

Cost of motoring and a fair deal

for Western Australians

Cost of motoring and a fair deal for Western Australians

Our economy and the quality of life Western Australians enjoy are inextricably linked to the performance of our transport system and the ability to move around our State using safe, easy, and sustainable mobility options. Like public transport, cycling and walking, motoring is critical to the State's economic, as well as our individual, wellbeing. As such, motoring will continue to feature strongly in the lifestyles of Western Australians and not surprisingly, the cost of motoring remains a high priority issue for the community.

As a leading mobility advocate, RAC seeks to ensure people have access to secure and affordable sources of fuel to meet their transport needs. Western Australian motorists at the retail level consume more than three billion litres of petrol and diesel vehicle fuel annually. Fuel price increases of just a few cents may seem inconsequential, however when we consider the huge volumes of fuel sold, a seemingly small price increase has a major impact on revenue generated within the fuel industry and consequently, the collective pain felt at the bowser by Western Australians.

According to figures from the Department of Industry and Science, a one-cent increase in the average cost of petrol can cost Western Australian motorists \$20 million in a single year.

Fuel pricing—in a ‘nutshell’

The domestic price for fuel in Australia is linked to international fuel prices through the application of the import parity price (IPP), which is the landed cost of importing fuel derived from the international price of fuels sold in Singapore. The landed cost of petrol and diesel is calculated using IPP corresponds to the purchase price in Singapore plus the cost of international freight, insurance, loss and local wharfage costs.

The benefit of using IPP is that this method of pricing is not under the control of domestic fuel suppliers, and the Australian consumer pays the same price, based on import parity irrespective of whether supply is from domestic production or from imports. The IPP will automatically provide price adjustments (both upwards and downwards) based on the international price of the product in question.

The Terminal Gate Price (TGP) under WA legislation is based on either the actual landed cost paid in respect of an imported petroleum product, or an amount determined by the supplier in accordance with WA Order 2013 IPP formula, using Platts Singapore benchmark product price assessments. Platts are a recognised global energy pricing information provider and a division of McGraw Hill Financial.

The TGP is a notional maximum wholesale price at which controlled petroleum products, such as petrol and diesel, may be sold by a supplier from a declared terminal. The actual wholesale price at a terminal may be higher than the TGP due to post-terminal charges, or

may be lower depending on contractual arrangements and discounts between fuel companies, wholesalers, re-sellers and retail partner arrangements.

To develop the local TGP price, each day the previous seven-days' prices are averaged. This is called the rolling average, and is designed to 'flatten out' sudden changes in the price. The rolling average is then converted to Australian cents per litre (Acpl) and the final Acpl figure is used as the base price for the local TGP calculation.

Retailers set the retail fuel price, or the amount motorists pay at the pump. The retail price of a particular fuel is related to the underlying wholesale price for the particular batch of fuel delivered to the retail outlet. The retail price includes business costs, retail margins and taxes such as fuel excise which is currently 39.2 Acpl on unleaded petrol and 39.2 Acpl on diesel fuel. In 2014, the Federal Government reintroduced fuel excise indexation, whereby fuel excise is indexed against inflation and therefore increased twice a year.

A fair go for Western Australians

Most Western Australian's feel the effects of a range of interlinked industrial, political and natural resource factors operating simultaneously at both a local and international scale, through fluctuations in the price they pay for fuel. To further understand current and future fuel pricing and supply issues in WA, RAC commissioned independent expert advice to explore some of the structural and system issues related to fuel pricing.

1. “Rockets and feathers”

It is a commonly held view that an increase or decrease in the Singapore benchmark price for fuel should be mirrored by an increase or decrease in the WA TGP and retail prices. However, at some WA sites, the well-known oil industry adage on prices of “up like a rocket, down like a feather” can be observed when the TGP and retail price are compared over time.

At one regional WA fuel retailer, it took approximately 10 weeks for a reduction in retail petrol prices to occur following the marked decline in the benchmarks starting October 9th 2014.

Figure 1 below plots the prices (AcpL) for two different grades of petrol for a period of just under five months. It takes about 10 weeks for the fall in the price at which retailers could buy petrol to be reflected in the price motorists had to pay.

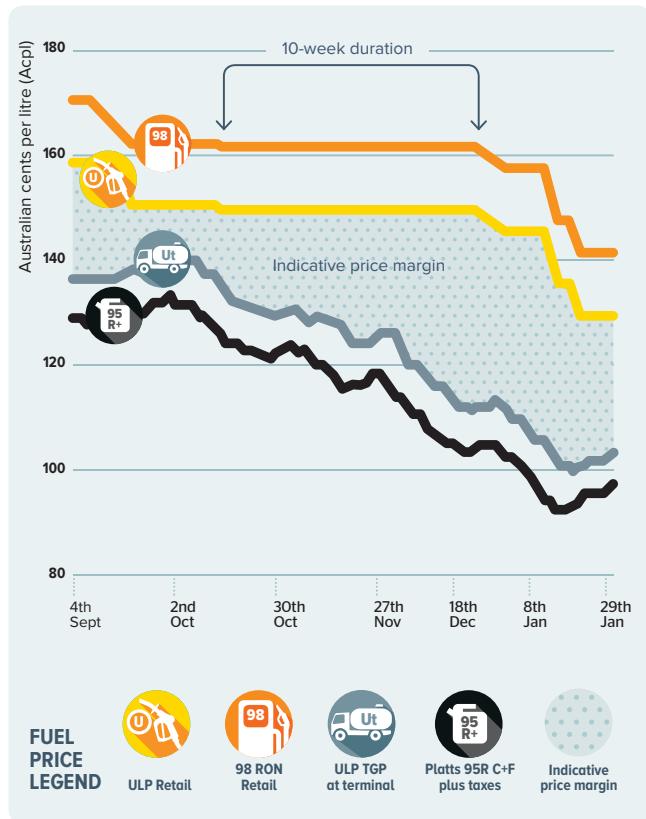


Figure 1 - Retail Petrol prices compared to TGP (regional WA town Sept 2014 - Jan 2015)

At sites in a different regional town, a similar reduction took approximately seven weeks. In other words, at these locations it took between seven and ten weeks for the fall in the price at which retailers could buy petrol and diesel to be reflected in the price paid by motorists.

One reason for this phenomenon in regional areas could be the slower turnover of fuel stocks. Put simply, the petrol in the tanks of regional petrol stations, purchased when the price was still high, takes far longer to sell out than in metropolitan areas, and therefore it takes longer for it to be replaced by the next tanker load purchased by the retailer at a lower price. This lag reflects the need for retailers, who may be small business people, to maintain their retail margins.

However, even after the price of fuel had fallen at these petrol stations the indicative price margin remained higher than before the fall in the benchmark price.

The Australian Competition and Consumer Commission (ACCC) in its role to prevent anti-competitive conduct, monitors fuel prices in all capital cities and around 180 regional locations. In 2014, in a move welcomed by the RAC, the Federal Government directed the ACCC to monitor the prices, costs, and profits relating to the supply of unleaded petroleum products and report at least quarterly for a period of three years.

There are other possible reasons for the observed regional price disparity, such as lower levels of competition in regional WA, as well as higher freight costs and periodic contractual changes for regional retailers that aren't clearly visible. The fact is, it is impossible to say with complete certainty why prices and retail margins do not always fall back in line with reductions in the TGP. This highlights the need for greater transparency in the fuel market. Consumer groups simply don't know enough about what happens to the price of a litre of fuel as it journeys from the bulk terminals through to depots and retail outlets and the reasons for the rises and falls in the prices motorists pay for fuel.

2. The untamed fuel

Fuel companies introduced the 98 Research Octane Number (RON) premium unleaded grade petrol into the Australian market in 2000-2001 to meet the demand from motoring enthusiasts for high performance cars with engines designed for 98 octane fuel.

Unleaded petrol carries a RON (Research Octane Number) rating which is used to measure 'knocking' resistance in spark-ignition internal combustion engines. 'Knocking', which can be heard as a 'rattling' or 'pinging' sound in the engine, occurs when parts of the air-fuel mixture prematurely ignite before the flame from the spark plug can reach it. 'Knocking' causes a decrease in performance and can also damage the engine. RON is determined by running the fuel in a test engine with a variable compression ratio under controlled conditions and comparing the results with those for mixtures of iso-octane and n-heptane.

When the 98 RON grade was launched in Australia, it only comprised about 1 per cent of the market, and as a "boutique" fuel, only supplied by a few fuel companies, it was termed a "proprietary product" and not included in the original *WA Petroleum Products Pricing Maximum Terminal Gate Price Order 2002*.

Today however, 98 RON petrol is available throughout WA from all suppliers and in 2014/15, the market share of 98 RON in WA increased to 12.1 per cent (or over 230 million litres).

Table 1 outlines the relative volumes and value of petrol sold in WA in 2014-15 for the three RON grades available in the market.

PETROL	MARKET (%)	VOLUME (kilolitres)	INDICATIVE AVG RETAIL PRICE (Acpl) for Perth Metro	MILLION (\$AUD)
98 RON	12.1	232,707	152	354
95 RON	13.2	254,161	146	371
91 RON	74.7	1,433,640	135	1939

Table 1 – Volumes and value of petrol sold in WA (FY 2014/15)

Recent pricing analysis commissioned by the RAC suggest the indicative margin for unleaded premium grade fuel is higher than for unleaded regular grade fuel. The pricing analysis also suggests that in future the sales volume of 98 RON may increase at the expense of 95 RON, particularly where WA retailers (especially in regional areas) do not sell 95 RON, as in the example shown in Figure 1.

Both 95 RON and 98 RON are premium unleaded grades of petrol, however only 95 RON is currently considered a ‘controlled’ product under WA petroleum pricing legislation and regulations. Consequently fuel companies are only required to report a TPG to FuelWatch² for 95 RON and not for 98 RON.

This has important implications from the motorist’s perspective because the amount fuel companies are paying for 98 RON in the wholesale market cannot be monitored from an assessment of the TGP. As a result, motorists have little indication of the retail margins that fuel companies are applying to 98 RON fuels. This is particularly important given the continuing increase in the proportion of 98 RON fuel sold whereby, the proportion of 98 RON fuel sold may exceed 95 RON in the next two years.

The growth in 98 RON market share is forecast to continue, possibly at the expense of 95 RON. Including 98 RON fuels in “Order 2013” would require a daily 98 RON TGP to be reported. This would improve price transparency at both the wholesale and retail levels.

It could potentially be straightforward for WA authorities to include the 98 RON grade since a range of 95 to 98 octane for premium unleaded petrol is designated in the definitions of the current *Petroleum Products Pricing Maximum Terminal Gate Price Order 2013*.

3. Comparing apples with apples

Fuel companies in Australia, with the acceptance of the ACCC, have established the use of the Platts 95 RON Benchmark for 91 RON ULP. This has not always been the case. During the transition to National Fuel Standards in 2000-2003 fuel companies also used Platts 92 RON for the 91 RON ULP benchmark.

The Singapore benchmark prices currently used are:

- › 91 RON ULP benchmarked against the Platts 95 RON benchmark
- › 95 RON PULP benchmarked against the Platts 97 RON benchmark
- › 98 RON PULP is not benchmarked

RAC’s investigations show that the benchmarks used to price fuel could be more relevant which, in the longer term, would provide greater transparency to those monitoring the fuel market.

Using more relevant Singapore RON benchmark approach would allow the Platts 92 RON benchmark to be used for 91 RON ULP and the Platts 95 RON benchmark to be used for 95 RON PULP. The Platts 97 RON benchmark would then be available as the benchmark price for 98 RON when this grade becomes a “declared” product (the untamed fuel).

Using the Platts 92 RON Singapore benchmark for pricing 91 RON ULP would not necessarily disadvantage fuel companies in Australia³ and while the proposed use of the Platts 92 RON benchmark for valuing 91 RON ULP could potentially only result in savings of a few cents per litre, for WA motorists as a whole, this would be a significant dollar amount.

Assuming “quality premiums” are not arbitrarily increased, a 15 Acpl difference in TGP differential would result in a saving to WA motorists of \$22 million per year. Year on year this reduction would result in total savings of at least \$110 million by 2020.

Changes to the benchmarks would eliminate the price distortion observed when 91 RON ULP is benchmarked against Platts 95 RON fuel. The difference between the Platts 95 RON and the Platts 92 RON benchmarks has already increased from about 0.5 Acpl in 2006 to the current level of around 2.5 Acpl today.

Towards greater fuel price transparency

While the global market will always be the most significant long-term influencer on fuel prices, there is strong evidence that there are opportunities to make our local market more transparent and rational. Merit exists in:

» Requiring TGP for 98 RON premium unleaded to be reported

To improve price transparency in WA at both the wholesale and retail levels, just as is the case with 95 RON, there should be a requirement for daily reporting of the TGP for 98 RON by fuel companies under the *Petroleum Products Pricing Act 1983 (WA)*.

» Using more relevant benchmark prices:

- › 91 RON ULP against the Platts 92 RON benchmark
- › 95 RON PULP against the Platts 95 RON benchmark
- › 98 RON PULP against the Platts 97 RON benchmark

About RAC

RAC is the leading advocate on the mobility issues and challenges facing our State and is committed to ensuring safe, accessible and sustainable mobility options for our members and the broader community.

²FuelWatch is an initiative of the Western Australian Government administered by the Department of Commerce and was Australia’s first and only fuel price monitoring and reporting service. Throughout most of WA, fuel retailers are required to notify their next day’s retail price for each fuel they sell by 2pm. Retailers must stay at the notified price from 6am for 24 hours avoiding intra-day price fluctuations.

³Although the recommended benchmarking for WA’s IPP and TGP calculations would most probably result in the same calculated IPP/TGP, possibly by quality premiums being increased, in the longer term a constraint is placed on the fuel companies because the ACCC, consumers, and those evaluating market movements, fuel quality changes and “quality premiums” would be able to see any unjustified price increases.