation to include other additional factors related to vertical relationships in the industry, such as the absence of wholesale price discounting in country areas and cross subsidisation of lower charge card margins by posted retail price margins (ACCC, 1996, p. 94). Fundamentally however the ACCC still believed the underlying cause was competition related, arguing that, "retail prices in most country centres would be lower if there was vigorous and effective competition" (ACCC, 1996, p. 96).

This paper extends the analysis of available survey data by means of a cross sectional regression of the survey data provided by the NSW LGSA in their submission to the Industry Commission Inquiry. The data cover country towns in NSW outside of the greater metropolitan area and include towns represented in the Country A and Country B classifications in Table 1. Summary statistics are given in Table 2. The dependent variable is the notional retail margin derived as in Table 1 (the difference between retail prices and the maximum endorsed wholesale price plus freight differentials and State franchise fees). Explanatory variables are the average population per outlet in each location (a proxy measure for potential economies of scale), the distance from Sydney (and hence proximity to competitive markets) and dummy variables for major highway location (increased sales from non local motorists) and independent operators.

The major result from this analysis is the significance of the distance and the independents explanatory variables. Given that the margins are derived after freight charges have been deducted, and both Parry (1995) and IC (1994) regard the ACCC freight differentials to be adequate, the distance variable should be expected to have a neutral impact on country prices. Here the retail margin rises by approximately 0.5 cents per hundred kilometres distant from Sydney. The significant positive coefficient is interpreted as indicative of an absence of competitive forces; that is, the further one is distant from the influence of the competitive Sydney market, the less is the incentive for competitive pricing and hence the higher the retail margin. This result also indicates that the country - metropolitan price differential, and hence the country price problem, is greatest in those regions that are more distant from the Sydney area. The significant negative coefficient for the independents dummy variable confirms the expected impact that independent operators have on local markets. Notional retail margins are usually very low and often negative in such markets and the major brand outlets are usually charged a lower wholesale price (under a price support system) in order to compete. Here the presence of independents lowers retail margins by an average 5.4 cents per litre. Given the tendency for independents to concentrate on metropolitan locations and their limited penetration into country areas, there is a potential collinear relationship between the two variables. However in this case there is no statistical evidence of multicollinearity from this source in the regression. Even so, a priori the presence of independents is associated with competition and the proximity of the limited number of independents to the greater metropolitan area in this study reinforces the argument that competition declines progressively as local markets are more distant from the competitive Sydney market.

The proxy measure for sales volume (average population to outlet ratio) generated a positive but non-significant sign. As a measure of economies of scale, the hypothesised sign of this variable is ambiguous. A higher average population

Table 2. Descriptive Statistics - Regression Analysis of Country Petrol Prices

Variable	Number	Mean	Standard Deviation	Minimum	Maximum
Margin	70	7.63	2.67	-1.32	13.03
Population	70	9,792	12,469	465	55,000
Outlets per location	70	7.91	5.76	1	27
Distance (kms)	70	477	212	79	1,160
Average Population per Outlet	70	996	696	155	3,830

Average Population per Outlet scaled to units of 1,000 and distance scaled to units of 100 kilometres in regression.

Table 3. Regression Analysis of Country Petrol Prices

Constant	Avg Popn	Distance	Highway	Independents
5.363	0.364	0.485	- 0.382	- 5.415
(6.56)*	(1.02)	(3.86)*	(- 0.75)	(- 4.17)*
	$R^2 = 0.46$	F = 13.66*	D-W = 2.24	

t-values in brackets. * Significant at the 1% level. Average Population per outlet in units of 1,000. Distance in units of 100 kilometres.
Data Source: NSW LGSA submission to *Industry Commission Inquiry* for period 14 December 1993 to 21 January 1994.

to outlet ratio may reflect both an opportunity to operate with lower retail margins, due to economies of scale, and an opportunity to extract higher retail margins from market power deriving from the smaller number of competing outlets.

The highway dummy variable generates the expected negatively signed coefficient but is also statistically insignificant. Other explanatory variables examined were the population of the local town (a proxy measure of market size) and the number of retail outlets in the local town (a proxy measure of local competition). However these two variables generated multicollinearity problems and hence were dropped from the estimating function. Spatial autocorrelation was also rejected at the 5 per cent level by a standard Durbin Watson test.

These results are generally consistent with those obtained by Longmire (1995) in a cross sectional regression analysis of Queensland regional petrol prices. He also found a strong positive relationship between price differentials and the distance of country locations from the capital city (Brisbane) fuel source. Although his study did not measure notional margins (price differentials net of freight and State franchise fees), Longmire still concluded that the price differentials exceeded those which could be justified by freight differentials. Of interest is his finding of no significance for the presence of other service factors such as self service, fast food products and specialised fuel outlets. This finding contradicts another of the "local factors" arguments. Contrasting results are evident with respect to economies of scale where a significant relationship is found between Longmire's proxy measure of sales volume (the number of fuel hoses at each outlet) and his measure of market power (the number of outlets per 100 km calculated on a moving average basis). Attempts to capture market power and economies of scale in this regression gave insignificant results for the proxy measures. The question remains however as to whether either study has correctly captured these two factors with their respective proxy measures.

In summary, whereas the results from both studies are mixed with respect to support for the local factors explanation, strong support is found for the claim that the country price differential increases with the distance from the capital city market. The extent to which this can be accepted as a reflection of diminishing competitive influence can be taken as support for the ACCC claim that the country price problem would be lessened by increased competition in country areas. The significant impact of independents suggests that the introduction of more independents into country areas may be the means by which increased competition can be achieved in country areas.

4. THE ROLE OF REGULATION AND VERTICAL RELATIONSHIPS IN THE INDUSTRY

The local factors explanation of Parry (1995) and IC the (1994) focuses exclusively on cost structures and horizontal competitiveness between retailers. However this explanation ignores the competitive effects of the vertical relationship between the petrol suppliers (the oil majors) and country retailers. This relationship is important because of the questionable level of competition in the industry. With now only four major oil companies in Australia (Australian Petroleum Pty Ltd, BP Australia Limited, Mobil Australia Limited and The Shell Company of Australia Limited), the industry has an oligopoly structure controlling a strategic product for Australian business and household needs. The oil majors have considerable market power with the potential for collusion and the extraction of monopoly profits. This market power has been recognised by government and a range of regulations have been imposed in an attempt to curb its potential.

The Petroleum Retail Marketing Franchise Act (1980) sets minimum conditions for retail franchise agreements. *The Petroleum Retail* Marketing Sites Act (1980) limits the number of retail sites that may be owned and operated by the oil majors. The Franchise Act was introduced to address the imbalance in negotiating power between small retail franchise operators and the oil majors and the Sites Act was intended to reinforce the Franchise Act by preventing the oil majors from adopting a total company owned and operated retail network. However, despite the clear intention to curb the market power of the majors, there is strong evidence that these Acts have not prevented vertical control of the industry by the oil majors and that perversely they may have added to the cost inefficiencies in the industry by inhibiting investment and rationalisation, especially in country retail networks (ACCC, 1996, p. 131).

For country Australia the most important of these regulatory measures is the

Intervention Pricing System (see IC, 1996, p. 4-5). Under this system the four major oil companies are required to notify the ACCC of intended price increases which the ACCC will endorse if the prices are below the indicator price levels calculated by the ACCC. In this way the maximum endorsed wholesale price of fuel (MEWP) is capped throughout the country with variations allowed for differential freight charges and State franchisee fees.

This system is a significant contributor to the country price differential. The problem being that the settings for determining the MEWP are too loose. Metropolitan retailers are frequently charged less than the MEWP. This is amply illustrated by the SSA survey data in Parry (1995 Attachment 2) that derives a notional retail margin for Sydney stations of only 0.01 cents per litre and the Industry Commission survey data reproduced in Table 1 of this paper. The latter shows a notional retail margin of -0.23 cents per litre for Sydney stations and a margin of only 0.40 cents per litre for stations in the densely populated greater metropolitan region stretching from Newcastle to Wollongong. These notional margins of roughly zero indicate that stations in the greater metropolitan area were on average receiving wholesale price concessions, probably under the guise of price support from the oil companies but which, regardless of their label, amounted to these stations being charged a lower wholesale price for the period of each of the reported surveys.

Supporting evidence on this practice is provided by a survey of individual trading records of retail outlets for the 1994/95 financial year. The survey data covering 10 outlets, 3 from one country region and 7 from the greater metropolitan area, were provided to the authors on a confidential basis. The metropolitan outlets are widely distributed over the greater metropolitan region, ranging in location from the greater Newcastle area to the southern suburbs of Sydney. The 3 country outlets are relatively large sites with highway locations, with average volume of 279 kilolitres per month (ranging from 229 to 346 kpm). In this regard they are comparable in size with the 7 metropolitan outlets whose average volume was 352 kilolitres per month (ranging from 174 to 558 kpm). The outlets are franchised to two of the four major oil companies.

With respect to the above question of average metropolitan margins, the 7 outlets revealed an average margin of 4.0 cents per litre (ranging from 2.7 to 5.7). This result supports the claim that expected average retail margins would be higher than that reported from the charge card data in the Parry Report. Similarly, gross margins derived prior to price support averaged only 0.73 cents; which is comparable in magnitude to the average notional margins reported in Table 1 using Industry Commission survey data and derived by subtracting the MWEP from the retail survey price. With respect to price support, the situation varied somewhat more than might have been expected between the 7 metropolitan outlets. Only one of the 7 outlets was not in receipt of price support. For the other 6, price support and other rebates varied from an average over the year of 1.5 cents to 5.2 cents per litre. It appears that one important factor in determining the extent of price support is the relationship between the oil company and the franchisee and the future plans that the oil company may have for the particular site. Some outlets appear to have a more supportive relationship with their oil company than do others.

To address the extent of the country price problem, the retail and wholesale prices for country and metropolitan outlets were compared. The average country retail petrol price for the period was 76.0 cents per litre and the average metropolitan retail price for the period was 67.2, giving an average gross retail differential of 8.8 cents per litre. Allowing for net differences in freight charges of 1.4 cents per litre, the unexplained component of the average country - metropolitan retail price differential for the year was 7.4 cents per litre. It is this component that provides a measure of the country pricing problem for this survey.

The local factors explanation of the Parry and Industry Commission Inquiries is that this differential is accounted for by higher retail margins in the country community. This claim is partially borne out by the finding of a higher average retail margin for the country outlets; 5.8 cents per litre compared to 4.0 cents per litre for the metropolitan outlets, a difference of 1.8 cents per litre. However, after correcting for higher freight charges and higher average retail margins, the retail price differential of 8.8 is reduced to 5.6 cents per litre, a figure that must be explained by wholesale price discrimination and not local factors. To put it in another way, gross average wholesale prices are 68.5 and 66.1 cents per litre, the difference reflecting ACCC net freight differentials, but average wholesale prices after freight charges and oil company support are included, change significantly to 70.2 and 63.2 cents per litre; a difference of 7 cents per litre. Allowing for a justifiable net freight difference of 1.4 cents per litre, this leaves an effective price subsidisation of metropolitan areas, in the form of lower average wholesale prices, of 5.6 cents per litre.

As is claimed by all three Reports, other income sources, expressed on a cents per litre of petrol sold basis for purposes of comparison, were less for the country outlets, at an average of 6.1 cents per litre relative to 10.1 cents per litre. This factor generates a higher average overall trading profit return for the metropolitan outlets, 14.3 cents per litre compared with 12.7 cents per litre for the country outlets.

Although this analysis is based on a small case study of a limited number of outlets, it does provide support for the claims that; (i) there exists a country price problem of significant size, (ii) the country - metropolitan price differential is only partly explained by higher retail margins in the country areas, and (iii) a significant contributing factor in the higher country prices is the higher wholesale price charged to country retailers by the oil companies.

The ACCC intervention pricing formula reinforces what is an effective subsidisation of metropolitan wholesale prices. Both Parry (1995) and IC (1994) acknowledge that certain components of the intervention pricing system formula are too generous. As a result, discounts below the ACCC's MWEP are possible. From the country community's point of view, the effect of the MWEP is to provide a regulation-backed justification for charging a price that is above the market price charged in the more competitive city market. This explains, as mentioned above, the existence of very low or even negative notional retail margins in the city. They are the result of city service stations being charged less than the maximum wholesale price. Clearly, even within the narrow focus of payments for petrol, the existing regulations have not only failed to protect country petrol consumers from the market power of the majors but have given the majors a platform on which to exercise that power.

In addition to the payments for petrol, which is the focus of the ACCC's regulations, there is a second flow of payments from retailers to oil majors in the form of rent (calculated increasingly as a percentage of the gross margin on petrol sales plus a percentage of the turnover on all other sales), franchise fees, inspection fees, credit charges and brand fees. These charges are not controlled by the ACCC. Clearly there is opportunity for the oil majors to use such charges as a means to further exploit their monopoly power. Specifically, it is a path by which oil majors can clawback for themselves any additional profits that arise from local factors associated with country markets.

However, in the survey discussed above, despite the evidence of higher country retail petrol margins, overall the country stations were less profitable, recording an average net profit rate of 1.8 cents per litre compared to 2.7 cents per litre for their metropolitan counterparts. As mentioned above, the major contributing factor to relative profitability was the greater income from other sources that derives to metropolitan stations. The only other element in the profit equation, that of expenses (other than those paid to the oil companies) such as wages electricity and bank charges, were on average roughly equal at 11.0 cents per litre for the country stations and 11.5 cents per litre for the metropolitan stations. Consistent with the general clawback thesis, it was the more profitable metropolitan stations that paid higher per litre site charges to their oil companies (4.2 cents per litre compared with 2.5 cents per litre for the country stations). Of note was the wide range of site payments stations. The country stations had payments ranging from 1.0 to 4.4 cents per litre and the metropolitan stations a range of 2.8 cents per litre to 6.4 cents per litre.

However, overall in this survey, the major contributing factor in the country - metropolitan price differential was the higher wholesale price charged to the country stations. It was by this mechanism that any excess profitability arising from the country market was extracted. This could be expressed in terms of overall payment to oil companies as a ratio of turnover: an average 79 cents per dollar of country turnover compared to 70 cents per dollar of metropolitan turnover.

Wholesale price discrimination and the clawback mechanism operating in country regions will have a number of negative impacts on country Australia. These are:

- a transfer of monopoly profit from the bush to the city which cannot be justified
- the entrenchment of collusive practices by country service stations by the oil majors
- the discouragement of investment in upgrading country service stations as

any resulting additional profits will at best be shared with the oil majors.

- scope for oil majors to increase site charges in such a way as to exert a uniform upward pressure on prices that does not disturb market share even though the increases in charges may differ in detail between majors and hence may not appear collusive.

To the extent that the oil majors have the ability to expropriate a significant proportion of the notional retail margin, they also have no incentive to encourage retail price competition in country areas. Once clawback and a counter-productive regulatory system are included in the explanation of high retail prices in country Australia, the country petrol price problem can no longer be dismissed solely in terms of "local factors" based on ineffective local competition and inefficiencies. An integral part of the country petrol price problem is multinational companies exercising monopoly power on a substantial region of Australia, aided and abetted by an ineffective, even counter-productive, regulatory system. The problem is very much an issue for petrol competition policy and therefore was a matter of concern for the ACCC Inquiry.

5. ACCC INQUIRY RECOMMENDATIONS

The ACCC Inquiry's recommendations are consistent with those of both the Industry Commission and the Parry Inquiry to the extent that they call for the removal of the various components of the current regulatory package including the intervention pricing system, the Franchise Act and the Sites Act. However behind the common deregulation call, there is a significant difference in approach between the ACCC and the other two inquiries. Unlike the IC who concluded that "there is effective competition in most petroleum product markets" (IC, 1994, pp. xviii-xix), the ACCC is not convinced that the industry is competitive. On the contrary, the ACCC accepts that the oil majors have "substantial market power" derived from an industry structure that is highly concentrated, has high entry barriers and because of the "breadth and depth of the horizontal and vertical relationships that have developed" (ACCC, 1996, p. 137). However the ACCC believes that conditions in the market are changing and that in the future the industry will be strongly influenced by "independents and independent importing" (ACCC, 1996, p. 137). The ACCC recommendation for deregulation is hence underpinned by a hope that future competition will be injected from these two sources. However it is not basing its recommendations entirely on its faith in the competitive market model. Rather it has qualified its key recommendation, that of removal of the intervention pricing system, by making it subject to certain adjustments taking place within the industry. Key amongst these adjustments are "further rationalisation of country retail sites and the development of imports as a viable competitive force" (ACCC, 1996, p. 132). A transitional period extending into 1997 is envisaged during which the ACCC will require evidence that such adjustments are taking place.

6. IMPLICATIONS FOR COUNTRY AUSTRALIA.

The ACCC thus intends to use its regulatory powers under the Prices Surveillance Act as a bargaining chip with the oil majors to enforce rationalisation and prevent barriers to independent entry being established. Under the ACCC vision the future force for competition and hence lower prices for country Australia depends very much on the entry of independents, underpinned by imported supply, into country Australia. Although evidence supports the impact of independents on prices in metropolitan markets in recent years (ACCC, 1996, p. 71), their continued impact depends very much on access to long term competitively priced supply. Hence imports are considered crucial if an independent source of supply for new entrants is to be guaranteed at competitive prices.

To date, the track record for independent importers in Australia is not impressive. Only two of the five importers present in 1990 are still importing. Of these five, two have been acquired by oil majors and one has ceased importing after experiencing severe price competition. (ACCC, 1996, p. 13). Access to terminal and storage facilities plus economies of scale form significant barriers to entry for importers. However, despite these problems, the ACCC is confident that both existing independent retailers and potential new independent retailers with substantial capital resources are considering importing (ACCC, 1996, p. 57). Import terminal facilities may be available following the Caltex-Ampol merger and there are forecasts of low priced refinery operations in the South East Asian region that could form a source of imported fuel.

But what are the prospects for independents moving into country markets? Would not larger volume metropolitan markets be more attractive to independent discount retailers? The ACCC makes frequent reference to country areas in defending its recommendations, and hence country Australia might trust that their interests will be promoted by the ACCC in any bargaining games that might occur with the oil majors. However, whereas this approach may force more prompt action on country site rationalisation, it is not likely to have much impact on the speed with which independents spread to country areas. The ACCC can only hope that "given time, independents ... may establish retail outlets in provincial cities and towns, thus extending the pricing effects" (ACCC, 1996, p. 14).

The competitive process may be enhanced if, as the ACCC suggests, local and State governments actively encourage new retailers such as supermarkets to enter the industry. Local government might also consider direct representation to independent retail chains to locate in country areas. Assistance with development applications and zoning regulations might be called for to entice the independents to look beyond the metropolitan areas. Vacant retail sites are already available in both country and metropolitan areas and more will become available if, as the ACCC expects, rationalisation is accelerated in country areas. One difficulty with respect to local authorities being involved in this process is, however, the possible political reaction from a local business community that sees its members and employees being closed down by elected local bodies. It may be easier if remote oil companies are seen to be the ones who rationalise local businesses.

Another industry phenomenon already emerging in country areas is multi-site franchising (MSF). Under this system, which the oil major are embracing in metropolitan Australia, one franchise operator will control multiple outlets. For example, Shell has established MSFs that exceed 30 sites whereas Mobil has established MSFs that typically cover 5 to 10 sites (ACCC, 1996, p. 37). One would expect that if pressure is successfully applied by the ACCC on the oil majors to increase the pace of rationalisation in country areas, this would increasingly take the form of MSF operations. In effect therefore, many country towns, both large and small, would see their local industry reduced to only four operators. If the expected removal of the intervention pricing system in 1997 is added to this scenario, in addition to the possible failure of independent penetration into many country areas, then the competitive state of the local market could worsen.

Although the argument that the current intervention pricing system has provided a platform for wholesale price discrimination against country areas is supported in this paper, this is not to say that the system has not had some benefit in limiting the extent of this discrimination and the overall level of prices. As the ACCC itself concludes, although "it is difficult to assess the precise effects of price regulation, ... it seems likely that the system has achieved a net benefit, helping to restrain the average level of prices below what might otherwise have prevailed" (ACCC, 1996, p. 137).

Ironically the major risk in the ACCC strategy for country Australia is that, in order to force restructuring and improved efficiency in country markets, it may have to honour a commitment to remove the intervention pricing system cap. However this act may in itself generate a less competitive market structure which, if independent penetration does not eventuate, will leave country areas without the protection of pricing regulation. As its strategy has a greater probability of succeeding in metropolitan areas, the ACCC may unwittingly contribute to a long term worsening of the country petrol price differential.

Local communities should thus do all that is in their power to improve the competitive structure of their local markets along the lines outlined by the ACCC, including such things as: price monitoring, formation of buyer groups, facilitation of alternative sources of retailing and direct enticement of independent chains. In addition they should maintain political pressure on the ACCC to develop a fall back strategy for country areas should its independents-based competitive strategy fail. Such a strategy might include the retention of selective intervention pricing for country areas that do not receive pricing reductions delivered to more competitive markets.

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