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The Role of the ACCC in Implementation of the New Tax System Changes

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1 Introduction

Australia's taxation system was substantially changed in 1999-2000 with the introduction of the New Tax System (NTS). The NTS introduced the broad-based consumption tax referred to as the Goods and Services Tax (GST) and abolished the Wholesale Sales Tax (WST). It also abolished a number of other narrow-based State and Territory indirect taxes. This package was accompanied by substantial income tax cuts and other measures to compensate people in the community disadvantaged by the GST.

The Australian Competition and Consumer Commission (ACCC) was given the task of oversighting the re-pricing which accompanied the indirect tax changes. Its role was fundamentally to ensure businesses adjusted prices correctly and did not mislead customers. This role was unpopular with business and considered unnecessary and possibly counter-productive by some commentators. There was strong political and consumer support for the role. There were both supporters and detractors who considered the ACCC had been given an impossible task.

Whilst the ACCC's oversight role extends until June 2002, the bulk of the re-pricing and the work of the ACCC in this area has now been completed. It is timely then to attempt, at least, a preliminary assessment of what was done by the ACCC and the outcomes achieved. The paper does this in a qualitative way. There may be scope for future econometric work to contribute to such an assessment.

The paper proceeds by first outlining relevant background including the political context and the legislative framework within which the ACCC has worked. It then outlines the key elements of the ACCC's strategy in undertaking its role. These include the *Guidelines* promulgated, the consumer information strategy especially the *Shopping Guide*, the Public Compliance Commitments obtained from large businesses, the compliance guide for small businesses, price monitoring, enforcement activity where non-compliance was found to exist and general use of the media. The inflation outcomes are considered in the broad macro-economic context and in the light of the expectations of these outcomes prior to them occurring. Finally the assessments of other informed parties of the ACCC's performance are noted.

The general conclusion of the paper is the ACCC has played a valuable role in the implementation of the NTS changes. It has given the community greater confidence in the re-pricing, helped ensure price changes have been in line with the tax changes and it has helped to minimise the general inflationary impact of the tax changes.

2 Background to the ACCC role

Legislation to implement the NTS was passed in June 1999. Key elements of the reform package included the introduction of the GST (expected to raise around $28b in its second year), removal of a number of indirect taxes, including the Wholesales sales Tax (WST) (reducing government revenues by around $22b); and significant reductions in personal income taxes (lower rates around $12b being offset to some extent by base-broadening measures around $6.5b). Additional Social Security payments totalling around $6b meant that the changes were expected to provide an overall fiscal stimulus to the economy of around $6b, or about 0.8 per cent of Gross Domestic Product[1].

The changes to indirect taxes were expected to have a significant impact on prices. Some products that had been taxed at rates of up to 32 per cent at the wholesale level, would after 1 July 2000 be taxed only at a 10 per cent rate at the retail level. Some items, especially services, would be taxed for the first time.   Items in the food, education and health areas would be tax-free. Others such as financial services and residential rents were to be input taxed. The combination of these changes meant that no consistency in the change in tax impacts was to be expected across products. To achieve the efficiency and equity benefits of the changes it was desirable that prices moved in line with the tax impacts. Some prices then could be expected to rise, some to fall and some to stay around the same level.

The ACCC was directed to oversight the pricing responses of businesses to the indirect tax and subsidy changes introduced by the NTS. The changes covered

[1] John Freebairn, "Issues in Measuring the Price Effects of Proposed Tax Reforms, Mercer-Melbourne Institute Quarterly Bulletin of Economic trends, Vol. 4 1999, pp. 41-55.

by this oversight commenced on 29 July 1999 with an initial reduction from 32 per cent to 22 per cent of the WST levied on luxury goods[2]. Excise on tobacco products rose on 1 November 1999. The major tax changes subject to oversight occurred on 1 July 2000 with the introduction of the GST; abolition of the WST; reductions in excise on petrol and diesel; changes to the Diesel Fuel Rebate Scheme and introduction of the Diesel and Alternative Fuel Grants and the Fuels Sales Grant Schemes; changes to the excise on alcoholic beverages; introduction of the Wine Equalisation Tax; introduction of the Luxury Car Tax; and abolition of the Bed Tax (NSW) and Tourism Marketing Duty (NT). Reductions in petrol and diesel excise and beer excise in March and April 2001 respectively were also covered. Financial Institutions Duty and stamp duty on quoted marketable securities were both abolished on 1 July 2001.

Politics and tax reform

The NTS changes were the culmination of a debate extending over one-quarter of a century in Australia over the wisdom of introducing a broad-based consumption tax. Numerous other countries had adopted such a tax, often in the form of a Value Added Tax (VAT). The GST is a multi-stage VAT. The impact of this tax is mainly felt by final consumers since businesses are generally able to obtain credits for the GST they pay. Since the tax is broad-based, it is less distorting than many other indirect taxes. It is suggested that it will reduce tax avoidance, provide better incentives for savings, and enhance export competitiveness. Proponents of a broad-based consumption tax also suggested that it would help reduce Australia's excessive reliance on income taxes, ensure adequate growth in government revenues, and assist in dealing with the problem of vertical fiscal imbalance evident in the Australian Federation.

Major proposals for reform of the tax system in the last one-quarter of a century have come from:

[2] The tax changes subject to ACCC oversight were specified in Section 75AT of the Trade Practices Act including those prescribed by Regulations.

- the *Taxation Review Committee* in 1975, which advocated the adoption of a VAT[3];

- the *Draft White Paper on Reform of the Australian Taxation System*, in 1985 particularly its ‘Option C’ of a broad-based retail tax[4]; and,

- the *Fightback! Taxation and Expenditure Reform for Jobs and Growth* blueprint which included a comprehensive VAT (referred to as the GST)[5].

The current Government’s policy, *Tax Reform: Not a New Tax, a New Tax System,* was published in 1998. It proposed a comprehensive GST, similar to *Fightback!*, but at a lower rate of 10 per cent rather than 15 per cent.

It is significant that all proposals for reform prior to the 1998 *Tax Reform* proposal had failed to receive the degree of political acceptance necessary for their implementation. There were many reasons for this, but one of relevance to this paper was the general public scepticism that businesses would exploit any tax changes through opportunistic pricing. There appeared to be genuine concern in the community that people would be taken advantage of.

A difference between the unsuccessful *Fightback!* proposal in the 1993 election and the successful *Tax Reform* proposal in the 1998 election was how the latter tackled voter/consumer concern about opportunistic pricing. *Tax Reform* tackled it aggressively by stating that the ACCC would have special powers "…to take action, including imposing penalties up to $10 million against businesses that adjust prices in a way that is inconsistent with changes in tax rates."[6] *Fightback!* was weaker on this issue. It proposed that the then Prices Surveillance Authority, which had no powers of enforcement, be assigned a ‘monitoring’ role. While not suggesting that this difference was the crucial factor to achieving public acceptance of the GST in 1998, it does indicate that the 1998 package was more alert to the pitfalls in selling indirect tax reform to the public. However, it is, perhaps, not overstating the case to suggest that a

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[3] Australia, Taxation Review Committee Report (Asprey), Canberra: AGPS, 1975.
[4] Australia, "Reform of the Australian Taxation System", Draft White Paper, Canberra: AGPS, 1985.
[5] Liberal and National Parties, Fightback! - Its your Australia, Canberra, November 1991.
[6] Commonwealth Treasury, Tax Reform: not a new tax, a new tax system, AGPS, Canberra, August 1998, p. 22.

strong price oversight role was an essential political pre-requisite for achieving major economic reform of the tax system in Australia.

Tax Reform indicated that the Government would legislate to provide the ACCC with special transitional powers to monitor prices formally and to take action against businesses that adjusted prices in a way that was inconsistent with changes in tax rates.[7] The Government's fundamental principle underlying this measure was that price changes on implementation of the GST should be consistent with changes in tax rates:

- consumers were to fully benefit from reductions in the tax rate where tax rates were reduced by the tax changes;
- consumers 'should not be exposed to greater than necessary price rises'; and
- there should be no 'exploitation of consumers' or 'excessive profiteering'.

Having fought an election on the basis of a commitment to implement *Tax Reform* it was difficult to see the Government departing from its prices oversight commitment. It is, of course, the case that the Government did modify its proposals, for example by excluding basic food from the GST, during consideration of the legislation by Parliament. However the same parliamentary opposition did not exist in relation to the price oversight provisions. In fact, the opposite was the case with opposition parties suggesting that the proposed price oversight arrangements were not likely to be sufficient to protect the community.

Criticisms of the ACCC's role

Despite the obvious political imperative, the role of the ACCC in oversighting the re-pricing response to the NTS changes has been widely condemned by business and industry commentators. Many of the critics had been key proponents of the reforms. There have been criticisms of the perceived 'draconian' nature of the legislation underpinning the ACCC's oversight role[8]. It was claimed that prices oversight was unnecessary and could only be harmful

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[7] Tax Reform, pp. 15, 22 and 85.
[8] Law Council of Australia, Submission on A New Tax System (Trade Practices Amendment) Bill 1998, April 1999.

in a competitive economy. Some, including the Chairman of the Productivity Commission, have worried that such a role could undermine the community's confidence in the operation of competitive markets[9]. Further prices oversight was likely to impose high costs of compliance on businesses. Borland pointed to the difficulties of measuring the underlying elements necessary to assess whether price changes were warranted[10].

Another suggestion was that it was inappropriate for the competition regulator to also have a price oversight role[11].

> If the proposed Goods and Services Tax legislation goes through, however, we will find competition principles and price control principles in direct conflict. Under it's a New Tax System (Trade Practices Amendment) Bill, the Government intends to give the ACCC the power to issue guidelines as to prices which should be charged and the power to specify prices which are to be charged by individual market entities. All of this heralds in an era of price control of the most draconian kind - allegedly to ensure that the new Goods and Services Tax, if enacted, is not "exploited". The future, in the writers view, will not be the "light handed" price surveillance of the past but a reversion to World War II price control. The ACCC may thus have the philosophically inconsistent tasks of both enforcing market competition and at the same time, price controlling industry participants[12]

The economic case for price oversight is fundamentally based on the existence of market failures, in particular market power and information asymmetry. When firms have market power, whether due to market dominance or cartelisation, they have discretion to set prices in a way that is not compatible with a competitive market. In this case they have discretion not to move their prices in line with the tax changes. The information asymmetry problem may arise when consumers have little knowledge of the factors that determine prices. It is highly likely, for example, that the majority of consumers had little knowledge of the taxes applying to particular products prior to 1 July 2000 and thus what the quantitative effect of the NTS changes on prices ought to have been. In these circumstances business may be able to influence consumer

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[9] Gary Banks, "Competition: the best price regulator", CEDA presentation, Perth, 21 November 2000.
[10] Jeff Borland, "Let's not waste time trying to gauge GST impacts", Australian Financial Review,20 March 2000
[11] See for example, Ian McEwin, "Watchdog needs an overhaul", Australian financial Review, 1 May 2000, p.17.

expectations in an opportunistic way There have been numerous examples, challenged by the ACCC, of industry groups 'talking up' the price impact of the tax changes[13].

In assessing criticisms of the price oversight regime it is important to have regard for what has actually been done by the ACCC in carrying out its role. Given the existence of market imperfections such as market power and information asymmetry, it cannot be assumed that oversight will necessarily produce worse outcomes. Further, given these imperfections, it cannot be assumed that oversight will reduce confidence in markets, rather the opposite may be the case.

It was of course also the case that there were vigorous supporters of the ACCC's prices oversight role. Consumer and welfare groups and unions considered the role to be important, in part, to ensure that there was not an erosion of the compensation arrangements put forward to assist disadvantaged groups. An important concern of some also was to ensure unwarranted price rises did not occur so as to trigger wage claims which if successful could feed into higher and on-going inflation.

Overseas experience does not caste much light on the desirability or otherwise of prices oversight in response to major tax change.[14] In the 1960s and 70s price changes in response to major tax changes were often monitored as part of established prices and incomes policy regimes. Canada established a separate Consumer Information Office to monitor price changes at the time of the introduction of the GST in that country in 1991. New Zealand did little to oversight the price changes in response to the introduction of its GST in 1986. In Japan the Price Bureau of the Economic Planning Agency conducted monitoring of the effects of an increase in the rate of the Consumption Tax from three per cent to five per cent in April 1997[15].

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[12] Warren Pengilley, "Who administers our Competition and Consumer Protection Laws?", Competition & Consumer law Journal, 1999, p.259.
[13] For example, "Makers claim GST will see car prices rise", Sydney Morning Herald, 4 December 1999.
[14] Tait, A. A., Value Added Tax: International Practice and Problems, International Monetary Fund, Washington, D.C., 1988. Chapter 10.
[15] Japan, Price Bureau, Economic Planning Agency, Price Report, 1997.

The actual inflation impacts of major tax changes in overseas countries in the past would have been influenced by many factors other than the price oversight arrangements adopted[16]. These factors include the precise nature of the tax changes made at the time; the size of the tax changes; the general economic environment; and the competitiveness of markets in the economy. Thus it is difficult to point to any one particular experience as giving guidance to Australia.

Whether the ACCC was the right body to perform the price oversight task is perhaps a lesser matter. The Australian Tax Office could, perhaps, have been given the task but it had no prior experience of prices oversight and arguably had enough on its plate in administering the new tax arrangements. A new body could have been established as in Canada, but it would not have had the advantages of an established administration and the synergies associated with the administration of general consumer laws, especially the laws against misleading and deceptive conduct. Further, whilst the promotion of competition may appear to be at odds with prices oversight, this is a fairly superficial view. Prices oversight is most appropriate where effective competition is not feasible. The first best policy would generally be to try to promote effective competition, but this may not be possible at least in the short term. The price oversight role in relation to the tax changes was for a limited time thus minimising the potential for harm to competition in the long term. And giving the prices oversight role to a competition regulator is more likely to ensure that any conflict between the promotion of competition and the operation of prices oversight will be resolved in the direction of the former.

The legislative basis of the ACCC's role

The New Tax System (Trade Practices Amendment) Act 1999 was passed by Parliament in June 1999 in conjunction with the *Tax Reform* bills. The Amendment Act inserted a new Part VB into the *Trade Practices Act* ('the Act'),

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[16] For example, the estimated effect of VAT introduction on the first quarter CPI change post-VAT, for example, was 6.6 percentage points of an 8.0 per cent increase in New Zealand in 1986. In Canada, 1.3 percentage points of the total first quarter CPI increase of 2.9 per cent was attributable to price changes associated with the introduction of the GST which replaced a Manufacturers Sales Tax.[16]

regarding price exploitation in relation to the NTS changes. This legislation applied to all businesses irrespective of the competitiveness of the markets within which they operate. This was a deliberate decision of the Government. The Commission was given a considerable augmentation to its resources, around $56 million over the three years, to administer the legislation and perform related tasks.

Price exploitation occurs if the price for a good or service is unreasonably high, having regard to the NTS changes alone and other matters, including suppliers' costs, supply and demand conditions and any other relevant matter[17]. The legislation was amended in December 1999 to ensure that it also covered prices which were increased in anticipation of the tax changes.

The term ‘unreasonably high’ is not defined in the Act, however the legislation (section 75AV) required the ACCC to issue guidelines about when prices will be regarded as unreasonably high.

The new law was very strong, with heavy penalties of up to $10 million per offence for price exploitation for a body corporate and $500,000 per offence for any individual executive involved. Similar penalties may apply to persons aiding and abetting an offence. The law was applied for a three-year transition period until 30 June 2002.

In addition, further legislation was passed[18] (section 75AYA) giving the Commission power under Part VB to deal with conduct that misrepresents the effect of the tax changes for the purpose of price exploitation. This new law

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[17] Section 75AU of the Trade Practices Act states that :

(1) A corporation contravenes this section if it engages in price exploitation in relation to the New Tax System changes.

(2) For the purposes of this section, a corporation engages in price exploitation in relation to the New Tax System changes if:

   (a) it makes a regulated supply; and
   (b) the price for the supply is unreasonably high, having regard alone to the New Tax System changes (whether the supply took place before or after those changes); and
   (c) the price for the supply is unreasonably high even if the following matters are taken into account:
      (i) the suppliers’ costs
      (ii) supply and demand conditions;
      (iii) any other relevant matter.

Section 75AU relates to corporations. States and Territories have agreed to introduce complementary legislation that will ensure full coverage of all businesses covered by the New Tax System changes.

complemented the ACCC's existing powers in relation to misleading and deceptive conduct.

In order to prevent and eliminate price exploitation, the ACCC was given a range of powerful statutory tools, including the power to:

- issue a price exploitation notice where the ACCC considers that a corporation has engaged in price exploitation (creating in any ensuing court proceedings the presumption that price exploitation has occurred) [Section 75AW];
- issue a notice specifying a maximum price that may be charged for a good or service during a specified period as an aid in the prevention of price exploitation [Section 75AX];
- monitor prices to assess the general effect of the NTS changes and issue a notice requiring a business to provide certain information to the ACCC [Section 75AY]; and
- report quarterly on its activities in relation to the prevention of price exploitation [Section 75AZ].

3. Key elements of the ACCCs prices oversight strategy

Central to the promotion of compliance with the legislation by the ACCC was the dissemination of information to business and the public so that markets would be more informed and competitive pricing would be facilitated. Many of the ACCC's activities, especially before 1 July 2000, were focussed on achieving compliance by preventing problems from later occurring. This involved on-going communication with both businesses and consumers to assist business and consumers to understand their rights and obligations under the legislation and the *Guidelines*.

The Guidelines

The Act required the ACCC to formulate *Guidelines* about what it considers constitutes price exploitation. The ACCC must have regard to these *Guidelines*

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[18] A New Tax System (Trade Practices Amendment) Act 2000

when considering whether to issue a price exploitation notice or a notice to aid in the prevention of price exploitation; and a court may have regard to The *Guidelines* in any proceedings concerning injunctions and penalties concerning price exploitation. The *Guidelines* are intended to provide greater certainty to business about the administration of the law by the ACCC.

The *Guidelines* were issued in July 1999.[19] They were updated in March 2000 to reflect an amendment to the Act, to clarify a number of policy issues raised with the ACCC since the release of the earlier draft and to address some new issues. The update did not amend the underlying principles of the *Guidelines*.

The *Guidelines* were developed in close consultation with key industry groups and were significantly modified as a result of this consultation. They aim to be general in nature, not unduly prescriptive in content, and relatively simple so that they can apply to all businesses. The ACCC resisted calls for more comprehensive industry specific rules. The *Guidelines* emphasise two significant factors not present in the legislation. These were firstly that the ACCC's focus in reviewing prices would be on the change in prices made in response to the tax changes, not the level of prices, and secondly, that the ACCC would have close regard to the competitiveness of markets when reviewing prices.

Further to provide clarity as to when the ACCC would consider a price change to be unreasonable two simple rules were specified, namely:

- the 'Dollar Margin Rule', which says that businesses should not increase net dollar product margins on account of the NTS changes alone; and
- the 'Price Rule', which says that no price should rise by more than 10 per cent on account of the NTS changes alone.

The Dollar Margin Rule permits firms to increase prices by the net increase in taxes and costs resulting from the NTS changes. Where the impact was to reduce taxes and costs, firms were required to reduce prices by at least this amount. This was a more favourable rule to business than other possible

[19] The Guidelines are available at www.accc.gov.au.

approaches such as the modified percentage margin rule initially put forward in a Preliminary Draft Guidelines document[20].

Economic theory suggests that elasticities of demand and supply will influence short and long run equilibrium pricing outcomes. In competitive markets the equilibrium price increases will be less than the net tax and cost increases in all cases, except when demand or supply is perfectly inelastic with respect to own price where they will be equal. Similarly, equilibrium price reductions will generally not be as great as the net tax and cost reductions. It has been suggested that the *Guidelines* were deficient in requiring firms to reduce prices by more than the equilibrium price in this case[21]. However, this ignores the fact that the *Guidelines* also recognised the impact of other relevant factors including supply and demand in determining prices. If excess demand could be shown to be present at the lower price which passed on the full amount of the net tax and cost reductions, this would be a justification to raise prices to the equilibrium level.

If markets which are less than fully competitive, either because of monopoly or cartelisation, profit maximising behaviour could encourage firms to increase prices by more than any net tax and cost impact of the NTS, or reduce prices by more than the net reduction in taxes and costs[22]. The *Guidelines* in these cases would have prevented firms increasing prices to the full profit maximising level but not prevented them from lowering prices to this level. The *Guidelines* did not require the maintenance of net dollar margins, they simply permitted firms to maintain margins.

The Price Rule was introduced to the amended *Guidelines* in March 2000. Public debate prior to this indicated some confusion as to what the *Guidelines* permitted in terms of price averaging across related products and averaging over time. There had also been claims that high compliance costs would cause prices to rise in excess of 10 per cent in some instances where the only change of significance was that the GST would apply. In some cases the effect of the price rule may have been to constrain price increases that would otherwise

[20] ACCC, Preliminary Draft Pricing Guidelines for GST Implementation, 23 April 1999.
[21] Peter Burn, "The ACCC's Price Monitoring Regime", Business Council of Australia Bullitin,
[22] Joseph E. Stiglitz, Economics of the Public sector, Third edition, pp.498-9.

have been permitted by the Dollar Margin Rule alone. However, since the *Guidelines* permitted the recovery of incremental compliance costs in most case the effect would be to lengthen the time period for recovery of these costs. The Price Rule had the very important effect of giving greater certainty to consumers and assisting monitoring.

The Everyday Shopping Guide

The ACCC considered that it was crucial for consumers to be directly informed about what to expect as a result of the NTS changes. The complexity of the changes meant that without assistance consumers would have had very little idea of what to expect.

To this end, the ACCC produced a publication — *Everyday Shopping Guide with the GST* — that provided a range of expected price movements for 185 common household goods and services as a result of the tax changes. This was mailed to all households in late May 2000. The *Shopping Guide* provided estimates of likely price changes, as a result of the NTS alone, over the six months from 1 July 2000. Coming from an independent agency it had more authority than others. It provided a more accurate basis on which consumers expectations could be formed. Informed consumers meant consumers who could be vigilant, who could shop around for the best and fairest price and who could question retailers about their prices. Informed consumers were more likely to advise the ACCC of instances where they believed price exploitation may have occurred.

The *Shopping Guide* also assisted business to set prices that were less likely to attract consumer and regulatory concern. In effect, if a business priced in accordance with the price estimates contained in the *Shopping Guide*, it was unlikely to attract the attention of the ACCC.

The estimates provided by the ACCC were based on work commissioned by the ACCC from Dr. Chris Murphy. His modelled results were modified in some instances by the ACCC to take account of more detailed information available to it, for example on actual taxation rates, retail margins and making some allowance for compliance costs. The estimates took account of both direct tax effects and indirect short-term supply chain cost savings. They could be provided at a more detailed product level than was possible using other available general equilibrium models.

The Government's 1998 *Tax Reform* policy document provided some industry estimates of cost and price impacts of the tax changes based on the PRISMOD price input-output model[23]. These long-term estimates covered only 107 industry groups compared to the 657 of the Murphy model. Moreover, the amendments to the 1998 *Tax Reform* package to secure passage of the legislation through the Senate in June 1999 meant that the PRISMOD estimates were no longer valid. The exemption of most food items from GST and amendments to the Diesel Fuel Grants Scheme were the major changes affecting predictions of the general effect on prices.

Murphy's model also produced aggregate long-term results that were not dramatically different from those of PRISMOD. The forecast impact of the tax changes on inflation was somewhat less than was the case with another general equilibrium model constructed by Professor Dixon.[24] Murphy's model incorporated a more optimistic view of achievable cost savings and a bigger exchange rate appreciation effect.

Whilst the *Shopping Guide* only provided estimated price changes for 185 separate goods and services, the ACCC utilised the other estimates obtained from the Murphy model, adjusted as considered appropriate, as a basis for assessing actual price changes identified through its monitoring work.

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Public Compliance Commitments

Another element of the ACCC's strategy to promote compliance was to invite Australia's biggest businesses to give a public commitment that they complied with the *Guidelines*. The ACCC established a public register for businesses which provided the ACCC with an acceptable Public Compliance Commitment

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[23] PRISMOD estimated an all industry average reduction in costs of 3.2 per cent (by 2001-02) and the additional increase in the annual CPI in 2000-01 was estimated to be around 3 percentage points (the much publicised estimate of a 1.9 per cent increase in the CPI was in fact significantly qualified within *Tax Reform* .

(PCC) were listed on a public register. The 35 organisations on that register included Australia's major retailers, manufacturers, the four big banks, telecommunications companies and transport companies

A PCC is a statement signed by the CEO of a business, stating that the business is committed to complying with the *Guidelines* and the Act. These are voluntary commitments in themselves not enforceable at law. The focus on big business was deliberate. In many instances big business is able to influence market prices and can provide a lead for smaller businesses.

PCC's provide an assurance to the community that no unfair advantage has been taken of the NTS changes to increase margins and they also provide greater certainty for the firms involved. The process of developing a PCC involved discussions with senior staff about how the *Guidelines* would be applied in the particular context, for example what product categories would be recognised by the ACCC, what level of price averaging was considered reasonable, whether the ACCC concurred with the assessments made of cost impacts, the appropriateness of price descriptions and so on. The companies generally agreed to provide the ACCC with cost and price information at least every six months, so that it cost savings achieved during the transition to the NTS and general compliance with the *Guidelines* could be monitored.

The PCC concept was new to the administration of the Act . There were reservations about the concept both within the ACCC and with many businesses and their advisers. Within the ACCC there was concern that a PCC may compromise possible later enforcement action and provide an opportunity for businesses to extract unwarranted concessions. Some businesses and legal advisers were worried about the use of confidential information provided to the ACCC and whether the PCC would have unwanted legal implications. Fundamentally the concerns on both sides reflected the levels of trust between the parties.

In retrospect it is apparent that the PCC process was a very effective way for the ACCC to convey its expectations of business and for business to ensure

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[24] Peter B. Dixon and Maureen T Rimmer, "Price results in PRISMOD and MONASH', mimeo., 1 September 1999.

compliance with the *Guidelines*. Having the CEO sign off on the Commitment meant that there was greater awareness of what was required at Board and senior management level which was passed on to personnel involved in pricing. It often gave corporate staff greater influence over the business units of these large organisations. Communication between the ACCC and the businesses concerned was enhanced by the effective liaison arrangements established under the PCCs. Finally, businesses with a PCC accounted for a disproportionately low number of complaints and enforcement actions. Many of these businesses have advised the ACCC of their satisfaction with the processes and outcomes involved.

Small Business Pricing Kit

While the PCC concept was directed at big business, the ACCC was acutely aware of the crucial importance of small business to a smooth re-pricing process. Initially the ACCC's focus was appropriately on making clear to business what the legislation and *Guidelines* required and what potential penalties existed for non-compliance. This task was not made easier by some industry leaders providing incorrect advice to their members about the status of the *Guidelines*[25]. It was quickly realised, however, that small business needed more than just to hear this message. Specific assistance was required to help small business identify cost savings and re-price in an acceptable manner. Otherwise, it was distinctly possible that many businesses would simply add 10 per cent to all their prices. To prevent this, the ACCC liaised extensively with industry associations and produced a *Small Business Pricing Kit*, which was provided free for several hundred thousand businesses.

The *Small Business Pricing Kit* contained:

- a Compliance Guide, which outlined in simple terms what was needed to comply with the *Guidelines* and gave many practical examples;
- a Cost Savings Estimator, which was a user friendly software package to enable small business to obtain an estimate of likely changes to its costs due to the NTS changes; and

[25] For example,Report by Graham Gardiner, “GST price cap ‘rubbish’, Bizreview, March 2000.

- a Retail Price Adjustor , which provided a calculation of the amount of WST in stock on hand and of retail prices taking into account cost savings in overheads, removal of WST and addition of GST.

The Cost Savings Estimator was based on modelling provided by Econtech. In essence, the *Kit* assisted small business to determine which costs should rise and fall and by how much prices should be adjusted. In this respect the ACCC considered that businesses using the model appropriately would be complying with the *Guidelines*.

Price Monitoring

The ACCC established and extensively advertised a telephone hotline number to facilitate inquiries and complaints from the public and business organisations about NTS pricing. The ACCC's web site also provided relevant information. Inquiries and complaints were often referred to compliance staff and investigators for detailed consideration and, in a relatively small number of cases, enforcement action.

In addition an extensive program of price surveys was undertaken to identify directly price movements which were outside the range of expectation established by the ACCC. A large general survey of prices was conducted in December 1999/January 2000 and May 2000, prior to the introduction of the GST, and in August 2000, October 2000, February 2001 and May 2001 after the introduction of the GST. This covered about 700 commonly purchased household goods and services from about 10,000 retail outlets in each of the eight capital cities and 100 towns across Australia. About 350,000 prices were collected each time the survey was conducted.

Other more specialised surveys were also conducted. These included a *Monthly Supermarket Survey* covering a ‘basket’ of 100 branded items sold in over 300 supermarkets in all States and the NT. Surveys covering petrol, diesel and auto LPG; banking products; beer and cigarettes; motor vehicles; building materials, products and housing; residential rents; long term resident caravan park and boarding house accommodation were also regularly conducted.

The surveys were important in providing the community with an authoratitive picture of the price changes that had occurred. They helped counter other less representative surveys conducted by the media, politicians and some industry bodies. The surveys also reinforced in the minds of many businesses an awareness of ACCC activities and the need to comply with the *Guidelines* and Act. They increased the risk of non-complying firms being detected. The ACCC followed up on many apparent anomalies highlighted by the surveys. Recently the ACCC accepted a court enforceable undertaking in relation to Quix convenience stores[26]. The company admitted to price exploitation by over-charging on in excess of 300 products. This matter came to light after assessing the results of the *General Survey* before and after the GST.

Pre-GST price changes

In general the ACCC's surveys did not point to any significant anticipation of the tax changes. For example, prices of goods subject to WST were not increased prior to the reduction and later abolition of WST to offset the effect of any later reduction which may have appeared to be in compliance with the *Guidelines*.

Pre-GST price changes from the ACCC's *General Survey* between December 1999/January2000 and May 2000 were generally quite moderate. The weighted average increase across the whole survey was just under 1 per cent over the period. Pre-GST price changes from the *Monthly Supermarket Survey* between January and June 2000 also were generally quite moderate, mostly less than increases of 2 per cent; the weighted average increase was1.2 per cent over the period.

Post-GST outcome

The bulk of the re-pricing associated with the NTS changes appears to have occurred in the September 2000 quarter and was broadly within the ACCC's estimates. Table 1 shows the estimated effects of the NTS and the results of the ACCC's surveys over three and twelve month periods from May 2000. The

[26] ACCC, "Quix to compensate Consumers for Price Exploitation", Media Release 217/01, 10

Monthly Supermaket Survey collections are continuing during 2001 and show moderate changes.

September 2001.

Table 1: ACCC Expected NTS Price Effects and Survey Results

Product group	Estimated New Tax System-effect on prices by end 2000	Survey average change after 3 months	Survey average change after 12 months
	%	%	%
Clothing and footwear	*7.5*	3.2	5.7
Fresh/unprocessed food	*-1.1*	3.2	13.4
Household furnishings and equipment	*2.2*	1.5	3.4
Household services and operation	*2.2*	2.3	4.9
Personal care	*1.5*	-1.3	1.2
Recreation — audio visual	*-3.6*	-5.0	-7.1
Recreation — other	*3.2*	2.2	1.4
Processed food and beverages	*-0.3*	0.2	3.4
Meals out and takeaway food	*9.2*	7.9	10.2
Miscellaneous goods and services	*3.6*	3.1	6.4
Medical and health	*5.4*	5.4	7.8
Motor vehicle expenses	*1.9*	1.0	7.2
Alcohol and tobacco products	*6.0*	7.1	11.9
All groups weighted average	***3.0***	**2.6**	**5.7**

The weighted average price change over the three months between the May 2000 and August 2000 surveys was +2.6 per cent. The upper-bound of the range of the ACCC's estimates of the effects of the tax changes *alone*, weighted on the same basis, was an increase of 3.0 per cent. Comparing the change in prices over three months provides the best indication of the effects of the tax changes alone, as it was long enough to allow retail prices to be adjusted for the tax changes, but not long enough for non-tax factors to have much influence. Nevertheless, other factors were expected to contribute to changes in some product prices during the period.

The period of comparison over twelve months (from the May 2000 survey to the May 2001 survey) is likely to include non-tax influences on price outcomes.

Such factors almost certainly contributed to changes in many product prices during the period. With Australia's inflation rate in quarters prior to the introduction of the GST running at about 0.8 per cent per quarter, some movements in prices due to other factors would be expected. These might include increases in supply costs, the depreciation of the dollar, fuel price rises and other short-term factors such as interruptions to supply.

The October survey data also confirmed that:

- price *changes* from the implementation of the NTS were consistent across capital cities and regional, although price *levels* may have been quite different;
- there were minimal differences in the size or direction of price change between sole outlet and multi-outlet businesses; and
- there were no substantial differences in average price changes between States and Territories, although again prices may have been at different levels.

Analysis of survey data indicates that a large majority of the prices expected to change substantially as a result of the NTS alone had already changed by early August. The data shows that about 19 per cent of surveyed prices related to products with NTS-effects estimated to be increases of 5 per cent or more. Of these prices, about 74 per cent showed increases of that magnitude and only 8.5 per cent had not changed at all. Also, only 1.7 per cent of 'no change' prices were for products that had NTS-effects estimated to be decreases of 3 per cent or more. These outcomes together indicate, at least for the products in the survey, that product prices likely to change substantially due to the NTS generally had changed by early August.

Table 2 provides a more detailed comparison of the survey results and the ACCC's estimates of the NTS price effects for a range of product groups. On three broad comparative classifications — 'higher', 'lower', and 'about the same' (within one percentage point) — the August 2000 results showed only the fresh food group having an average price change higher than the ACCC estimate. Even with non-tax factors increasingly influencing prices by February

2001, for eight of the 13 groups the average price changes were still lower than or about the same as the ACCC's estimates.

Table 2: Comparison of price changes and ACCC estimates of NTS effects

Product group	Aug 2000 survey vs. estimates	Feb 2001 survey vs. estimates
Fresh/unprocessed food	higher	higher
Processed food & beverages	about the same	higher
Meals out & take away food	lower	about the same
Clothing & footwear	lower	lower
Household furnishings & equipment	about the same	about the same
Household services & operation	about the same	higher
Personal care	lower	lower
Recreation — audio visual	lower	lower
Recreation — other	about the same	lower
Miscellaneous goods & services	about the same	about the same
Medical & health	about the same	about the same
Motor vehicle expenses	about the same	higher
Alcohol and tobacco	about the same	higher

Petrol Prices

Following the removal of the maximum wholesale price for petrol and diesel in August 1998, the ACCC has only informally monitored fuel prices. Data on retail prices has been obtained from organisations specialising in the collection of this information. Import price and wholesale price data are also monitored by the ACCC. The main drivers of fuel prices are overseas prices, the exchange rate, since overseas prices are generally quoted in $US, domestic taxes and, in capital cities, discount cycles. Monitoring was stepped up when the NTS changes were introduced. It covered some 4000 sites, 2500 in capital cities and 1500 in 150 country towns across Australia.

For petrol and diesel the imposition of the GST was offset by reduced excise and cost reductions of relatively uncertain magnitude and timing. The Fuel Sales Grant was paid to retailers to ensure already higher prices in rural and remote areas did not rise further relative to those in the cities.

Given the volatility of fuel prices it was necessary to assess movements in prices over a reasonable period of time to determine whether cost savings and the Grant had been passed on to customers as would be required to comply with the *Guidelines*. The ACCC publicly reported on price movements over the September quarter 2000. It concluded that prices had not increased by as much as might be expected given movements in underlying factors especially rising international prices for crude oil and product. The implication was that it was possible that refineries had passed on the full extent of long term cost savings assumed to be possible by the Government. Similarly, with the Grant it was concluded that this was being passed on. A significant investigation was undertaken on this matter after complaints were received from some franchisees suggesting that oil companies had modified their price support arrangements to capture the Grant.

There is a high degree of public scepticism regarding the competitiveness of the petroleum industry. There is also dissatisfaction with the volatility of prices in capital city markets and the significant gap which often exists between city and country prices especially when city prices are at the low end of the cycle. This dissatisfaction was heightened by the increase in the general level of prices to historically high levels in the period after the introduction of the GST, due largely o international factors. This prompted the Government to reduce excise and abolish future automatic indexation of excise rates in March 2001. The ACCC again monitored the impact of these changes on prices. The ACCC was also asked to report on ways to reduce fuel price variability. A discussion paper was prepared which canvassed a range of options from do nothing to significant reform of existing anti-competitive regulation to further comprehensive regulation. The ACCC cautioned against intervention that would dampen competition in the industry. This was in the context of a number of state governments moving to introduce price regulation in their own jurisdictions and of proposals from the Federal Opposition for further substantial regulation of the industry.

Given the level of on-going public concern about fuel prices and the often relatively uninformed proposals for regulatory intervention, there is, arguably, a role for an independent expert body to provide occasional commentary on industry trends, respond to complaints and as necessary conduct investigations. Having a national perspective is important to minimise regulatory distortion across the country and to avoid unnecessary regulation. Some in the community may have greater confidence in the industry given that the ACCC has not concluded that price exploitation is apparent in the industry's response to the NTS changes. Certainly they are more likely to believe the ACCC on this than the industry itself.

Enforcement

The ACCC placed great emphasis on promoting compliance with the legislation and *Guidelines* through its awareness programs, publications, liaison with industry groups and individual businesses particularly through the telephone inquiry service and hundreds of meetings. This activity aimed to prevent the occurrence of problems. By itself, however, it is not sufficient to ensure effective compliance. For this it is necessary to have a credible threat that non-compliance will have adverse consequences for the perpetrator. It is the expected penalty as well as the expectation of detection that is likely to be taken into account by someone tempted not to comply. The legislation provided for the possibility of very large penalties, up to $10 million per offence for a corporation and $500,000 for individuals including anyone aiding and abetting, for engaging in price exploitation. Whether a court would impose fines near these levels was and still is unknown. This in part may be influenced by the clarity of determining when an offence occurs.

The enforcement objectives of the ACCC in relation to the NTS changes were no different to other areas within its responsibility. These are to stop conduct breaching the law, seek redress for those suffering from the illegal conduct, seek to prevent that illegal conduct from occurring again in the future and seek appropriate court outcomes when necessary to ensure deterrence. Regard may be had for the cost-effectiveness of the enforcement action and the speed with which outcomes can be obtained. The priorities for action are strongly influenced by the blatancy of any breach, the economic detriment involved and the likely precedent setting than may arise from the action.

There is a range of alternative actions that the ACCC could take with respect to NTS related matters. These include doing nothing, other than perhaps drawing a matter to the attention of the business involved for appropriate action, resolve a matter informally by agreement on appropriate action, more formally accepting Undertakings pursuant to Section 87B of the Act, issue a notice of price exploitation or a notice to prevent price exploitation, or take court action to obtain injunctions, pecuniary penalties or other orders.

Overwhelmingly in its enforcement work relating to the NTS changes the ACCC has emphasised administrative resolution of matters. Many of the matters drawn to its attention have been relatively minor reflecting in large part the difficulty many small businesses, in particular, had in coming to terms with the NTS in a relatively short time time-frame. However, there were also a significant number of matters which arose because of poor attention to detail by businesses and in some cases simply carelessness. Whilst businesses like to suggest that all mistakes are inadvertent in some cases this is difficult to believe. Whether or not there was an element of deliberateness involved, mistakes should be corrected. If businesses were willing to rectify mistakes quickly even on more serious matters Undertakings were accepted. The relatively few matters finding there way to court generally reflected the unwillingness of the business concerned to correct the matter.

Only in one case was a Section 75AW notice issued. This concerned a video hire firm which it was alleged had increased prices at some of its outlets in anticipation of the introduction of the GST. The ACCC took this matter to court but it was eventually settled between the parties. There is no doubt that the ACCC's actions with respect to this matter greatly heightened business awareness of the price exploitation laws in the period immediately before the introduction of the GST. The ACCC has issued no notices under Section 75AX. There could be the potential for an ongoing monitoring requirement if a maximum price was specified in a particular instance as provided for by this notice. Nearly one-half of the matters dealt with by Undertaking or in the courts have concerned the misleading and deceptive conduct provisions of Part V of the Act rather than the price exploitation provisions.

A brief summary of relevant enforcement statistics is provided below. Overall it is suggested that the ACCC has been very active in its enforcement role. It has sought to achieve existing ACCC enforcement objectives in a balanced way recognising the difficulty many small businesses in particular had in implementing the new taxation arrangements and the uncertainty which sometimes was associated with what these arrangements actually were.

- 177,000 calls to the GST Priceline and ACCC Infocentre, (123,000 inquiries and 54,000 complaints) between 1 July 1999 and 30 June 2001; and
- 6200 GST-related matters investigated;
- 605 active matters as at 30 June 2000 (including 300 beer excise reduction matters);
- more than 700 corrective actions;
- nine cases filed in court, consent orders in 4 of these;
- 47 cases Section 87B court-enforceable Undertakings;
- over 600 informal administrative undertakings;
- more than $10 million in total refunds paid to nearly one million consumers (In a few cases where consumers could not be contacted or where the amounts involved were small donations were provided to charities instead of refunds);and
- 71 businesses implemented/upgraded trade practices compliance programs or trade practices compliance training.

Matters identified by the ACCC in respect of price exploitation include not passing on WST reductions correctly; anticipating the tax changes by increasing prices before they occurred; incorrectly charging GST on GST-free items; incorrectly charging GST on non-reviewable contracts especially in home building and leasing; not making appropriate adjustments to prices or ensuring refunds have been paid when tax rules have been amended or clarified; and increasing prices by more than 10 per cent.

Many matters have been settled under the misleading and deceptive conduct provisions of Part V of the Act. "Beat the GST" claims were popular prior to the introduction of the GST. After its introduction, "GST-free" claims have been common. As the legislation did not require prices to be specified as GST-inclusive, there is the potential for businesses to quote prices in a way which is misleading and sometimes deceptive by not quoting the full price or using small print disclaimers, especially to final consumers. The ACCC has expressed the view that it is better for prices to be quoted as GST-inclusive to avoid potential problems of this sort and also general confusion. Many businesses, however, apparently think that they are able to gain a competitive edge over their competitors if they can give most prominence to the GST-exclusive price. The *Guidelines* referred to a limited number of exceptions to the generally preferred position.

Media

The ACCC and particularly its Chairman Professor Fels have a high media profile. This largely reflects the nature of the work of the ACCC as a public interest agency. Inevitably it will be perceived to be confrontationist by those who it acts against. The NTS prices oversight role further lifted this profile as the tax changes were the subject of significant public interest.

At the time of the changeover to the NTS the ACCC advertised extensively on radio and in newspapers its messages about the re-pricing, including the *Shopping Guide* estimates. The media campaign complemented other information activities including publications directed at consumers - the *GST Talk* series and business -the *News For Business* series and the general community – the *GST Bulletin* series. Targeted communications campaigns were also directed to major ethnic groups and Aboriginals and Torres Islanders. It was appropriate, as an independent agency, that the ACCC was able to conduct its media and communication campaigns independently and not as part of the broader Government campaign relating to the tax changes.

In general the business community have been quite critical of the use of the media by the ACCC, especially where particular businesses are highlighted. The damage to reputation can be quite significant if consumers are made aware of some contravention of the law or ethical standard. The ACCC does not generally refer to businesses that are subject to investigation. Sometimes a matter is made public knowledge by others. It is appropriate, however, that the outcome of investigations, court actions and so on are made public by the ACCC so that other businesses will be aware of the matters and can, if necessary, amend their own conduct to comply with the law. Consumers are also entitled to know the outcome of matters dealt with by the ACCC. They may wish to take follow on action, for example to pursue other remedies or simply to change their buying behaviour.

In relation to the NTS role it is important to note that Parliament specifically endorsed the use of publicity in the form of so called 'shame notices'- the notices able to be issued under sections 75AW and 75AX of the Act.

4 Evaluation of the ACCCs role

The macro economic context

Before commenting specifically on the impact of the ACCC in the re-pricing process it is useful to review briefly the broad economic picture applying during the transition to the GST. This broad environment would have influenced the pass through of NTS changes into prices. The broad environment would in turn have been impacted by the NTS changes especially by influencing demand.

In the period leading up to the introduction of the NTS the Australian economy had been growing strongly. The annual rate of growth in Gross Domestic Product reached historically high levels in the March and June quarters of 1999, around the time of the initial reduction in the WST for luxury products from 33% to 22%. Domestic and overseas demand were both growing strongly, the latter especially encouraged by increased competitiveness due to lower exchange rates. GDP growth slowed in the second half of the year but remained at a high level.

Consumer prices increased by around 1.0-1.5% during 1999 well below the Reserve Bank of Australia's (RBA) target range. However, concerns about mounting inflationary pressures induced the RBA to take pre-emptive action in October 1999 to increase interest rates. Interest rates had been rising overseas for some time before this and domestic rates had been at relatively low levels encouraging demand growth. There was some concern about possible increases in wages costs with falling unemployment. Import and producer price indexes were also rising under the pressure of further falls in exchange rates and rising oil and petrol prices. The RBA Governor made it clear that monetary policy was not tightened because of the GST. "We at the Reserve Bank are still operating on the assumption that the GST will affect prices only on a one for one basis, and that wages will not be raised to compensate for the GST"[27].

GDP growth continued to ease in the first half of 2000. Consumer price inflation increased by around a further 1.0 per cent and the RBA further tightened monetary policy. Cash rates were increased three times in this period. (A further increase in cash rates occurred in August 2000.)

In the quarter immediately after the introduction of the GST the rate of GDP growth again declined and inflation jumped sharply, driven by the NTS re-pricing. In the December quarter GDP actually declined slightly whilst inflation fell sharply.

In 2001 there has been a further easing of GDP growth. Inflation has increased slightly to be at around the 3% level. The RBA eased monetary policy early in the year following revised lower growth forecasts for major overseas countries and the lower than expected CPI outcomes in the September and December quarters in 2000[28]. The September quarter figure was 3.7 per cent and the December quarter 0.3 per cent.

The Treasury's 2000-2001 Budget estimate was for a total increase in September quarter 2000 CPI of 4.5 per cent with the tax changes contributing 3.75 percentage points and ongoing inflation 0.75 percentage points. The Treasury's estimates of the impact were higher, however, than most private economic commentators' estimates. A survey of 22 bank and business economists reported in *The Age* on 5 January showed an average estimate of a 3.1 per cent increase in the September quarter CPI due to the tax changes. The range of the estimates was 1.75 to 4 per cent. The Acting Treasurer on the day of the release of the September CPI, stated that '…"a little less than 3 per cent appears to be the one-off impact of *The New Tax System*, significantly lower than the 3¾ per cent estimated in the Budget."[29]

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[27] I.J. Macfarlane, "Managing the Expansion", talk to Economic society of Australia (Victorian Branch), 11 February 2000, p.8.
[28] I.J. Macfarlane, "The Economy and Monetary policy", Talk to Economic Society of Australia (Victorian branch), 10 April 2001.
[29] The Hon. John Fahey, Treasurer, Press Release No. 100, 25 October 2000.

The Australian Bureau of Statistics also published a rather inconclusive 'Feature Article' on an 'experimental constant tax rate measure' of price change. Because of technical difficulties with the treatment of WST in this measure, it concluded that the result indicating that the NTS contributed 1.7 percentage points was 'implausibly low'. A modification to this measure produced an estimate of 2.3 percentage points attributable to the NTS.

In retrospect, a reasonable assessment of the effects of the tax changes appears to be less than 3 percentage points of the September quarter increase, perhaps somewhere between 2.5 to 3 percentage points.

As was expected the NTS had different impacts on the demand for particular products. Three important consumer items are housing and household items, motor vehicles and clothing. The demand for housing increased significantly in the six to nine month period leading up to the introduction of the GST. Low interest rates had already stimulated a high level of demand but the prospect of higher house prices after 1 July 2000 added further to this demand. Prices rose sharply in line with this anticipatory buying. The collapse in demand for new housing after 1 July 2000 accounted for the fall in GDP in the December quarter and was accompanied by a fall in prices.

In the case of motor vehicles, the opposite effect was anticipated as motor vehicle prices were expected to fall with the removal of the 22 per cent WST. The deferral of demand was to some extent to be offset by the phased introduction of input tax credits on business purchases. Motor vehicle registrations were around 164000 in the March and June quarters of 1999. They fell over the next two quarters by around 8 per cent. After rising by 3 per cent in the March quarter of 2000, they fell again by 13 per cent in the following quarter. Whilst industry representatives suggested there had been significant pre-GST price discounting the evidence available to the ACCC did not suggest that this had occurred to the extent claimed by the industry. Industry representatives were suggesting that consumers should not expect any further reductions when the tax changes actually came into place because of this anticipation. The deferral of demand was clearly evident as the average sales in the September and December quarters were 36 per cent higher than in the

June quarter. Moreover, prices of domestically produced vehicles did decline after 1 July 2000 by around 6 per cent, in line with ACCC expectations.

Clothing and soft-goods retailing were similar to housing in that WST generally did not apply but GST was imposed from 1 July 2000. Retail turnover for these products jumped by 7.8 per cent in the June quarter but fell by 15.5 per cent in the September quarter. Since then turnover has stabilised at around its pre-June quarter trend level. Demand anticipation effects would have been evident for many other product groups. For other products the demand effects of changing relative prices will take longer to be evident. Similarly it is difficult to assess in the short term what the overall effect of the indirect tax changes on business and final consumer demand will be.

ACCC contribution to the inflation outcome

There appears to be reasonable consensus among commentators that at least initially the NTS re-pricing contributed less to inflation than was expected beforehand. The Acting Treasurer suggested:

> Intense competition in the Australian economy, and effective monitoring by the ACCC, are likely to have resulted in some of the tax increases being absorbed by sellers, and cost savings flowing from the tax changes may have been passed into final retail prices more quickly than anticipated'.[30]

The RBA has also commented on the influences on inflation in the second half of 2000.

> The second half of the year has seen three strong cost-push inflationary pressures- the GST adding 10 per cent to many prices; an exchange rate which had fallen 15 per cent over the first ten months of 2000; and a world petroleum price which was 87 per cent higher (in terms of Australian dollars) than eighteen months earlier. …….Faced with these cost pressures, it looks as though many producers (particularly in manufacturing) found it difficult or impossible to pass on these price increases quickly, particularly in an environment where low inflation was well established, competition was vigorous and there was a fair amount of 'moral suasion'. Quantifying this price squeeze is quite difficult, and assessing its role in the slowdown more difficult still, because the starting point of profits was so strong. And, of course, there were some sectors (notably exports) where profits were substantially boosted by the lower exchange rate. But there is little doubt that some businesses *felt* squeezed, and this had a general dampening effect on their animal spirits[31].

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[30] Ibid.
[31] Reserve Bank of Australia, "The Australian Economy", Bulletin, April 2001, pp. 8-9.

Some of the ACCC's activities may fit within the description of 'moral suasion' though presumably some Government and even some RBA activities might also qualify.

Business critics of the ACCC's price oversight role have suggested that

> We have seen the ACCC's approach to price monitoring during the introduction of the GST and it has shown itself inflexible in understanding the pricing behaviour of business. Its actions may have resulted in a slower growth rate for prices during the introduction of tax reform, but to the extent that was true, it was also partly responsible for the slowdown in activity that followed the introduction of the new tax system.[32]

Given that the economy was slowing prior to the introduction of the NTS changes and that many businesses did not increase prices as much as they could have under the *Guidelines,* and sometimes reduced them by more than was required, it is questionable whether the ACCC was a direct source of the business profit squeeze. However, there are a number of ways in which the ACCC has assisted in minimising the inflation outcome. Firstly the ACCC's activities have helped to reduce inflationary expectations and encouraged stronger competition by promoting consumer vigilance.

It is clear that many consumers were uncertain or ignorant of the likely effects of the tax changes prior to their introduction. Surveys indicated that consumers expected prices to rise much more than the estimates provided by the Treasury and economic commentators.[33] For example, the Melbourne Institute of Applied Economic and Social Research's *Melbourne Institute Consumer Inflationary Expectations* reported that inflation expectations increased through 1999 as households began to factor in the effect of the NTS, with expectations rising sharply in early 2000. In July 1999 the median expected inflation rate of the survey sample was 4.9 per cent, in April 2000 it was 5.6 per cent, but in May it reached 8.2 per cent. Of those respondents that said prices would rise (75 per cent), around 40 per cent believed prices would increase by 10 per cent.[34] This was despite the zero rating of food under the GST and the

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[32] Australian Chamber of Commerce and Industry, "Prices Surveillance and the ACCC", Media Release, 12 June 2001

[33] Melbourne Institute of Applied Economic and Social Research, Don Harding and Matt Hammill, Monitoring the GST, 20 July 2000 `

[34] Ibid., Consumer Inflationary Expectations, 13 July 2000, p.1

abolition of WST at 22 per cent on many major consumer durable and motor vehicles.

The ACCC launched its *Shopping Guide* in late May 2000. This was distributed to every household in Australia and accompanied by a national media information campaign. The basic message of this was that ‘some products’ prices would go up, some would go down and some would stay about the same when the tax changes came into effect. This campaign appears to have had a significant impact in lessening inflation expectations. The median expected inflation rate of the *Consumer Inflationary Expectations* survey sample peaked in May and fell to 7.1 per cent in June, prior to consumers having any direct experience of re-pricing associated with the GST. By only the second week of July the survey’s median expected inflation rate had fallen to 4.6 per cent. Harding and Hammill observed that "The main reason for this decline…was a fall in the proportion of consumers expecting prices to rise by 10 per cent."[35]

Secondly, in some cases the *Guidelines* clearly acted to restrain businesses from increasing prices more than was justified by the tax changes. They did this not by squeezing dollar margins, but by preventing margins from increasing in a windfall manner. Of particular significance here were businesses whose prices were linked to other indicators which increased as a result of the NTS changes but whose costs did not rise commensurately. For example, many regulated monopoly businesses are subject to CPI related price caps. To the extent that the CPI rose as a result of the tax changes so would the prices charged by these businesses. The ACCC worked closely with other price regulators in Australia to ensure that only the cost impact of the tax changes was reflected in prices and that, where it was appropriate, the GST spike in the CPI escalator was removed. Similar issues arose in some monopoly non-regulated sectors such as shopping centres. CPI escalators are commonly used in leases. Rentals are also often linked to turnover that was also impacted by the tax changes.

Thirdly, it is likely that the timing of some price changes was influenced by ACCC activities. Under the PCC framework big businesses were encouraged to identify and seek likely cost savings. Further, they were encouraged to reflect these cost savings in their prices in advance of them actually being realised. In part, the *Guidelines* implied that businesses that did not continuously set new prices should do this in order to comply with the Dollar Margin Rule. In some cases, businesses went beyond this. Also in numerous cases businesses later claimed that anticipated cost savings had not been realised, although it was generally very difficult to assess this precisely.

Some businesses were unable to recover immediately their compliance costs in their re-pricing. For example, a clothing retailer may have had few cost savings on imported stock but significant up front compliance costs. As the 10 per cent GST applied with no other tax offsets it could be difficult to comply with the 10 per cent price rule and immediately recover these costs.

Many businesses chose to clearly separate their NTS related re-pricing from their non-NTS related re-pricing. Indeed large retailers specified to manufacturers that they would not accept any price adjustments for several months around the time of introduction of the GST. This was to enable them to ensure that they had appropriate systems in place and to avoid confusing customers and no doubt the ACCC as to whether price changes appropriately reflected the tax changes. While this was happening there could have been some squeeze in some margins, especially if market pressures to hold prices were stronger later on.

Fourthly, it is likely to be the case that some businesses did choose not to alter prices to the extent they would have been permitted to do so. This was to avoid attracting adverse public comment and possible investigation by the ACCC. Early in the changeover period some businesses were strongly criticised by politicians for increasing some of their prices by 10 per cent. Even though the ACCC did not consider the *Guidelines* to have been breached in these cases, the adverse media attention made other businesses more conservative in their pricing decisions. Similarly, there is no doubt that the business community generally was very sensitive to the strong powers of the ACCC to enforce the price exploitation law and its high level of resources to do

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[35] Harding, D. and Hammill, M., Monitoring the GST, Melbourne Institute of Applied Economic

so. Again the natural reaction would in some cases be to err on the side of conservatism. For this reason many businesses seem to have chosen to make use of the 'safe harbours' provided by pricing within the ACCC cost and price estimates made widely available. These estimates would not have accurately reflected the costs of each individual business.

Has there been a 2001 margin catch-up?

In the first half of 2001 inflation has risen more than was expected by official forecasters. The March quarter increase was 1.1 per cent and the June quarter was 0.8 per cent. The RBA has suggested that;

> This pickup seems, in part, to reflect the flow through of accumulated upstream price pressure related to the exchange depreciation over the past two years, as well as higher raw material prices. It may also reflect some more general rebuilding of retailers' margins, given the improvement in economic conditions since the second half of last year. It is possible, however, that the increase could also reflect some delayed pass-through of GST related price adjustments, although the size and timing of these effects will never be known precisely[36].

Earlier in the year the RBA expressed a stronger view regarding the possible delayed pass through of the tax changes.

> With the benefit of the March quarter (CPI) reading, it appears that businesses were initially slow to pass on some of the tax effects and various other cost pressures which were experienced during 2000, temporarily accepting a reduction in profit margins. This resulted in the lower-than-expected September and December quarter readings for CPI and underlying inflation. In the most recent quarter, it appears that more of these cost pressures have begun to be passed on, with the result that some of the price rises which were expected to occur last year have now shown up[37].

Whilst it is possible that some businesses may have sought to increase prices to recover tax-related cost increases previously not recovered there are a number of factors that suggest this may not be the case. Firstly there is the ACCC survey evidence previously referred to which suggests that the bulk of prices expected to change substantially either up or down had done so by the time of the August 2000 survey. Secondly, by mid 2001 most PCC companies had provided written assurances to the ACCC that they would not be increasing prices further on account of the NTS changes. On the strength of these

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and Social Research, 20 July 2000, p. 3.
[36] Reserve Bank of Australia, Statement on Monetary Policy, Bulletin, August 2001, p. 54.
[37] Ibid., Statement on Monetary Policy, Bulletin, May 2001, p. 45.

assurances the ACCC has not insisted on further six monthly reports from the businesses. Thirdly, any business seeking to increase product prices by more than 10 per cent cumulatively on account of the NTS changes alone would be in breach of the P rice Rule.

The ACCC has seen plenty of evidence that non-tax related cost pressures are impacting on prices. However, there does not seem to be much evidence to date that profit margins are being restored to the levels that may have existed prior to the NTS changes. There is even less evidence that recent margin movements are in some way related to the tax changes of one year ago.

Compliance costs

The beneficial impacts of prices oversight need to be assessed in light of the costs of implementing that oversight. One aspects of this is the compliance costs associated with the activity. There are both the administrative costs for the ACCC and costs imposed on business by this oversight over and above what business would incur in any event.

The significant level of funding for the ACCC reflected a Government determination to ensure that the oversight role was performed effectively. The bulk of the $56m available to the ACCC has been used to cover the costs of externally provided price monitoring services and to provide information and awareness services. It has been used to run radio and newspaper advertisements informing the community about re-pricing issues, to distribute the *Shopping Guide*, and other publications such as the *Small Business Compliance Kit*, to operate the call centre, and to meet staff commitments. Staff numbers have adjusted flexibly according to need. Around 1 July 2000, the ACCC had around 70 call centre operators, internally trained. This number rapidly declined as the volume of calls subsided. Peak staffing in the ACCC's GST Division reached around 120; current staffing is around 20.

Business compliance costs are difficult to assess and separate from costs that would have been incurred in any way due, for example, to having to introduce new accounting practices to cope with the taxation requirements and to deal with customer relations issues in an appropriate manner. Where possible the ACCC sought to minimise the costs its own activities imposed on business and this objective was emphasised in the *Guidelines.* But in many cases businesses went beyond what was required to satisfy requirements. Significant costs to business included the use of consultants to help identify cost savings, verify the accuracy of re-pricing and provide advice on legal requirements. Also significant costs were incurred by many retailers in ensuring appropriate audit trails were put in place to deal with complaints.

In some cases the ACCC was the catalyst for businesses undertaking work, which increased costs but also produced benefits. For example, businesses some times lacked appropriate global oversight over procurement activities and contract monitoring. The requirement that they reflect cost savings in prices meant that internal procedures in these areas were frequently strengthened. Further, the requirement to review changes in product costs and relate price changes to cost movements frequently meant that businesses had to review existing practices. In numerous cases it was reported that the opportunity was taken to effect improvement s in pricing procedures. Often prices are set by businesses in a very ad hoc, arbitrary manner with considerable discretion as to timing of changes. Businesses often welcomed ACCC advice in relation to community perceptions about pricing around the time of the NTS introduction.

Within the constraints of the Dollar Margin Rule and the Price Rule businesses were permitted by the *Guidelines* to recover the incremental costs associated with the NTS changes, including those associated with prices oversight. In many cases these costs were overstated initially as businesses sought to cover the cost of the high risk outcomes and included the costs of new systems introduced at the time of the NTS, but not fully required by it. The relatively smooth transition to the NTS system, facilitated at least in a small way by the ACCC oversight role, meant that actual costs were often less than expected, for example, systems did not break down and there were far fewer consumer complaints than expected.

5 Conclusion

An essential element of the NTS introduction has been oversight by the ACCC of the re-pricing due to the tax changes. Strong legislation was passed and substantial resources given to the ACCC to perform this task. The general objective was to prevent price exploitation in relation to the tax changes. This helped maintain public confidence and reduced the risk of increasing on-going inflation. From an economic perspective the existence of market power and information asymmetry justified an oversight role.

The ACCC adopted a comprehensive strategy to ensure compliance. This emphasised awareness raising and information provision. A crucial element of this was the development, in close consultation with industry groups, of simple pricing guidelines. The *Guidelines* were implemented flexibly with a concern to minimise compliance costs. The publication of the *Shopping Guide* was another important measure aimed at influencing consumer expectations and business behaviour. It was strongly pro-competitive in effect.

Extensive liaison was undertaken with businesses throughout the transition period. Discussions helped to develop approaches for applying the *Guidelines*.. There was a focus on big business through the PCC program. Special guidance was developed so that small businesses could avoid expensive analysis of cost savings and to facilitate easy pricing calculations. Awareness, information and assistance measures were supported by active monitoring and enforcement activity. A substantial number of complaints and pricing anomalies were investigated and a vigorous approach taken to ensure correction of errors. Enforcement activity emphasised administrative resolution of problems rather than heavy-handed regulation or reliance on the price exploitation legislation. Many actions were taken under existing consumer protection laws. Where satisfactory administrative resolutions could not be achieved, however, the ACCC had no hesitation in taking matters to court.

The evidence suggests that the spike in the CPI caused by the tax changes was less than had been expected. The slowing of economic growth, which coincided with the introduction of the NTS was, perhaps, fortuitous in this respect, though no doubt it was also influenced by changes in monetary policy settings in the previous year. Vigorous competition in this environment, together with the ACCC's active oversight, are seen as having an impact on the inflation outcome. The ACCC had a pro-competitive influence as well as exercising significant moral suasion. Its activities have prevented businesses from engaging in price exploitation.

In some cases conservative approaches to pricing may have caused small reductions in profit margins around the time of the changeover. ACCC evidence tends to support the view that the NTS re-pricing was largely completed in the September quarter 2000. Any subsequent margin recovery by businesses would seem to relate to non-NTS related pricing.