NSW Economics & Business Teachers' Conference
9 March 2001
Sydney

The GST: the ACCC's role and the impact on prices

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1 Introduction

Thankyou for the invitation to address your conference today. I have no doubt that the introduction of the New Tax System has been a topic of great interest to you and your students over the past year or so and will continue to be for some time to come. My brief today is to talk about the role of the Australian Competition and Consumer Commission (ACCC) in relation to the New tax System changes. This inevitably means my focus is largely on the pricing impacts of the changes.

The ACCCs role covered the indirect tax and subsidy changes only. The most significant of these changes was the introduction of the Goods and Services Tax (GST). Other significant changes were the phased reduction and elimination of the Wholesale Sales Tax (WST), changes to petrol, cigarette and beer excises, introduction of a Luxury Car Tax, changes to the Diesel Fuel rebate scheme, introduction of a Fuel Grant Scheme, and abolition of a number of state taxes, including Bed Taxes and, from 1 July 2001, Financial Institutions Duty and Stamp Duty on Marketable Securities.

2 Background

Australia's GST is similar to the value added taxes operating in many other countries. The essential feature of these taxes is that tax is levied on the 'value added' by a business. The GST is levied at each stage in the production and distribution process, but is intended to be passed on to final consumers. This is achieved by allowing businesses an 'input tax credit' on the GST they pay on inputs. However, consumers cannot obtain an input tax credit for anything acquired or imported for private consumption.

2.1 The GST in Australian tax policy debates

Debate over the reform of Australia's indirect tax system extended over many years prior to the introduction of the New Tax System changes.

A recurring theme in tax policy debate was the introduction of a 'broad-based' consumption tax ¾ a VAT/GST being only one variant ¾ to replace the 'narrower-based' WST and other relatively distorting state taxes. Integral to many of the variations on this theme was a proposal to reduce personal income tax rates in association with the consumption tax. Proponents of such reform invariably criticised what was described as Australia's 'over-reliance' on income tax as the federal government's major revenue source.

Major proposals along the way have been:

- ? 1975 the (Asprey) *Taxation Review Committee,* which advocated the adoption of a VAT;
- ? 1985 the (Labor Government's) *Draft White Paper on Reform of the Australian Taxation System*, particulary its 'Option C' of a broad-based retail tax;
- ? 1991 the Liberal & National Parties' *Fightback! Taxation and expenditure Reform for Jobs and Growth* proposed a comprehensive VAT (referred to as the GST).

The current Government's policy published in 1998 ¾ *Tax Reform: Not a New Tax, a New Tax System* ¾ proposed a comprehensive GST, similar to the *Fightback!* proposal but at a lower rate of 10 per cent rather than 15 per cent.

What was different about the *Tax Reform* proposal that allowed it to actually be implemented (although with the exclusion of food and some other adjustments to the original pla n), when other broadly similar proposals were discarded? The answer lies in developments in Australia's broader political economy, rather than in any technical superiority of the specific proposals. Three decades of tax policy debate had not resolved what a growing number of political and economic commentators regarded as fundamental problems in Australia's taxation structure. One of these problems ¾ the imbalance between the States' revenue powers and expenditure responsibilities ¾ was exacerbated in 1997 by the High Court's ruling that the States could no longer levy 'franchise' taxes on commodities. By the launch of the *Tax Reform* proposal a greater receptiveness to change existed.

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 businesses possibly exploiting the indirect tax changes through opportunistic pricing. *Tax Reform* tackled this issue head-on 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.' *Fightback!* was weaker on this issue in 1993. The then Prices Surveillance Authority, which had no powers of enforcement, was to be assigned a 'monitoring' role. While not suggesting that this difference was instrumental to the public acceptance of the introduction of a value added tax , it does indicate that the 1998 package was more alert to the pitfalls in selling indirect tax reform to the public.

2.2 Effect of VAT introduction on prices overseas

Value-added type taxes have been adopted by nearly all OECD countries and about 80 countries worldwide. They have often replaced wholesale or retail sales taxes. The inflation impacts associated with these changes have differed greatly depending on actual circumstances in each case.

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.

Governments generally have been extremely concerned about the reaction of consumers (and voters) to the effect of introducing a value added tax. In response most governments have undertaken extensive information campaigns and some have implemented price monitoring arrangements. In the 1960s and 70s when prices and incomes policies were more in vogue, the tax/price changes were sometimes covered by more general price control arrangements.

Whilst it is difficult to infer much from the evidence, there is a slight suggestion that better inflation outcomes were achieved when there was some active oversight of the repricing in response to tax changes.

3 The ACCC's role in the *New Tax System*

In recognition that there would be community concern about the possibility of consumer exploitation and excessive profit taking, the Government's plan for tax reform announced that it would legislate to provide the ACCC with special transitional powers to formally monitor prices and power to take action against businesses that adjust prices in a way that is inconsistent with changes in tax rates. 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 are 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'.

The ACCC was given the task of ensuring that repricing by businesses on the implementation of the tax changes did not offend against these principles.

Opinions may differ on whether Government intervention in the adjustment of markets to the tax changes was required on strictly economic grounds. Current mainstream economists generally are sceptical of the benefits of direct price intervention. However, the existence of monopoly power in some markets and information asymmetry across many markets provides some economic rationale for the ACCCs role in this area. From a broader political economy perspective, the ACCC role was a vital one in helping to ensure community acceptance of the changes to the tax system many economist commentators had advocated for several decades.

3.1 The legislative basis of the 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’*)*, regarding price exploitation in relation to the New Tax System changes. This legislation applies to all businesses irrespective of the competitiveness of the markets within which they operate. 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. 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 Commission to issue guidelines about when prices will be regarded as unreasonably high.

The new law is 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 applies for a three year transition period until 30 June 2002.

In addition, new legislation was passed (section 75AYA) that gives 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 complements the Commission’s existing powers in relation to misleading and deceptive conduct.

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

- issue a section 75AW notice where the Commission considers that a corporation has engaged in price exploitation (creating the presumption that price exploitation has occurred in any ensuing Court proceedings);
- issue a section 75AX 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;
- issue a section 75AY notice requiring a business to provide certain information to the Commission; and
- monitor prices to assess the effect of the NTS changes, and to investigate cases of price exploitation.

3.2 Key elements of the strategy to influence NTS-related repricing

Central to the promotion of compliance 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 Commission's activities, especially before 1 July 2000, were focussed on achieving compliance by preventing problems from 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 when considering whether to issue a price exploitation notice or a notice to aid in the prevention of price exploitation; and the Court may have regard to *The Guidelines* in any proceedings concerning injunctions and penalties concerning price exploitation. *The Guidelines* provide greater certainty to business about the administration of the law by the Commission.

The Guidelines were issued in July 1999. They were updated during 2000 to reflect an amendment to the Trade Practices Act, to clarify a number of policy issues raised with the ACCC since the Guidelines' initial release last July and to address some new issues. The update did not amend the underlying principles of the Guidelines. They continue to provide broadly applicable, economy-wide principles.

The Guidelines are very simple and clear with two key rules applying:

? 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 Everyday Shopping Guide

The ACCC believed 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 Commission produced a publication ¾ *Everyday Shopping Guide with the GST* ¾ that provided a range of expected price movements for 185 common household goods and services as a result of the tax changes. This was very widely distributed in late May 2000. The *Shopping Guide* provided estimates of likely price changes, as a result of the New Tax System alone, over the six months from 1 July. 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. The *Shopping Guide* meant that there were 19 million informed consumers who could advise the Commission of instances where they believed price exploitation may have occurred.

The *Everyday 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 guide, it was unlikely to attract the attention of the regulator.

Public Compliance Commitments

Another element of the Commission's strategy to promote compliance was to invite Australia's biggest businesses to give a public commitment that they complied with the Guidelines. A Public Compliance Commitment is a statement signed by the CEO of a corporation, stating that the Company is committed to complying with the *Price Exploitation Guidelines* and the price exploitation provisions of the Trade Practices Act. These are voluntary commitments that are 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. Public Compliance Commitments provide an assurance to the community that no unfair advantage has been taken of the New Tax System changes to increase margins.

The ACCC established a public register for organisations it deemed to have adopted acceptable Public Compliance Commitments. There are 35 companies on that register, including Australia's major retailers, manufacturers, the four big banks, telecommunications companies and transport companies. The ACCC has detailed pricing methodology from these major companies, which will help to ensure that consumers receive the full benefits from the abolition of the WST and other tax-related cost savings. The companies also will provide the ACCC with cost and price information at least every six months, so that it can monitor savings achieved during the transition to the New Tax System.

Small business pricing kit

While the public compliance commitment concept was directed at big business, the ACCC was acutely aware of the crucial importance of small business to a smooth repricing process. Almost every supply chain contains a small business. Small business had less resources to seek advice and assistance during the transition and therefore was a risk area for not passing on savings. If one part of the supply chain failed to pass through savings, and just added 10 per cent, the end result would have been higher prices to consumers.

The Commission recognised the potential for some smaller businesses, in the face of no affordable alternative, to just add 10 per cent to pre-1 July 2000 prices. To help prevent such an undesirable, and probably illegal, repricing action, the Commission released a *Small Business Pricing Kit* to help small business identify and pass on cost savings likely to result from the tax changes. In essence, the *Kit* assisted small business to determine which costs should rise and fall and by how much.

Price Monitoring

The Commission has supplemented information received from individual consumers through its GST Hotline with comprehensive price monitoring and survey activities. In total the ACCC will collect well over 3 million prices in its specially commissioned surveys of retail prices. Two surveys ¾ the (approximately quarterly) *General Survey* and the *Monthly Supermarket Survey* ¾ provide data to compare pre-GST prices with post-GST prices. The surveys also enabled an assessment of whether suppliers have ‘anticipated’ the introduction of the GST by increasing prices before July 1 2000.

The *Monthly Supermarket Survey* collects prices of a ‘basket’ of 100 branded items sold in over 300 supermarkets in all States and the NT. The *General Survey* covers prices for a wide range of goods and services ¾ about 700 in total ¾ commonly purchased by households. Collection of price information occurs in all States, the Australian Capital Territory and the Northern Territory. Prices are collected in about 10,000 retail outlets in each of the eight capital cities and 100 towns across Australia. There is a total of about 350,000 prices comparable across all collections. The size of the *General Survey* is substantial by any reasonable measure. An indication of the size of this survey is provided by comparison with the *Consumer Price Index*. The Commission understands that in the collection of the *CPI*, the Australian Bureau of Statistics obtains around 100,000 separate prices each quarter.

The coverage of the ACCC’s monitoring, through the two retail surveys and access to existing product-specific price databases, includes:

- most consumer items previously subject to 22 per cent WST (eg TVs, stereos);
- about 400 food and household items purchased in supermarkets;
- beer and cigarettes;
- petrol, diesel and auto LPG;
- motor vehicles;
- residential rents’;
- building materials, products and house costs;
- clothing;
- restaurants;
- household services such as dry cleaning, shoe repairs; and
- some professional services.