

It is sometimes claimed that economists are obsessed by competition. The reason is simple.

Competition matters, a lot!

Petrol provides a great example of the effects of local competition. [Costco entered the Sydney](#) market selling petrol about a bit over a year ago. And for most consumers, that is irrelevant. But if the Costco outlet is close to you, then it matters a lot.

Following a reader's comment, I started to track the effect of Costco's price on the local petrol market around Casula in Sydney's west. The results (from the Motormouth website) were startling.

For example, in March last year, motorists could save between 3 to 8 cents per litre by filling up at Costco rather than an alternative outside the 'Liverpool' area. And the savings were even bigger if you filled up at Costco rather than, say, on the north shore, where the gap could be up to 20 cents per litre.

Now, few people are going to drive from Lane Cove to Casula just to save \$5 to \$10 on a tank of petrol. The time, effort and fuel used up would eliminate most of the gain.

So the real interest from Costco's petrol pricing is on local competition.

Not only could you save by buying petrol from Costco, you could also save, for example, by buying petrol at Woolworths in Prestons compared to Woolworths in Seven Hills. Costco's discount petrol not only drives down its price, but its immediate competitors have to follow it down.

Competition matters a lot in petrol retailing. But, as the Australian Competition and Consumer

Commission has long argued, competition occurs in local petrol markets. Cheap prices in one suburb may have little, if any, impact on the other side of our major cities.

The importance of competition is highlighted by the ACCC's [latest petrol reports](#) . At the macro-level, falling oil prices are driving down the price we pay at the pump. This fall was predictable although the speed and size of the drop in the world oil price has surprised pretty much everyone [including myself](#) !

So overall motorists can expect lower prices for the remainder of 2015. The oil price will start to edge back up as new projects are put on the shelf, but the increased world supply is not going to suddenly disappear.

But what about at the micro level?

As the ACCC's charts show, consumers in rural centres, like Tamworth, Toowoomba, and Kalgoorlie have received a lot less of the benefit of falling petrol prices than their cousins in the major metropolitan cities. For example, in July, Townsville drivers paid around 2 cents per litre more than their city counterparts. By December, the gap had grown to 20 cents. Similarly, in July, residents in Alice Springs paid around 26 cents more per litre than in the cities. By December this had grown to 44 cents.

No-one expects regional petrol prices to be the same as city prices. There are extra transport costs and lower volumes through fuel depots in regional areas that push up the cost of supply. And, petrol prices have dropped in regional Australia as world oil prices have fallen. But they have dropped by a lot less than prices in the five largest cities in Australia.

The ACCC is going to investigate this disparity. What they will find is a well-known economic phenomenon called '[rockets and feathers](#)' .

When oil prices rise, then retail petrol prices tend to rise rapidly, like a rocket. But if oil prices

fall, then the retail response of petrol prices is much slower. Petrol prices fall slowly, like a feather. The end result may be the same, but there is a difference in the time taken to get there. And consumers lose on both sides. The fast rising prices mean consumers pay more. The slow falling prices also mean consumers pay more.

Rockets and feathers is not collusive behavior. It is not a deliberate plot by petrol retailers to screw consumers. Indeed, it is not an Australian phenomenon at all, but is found world wide for a range of different products. The level of [competition and consumer search](#) drives it.

Rural motorists suffer from slower petrol price falls because competition at the retail level in rural and regional Australia is not as strong as in the cities. In the cities, no retailer can get away with a slow price drop. There are too many aggressive competitors. But the same doesn't hold true in many country towns.

The ACCC's investigation will highlight the different levels of competition, but the real issue is what to do about it. There is no point trying to force more retailers into rural areas. This will just lead to bankruptcies or taxpayer subsidies when oil prices stabilize and petrol volumes cannot sustain the number of retail outlets.

An alternative is to try and reduce consumers' search cost. If motorists can easily find the lowest petrol price then this will help competition. But care is needed. Swapping information about petrol prices can help retailers keep prices higher, as the ACCC is arguing in its [current case](#) before the Federal Court.

A key is to get information out to consumers in an easy form and in a public way, at the same time as competitors get the information. But even this may lead to unintended consequences.

Perth uses a [fuelwatch scheme](#) to help inform consumers of petrol prices and lower search costs. The scheme has two parts – a restriction on retailers varying petrol prices during the day and a system to inform consumers of cheap fuel prices. Perth is the only major city to use this scheme. And as the ACCC's [latest price cycle information](#) shows, Perth is also the major city with the most volatile petrol prices in the last month.

## Rockets and feathers: Why competition matters for petrol pricing

Written by The Conversation

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So competition matters a lot in petrol retailing. And there is not a lot that governments can do about it. The best result from the ACCC's inquiry may be the recognition that rockets and feathers in regional petrol prices are unavoidable. However, that is unlikely to satisfy the politicians.

*Stephen King does not work for, consult to, own shares in or receive funding from any company or organisation that would benefit from this article, and has no relevant affiliations.*

**Read more** <http://theconversation.com/rockets-and-feathers-why-competition-matters-for-petrol-pricing-36489>