GST

The role of the ACCC in implementing the New Tax System changes

Following is an edited version of a presentation by Commissioner David Cousins to the 30th Annual Conference of Economists in Perth, 23–26 September 2001.

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, 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 Commission's role was to monitor the re-pricing which accompanied the changes and see that businesses adjusted prices correctly and did not mislead customers. It was a role that was unpopular with business, considered unnecessary and possibly counter-productive by some commentators but strongly supported politically and by consumers.

The Commission's prices oversight role extends until June 2002 but, with the bulk of the re-pricing and the work of the Commission on the NTS now completed, it is timely to give a qualitative assessment of its tasks and their outcomes.

This paper gives some background including the political context and the legislative framework within which the Commission has worked. It then outlines the key elements of the strategy adopted to ensure compliance. This emphasised raising awareness and providing information. A crucial element was developing simple pricing guidelines in close consultation with industry groups.

The strategy included disseminating information to business on pricing guidelines and to consumers on retail prices via publications and the media. Also, public compliance commitments were obtained from large businesses, a compliance guide published for small businesses, prices monitored and enforcement instigated when non-compliance was detected.

The inflation outcomes are considered in the broad macro-economic context. Finally the assessments of other informed parties of the Commission's performance are noted.

The general conclusion of the paper is the Commission has played a valuable role in implementing 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 inflationary impact of the tax changes.

Background to the Commission's role

Legislation to implement the NTS was passed in June 1999. Key elements of the reform package included:

- introducing the GST (expected to raise around $28 billion in its second year);
- removing some indirect taxes, including the WST (reducing government revenues by around $22 billion); and
- significantly reducing personal income taxes (lower rates around $12 billion being offset to some extent by base-broadening measures around $6.5 billion).

Additional social security payments of about $6 billion meant the changes were expected to provide an overall fiscal stimulus to the economy of about $6 billion, or about 0.8 per cent of gross domestic product.[1]

[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.

The changes to indirect taxes were expected to significantly affect prices. Some products that had been taxed at rates of up to 32 per cent at the wholesale level would be taxed only at a 10 per cent rate at the retail level after 1 July 2000. 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 the changes in tax effects across products would be inconsistent. To achieve the efficiency and equity benefits of the changes prices needed to move 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 Commission was directed to oversight the pricing responses of businesses to the indirect tax and subsidy changes introduced by the NTS. The changes covered by this oversight began on 29 July 1999 with an initial reduction from 32 per cent to 22 per cent of the WST 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:

- 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 Fuels Grants and the Fuel Sales Grants 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).

Petrol and diesel excise and beer excise in March and April 2001 respectively were also reduced. 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 on 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. It mainly affects 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 also suggested 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:

- the *Taxation Review Committee Report* in 1975, which advocated the adoption of a VAT;
- the draft white paper, *Reform of the Australian Taxation System*, in 1985 particularly its option C of a broad-based retail tax; and
- the *Fightback! Taxation and Expenditure Reform for Jobs and Growth* blueprint which included a comprehensive VAT (referred to as the GST).[3]

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.

All proposals for reform before the 1998 tax reform proposal had failed to receive the political acceptance necessary for their implementation. There were many reasons for this, but one relevant to this paper was the 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 one was how the latter tackled voter/consumer concern about opportunistic pricing. *Tax Reform* tackled it aggressively by stating that the Commission 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.'[4]

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

3 Liberal and National Parties, *Fightback! — It's your Australia*, Canberra, November 1991.

4 Commonwealth Treasury, *Tax Reform: not a new tax, a new tax system*, AGPS, Canberra, August 1998, p. 22.

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

Tax Reform indicated that the Government would legislate to provide the Commission with special transitional powers to monitor prices formally and to act against businesses that adjusted prices inconsistently with changes in tax rates.[5] 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. That is:

- consumers were to fully benefit from reductions in the tax rate if 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. The Government did modify its proposals, for example by excluding basic food from the GST, during consideration of the legislation by Parliament but there was not the same parliamentary opposition to the oversight provisions. Rather, opposition parties were suggesting that the proposed arrangements were not likely to be sufficient to protect the community.

Criticisms of the Commission's role

Despite the obvious political imperative, the role of the Commission 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 Commission's oversight role.[6] It was claimed that prices oversight was unnecessary and could only be harmful 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.[7] 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.[8]

Another suggestion was that it was inappropriate for the competition regulator to also have a price oversight role.[9]

> If the proposed Goods and Services Tax legislation goes through, however, we will find competition principles and price control principles in direct conflict. Under its 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.[10]

The economic case for prices oversight is fundamentally based on the existence of market failures, in particular market power and information asymmetry. When firms have market power, whether

5 Tax Reform, pp. 15, 22 and 85.

6 Law Council of Australia, Submission on A New Tax System (Trade Practices Amendment) Bill 1998, April 1999.

7 Gary Banks, 'Competition: the best price regulator', CEDA presentation, Perth, 21 November 2000.

8 Jeff Borland, 'Let's not waste time trying to gauge GST impacts', *Australian Financial Review*, 20 March 2000.

9 See for example, Ian McEwin, 'Watchdog needs an overhaul', *Australian Financial Review*, 1 May 2000, p. 17.

10 Warren Pengilley, 'Who administers our Competition and Consumer Protection Laws?', *Competition & Consumer Law Journal*, 1999, p. 259.

because of 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 most consumers knew little of the taxes applying to particular products before 1 July 2000 and thus what the quantitative effect of the NTS changes on prices ought to have been. Therefore business could influence consumer expectations opportunistically. There have been numerous examples, challenged by the Commission, of industry groups 'talking up' the price impact of the tax changes.[11]

In assessing criticisms of the prices oversight regime it is important to examine what the Commission has done in carrying out its role. Given the 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.

There were also vigorous supporters of the Commission's prices oversight role. Consumer and welfare groups and unions considered the role to be important, in part, to ensure that the compensation arrangements for disadvantaged groups were not eroded. Some were also concerned that unwarranted price rises did not occur and trigger wage claims which, if successful, could increase inflation.

Overseas experience does not cast much light on the desirability or otherwise of prices oversight in response to major tax changes.[12] 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 when its GST was being introduced. 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 monitored the effects of an increase in the rate of the Consumption Tax from 3 per cent to 5 per cent in April 1997.[13]

The 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.[14] These include the precise nature of the tax changes; their size; the economic environment; and market competitiveness.

Whether the Commission was the right body to perform the prices oversight task is perhaps a lesser matter. The Australian Tax Office could, perhaps, have been given the task but it had no previous 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, while the promotion of competition may appear to be at odds with prices oversight, this is a fairly superficial view. Prices oversight is most appropriate when 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 prices oversight role was for a limited time thus minimising the potential for long-term harm to competition. And giving the prices oversight role to a competition regulator was more likely to ensure that any conflict between the promotion of competition and the operation of prices oversight would be resolved in the direction of the former.

The legislative basis of the Commission'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 regarding price exploitation in

[11] For example, 'Makers claim GST will see car prices rise', *Sydney Morning Herald*, 4 December 1999.

[12] Tait, AA, *Value Added Tax: International Practice and Problems*, International Monetary Fund, Washington, DC, 1988. Chapter 10.

[13] Japan, Price Bureau, Economic Planning Agency, *Price Report*, 1997.

[14] 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.

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's resources were augmented considerably by about $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.[15] The legislation was amended in December 1999 to ensure that it also covered prices that were increased in anticipation of the tax changes.

The term 'unreasonably high' is not defined in the Act, however the legislation (s. 75AV) required the Commission to issue guidelines about when prices would 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.

[15] 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; and

(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.

In addition, further legislation was passed (s. 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.[16] This new law complemented the Commission's existing powers for misleading and deceptive conduct.

To prevent and eliminate price exploitation, the Commission was given a range of powerful statutory tools, including the power to:

- issue a price exploitation notice when the Commission considers that a corporation has engaged in price exploitation (creating in any ensuing court proceedings the presumption that price exploitation has occurred) — s. 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 — s. 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 Commission — s. 75AY; and
- report quarterly on its activities in relation to the prevention of price exploitation — s. 75AZ.

Key elements of the Commission's prices oversight strategy

Central to the promotion of compliance with the legislation by the Commission was the dissemination of information to business and the public so that markets would be more informed and competitive pricing facilitated. Many of the Commission's activities, especially before 1 July 2000, focused on achieving compliance by preventing problems from occurring later. This required communicating effectively with businesses and consumers to help them understand their rights and obligations under the legislation and the guidelines.

The guidelines

The Act required the Commission to formulate guidelines about what it considered constituted price exploitation. The Commission must have regard to these guidelines when considering whether to issue a price exploitation notice or a notice to help prevent

[16] *A New Tax System (Trade Practices Amendment) Act 2000.*

price exploitation; and a court may have regard to the guidelines in any proceedings dealing with injunctions and penalties for price exploitation. The guidelines are intended to provide greater certainty to business about the administration of the law by the Commission.

The guidelines were issued in July 1999.[17] They were updated in March 2000 to reflect an amendment to the Act, clarify some policy issues raised with the Commission since the release of the earlier draft and 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. They aim to be general, not unduly prescriptive, and relatively simple so that they can apply to all businesses. The Commission resisted calls for more comprehensive industry specific rules. The guidelines emphasise two significant factors not present in the legislation. The Commission's focus when reviewing prices would be on the change in prices made in response to the tax changes, not the level of prices and competitiveness of markets.

Two simple rules were:

- 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 from the NTS changes. If the impact was to reduce taxes and costs, firms were to reduce prices by at least this amount. This was a more favourable rule to business than other possible approaches such as the modified percentage margin rule initially put forward in a preliminary draft guidelines document.[18]

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 always be lower than the net tax and cost increases, except when demand or supply is perfectly 'inelastic-for-own-price' when 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.[19] 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 justify raising prices to the equilibrium level.

For markets that 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.[20] 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 net dollar margins to be maintained, they simply permitted firms to maintain margins.

The price rule was introduced to the amended guidelines in March 2000. Public debate had indicated some confusion about what the guidelines permitted for price averaging across related products and averaging over time. There had also been claims that high compliance costs would cause prices to rise, sometimes by more than 10 per cent when the only significant change 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 have been permitted by the dollar margin rule alone. However, since the guidelines permitted the recovery of incremental compliance costs the effect would generally be to delay the recovery of these costs. The price rule had the important effect of increasing certainty for consumers and helping monitoring.

The *Everyday shopping guide*

To ensure that consumers knew what to expect from the complex NTS changes, the Commission produced a publication — *Everyday Shopping Guide with the GST* — that provided a range of

[17] The guidelines are available at <http://www.accc.gov.au>.

[18] ACCC, Preliminary draft pricing guidelines for GST implementation, 23 April 1999.

[19] Peter Burn, 'The ACCC's price monitoring regime', *Business Council of Australia Bulletin*, vol. 2, no. 2, 2000.

[20] Joseph E Stiglitz, *Economics of the public sector*, 3rd edition, pp. 498–9.

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 could be vigilant, shop around for the best and fairest price and question retailers on prices. Informed consumers were more likely to advise the Commission if they believed price exploitation may have occurred.

The *Shopping Guide* also helped 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 Commission.

The estimates provided by the Commission were based on work commissioned from Dr Chris Murphy. The Commission modified some of his modelled results to take account of more detailed information, for example on actual taxation rates, retail margins and 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.[21] 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.

[21] 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*.

Murphy's model also produced aggregate long-term results that did not dramatically differ from those of PRISMOD. The forecast impact of the tax changes on inflation was somewhat less than for another general equilibrium model constructed by Professor Dixon.[22] Murphy's model incorporated a more optimistic view of achievable cost savings and a bigger exchange rate appreciation effect.

While the shopping guide only provided estimated price changes for 185 separate goods and services, the Commission used 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.

Public compliance commitments

Another strategy to promote compliance was to invite Australia's biggest businesses to give a public commitment that they complied with the guidelines. The Commission established a public register of businesses that provided it with an acceptable public compliance commitment (PCC). The 35 registered organisations 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.

PCCs 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. In developing a PCC, companies discussed with senior staff how the guidelines would be applied, for example:

- what product categories would the Commission recognise;
- what level of price averaging would be considered reasonable;
- would the Commission concur with the assessments made of cost impacts; and
- how appropriate were price descriptions.

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

The companies generally agreed to provide the Commission with cost and price information at least every six months, so that 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 Trade Practices Act. Some within the Commission and many businesses and their advisers had reservations about the concept. Some in the Commission were concerned that a PCC may compromise possible later enforcement action and allow businesses to extract unwarranted concessions. Some businesses and legal advisers were worried about the use of confidential information provided to the Commission 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 effective in conveying its expectations of business and for business to ensure compliance with the guidelines. Having the CEO sign off on the commitment meant there was greater awareness of what was required at board and senior management levels and this was passed on to personnel responsible for pricing. It often gave corporate staff greater influence over the business units of these large organisations. Communication between the Commission and businesses was enhanced by the effective liaison arrangements established under the PCCs. Finally, businesses with a PCC accounted for relatively few complaints and enforcement actions. Many of these businesses have advised the Commission of their satisfaction with the processes and outcomes involved.

Small business pricing kit

While the PCC concept was directed at big business, the Commission was acutely aware of the crucial importance of small business to a smooth re-pricing process. Initially the Commission'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.[23] 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 Commission liaised extensively with industry associations and produced a small business pricing kit, which was provided free to several hundred thousand businesses.

The 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 estimate likely changes to its costs from the NTS changes; and
- 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 helped small business decide which costs should rise and fall and by how much. The Commission considered that businesses using the model appropriately would be complying with the guidelines.

Price monitoring

The Commission established and advertised extensively a telephone hotline number for public and business inquiries and complaints about NTS pricing. The Commission's website also provided relevant information. Inquiries and complaints were often referred to compliance staff and investigators for detailed consideration and, in relatively few cases, enforcement action.

Prices were also surveyed extensively to identify directly price movements outside the Commission's expectations. Large general surveys were run in December 1999/January 2000 and May 2000 before the NTS, and in August 2000, October 2000, February 2001 and May 2001 after it was introduced. Surveys 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 in each survey.

Other more specialised surveys included a monthly supermarket survey covering a 'basket' of 100

[23] For example, report by Graham Gardiner, 'GST price cap "rubbish"', *Bizreview*, March 2000.

branded items sold in more than 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 provided the community with an authoritative picture of price changes. They helped counter other less representative surveys by the media, politicians and some industry bodies. The surveys also reinforced in the minds of many businesses an awareness of Commission activities and the need to comply with the guidelines and Act. They increased the risk of non-complying firms being detected. The Commission followed up on many apparent anomalies highlighted by the surveys. Recently the Commission accepted a court enforceable undertaking in relation to Quix convenience stores.[24] The company admitted to price exploitation by over-charging for more than 300 products. This matter came to light after assessing the results of the General Survey before and after the GST.

[24] ACCC, 'Quix to compensate consumers for price exploitation', media release 217/01, 10 September 2001.

Pre-GST price changes

In general the Commission's surveys did not point to any significant anticipation of the tax changes. For example, prices of goods subject to WST were not increased before the WST was reduced and later abolished, to offset the effect of any later reduction which may have appeared to comply with the guidelines.

Pre-GST price changes from the Commission's general survey between December 1999/January 2000 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 2 per cent; the weighted average increase was 1.2 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 Commission's estimates. Table 1 shows the estimated effects of the NTS and the results of the Commission's surveys over 3 and 12-month periods from May 2000. The monthly supermarket survey collections are continuing during 2001 and show moderate changes.

Table 1. ACCC expected NTS price effects and survey results

Product group	**Estimated NTS-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 and August 2000 surveys was +2.6 per cent. The upper limit of the range of the Commission'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 before the GST was introduced 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 areas, although price levels may have been quite different;
- there were minimal differences in the size or direction of price changes 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 most 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 with NTS effects increased by about 5 per cent or more. Of these prices, about 74 per cent increased by that amount and only 8.5 per cent did not change. 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 prices likely to change substantially because of the NTS generally had changed by early August.

Table 2 provides a more detailed comparison of the survey results and the Commission'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 Commission 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 Commission'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 & takeaway 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

From when the maximum wholesale price for petrol and diesel was removed in August 1998, the Commission has only informally monitored fuel prices. Data on retail prices has been obtained from specialised data-collection organisations. Import price and wholesale price data are also monitored by the Commission. The main drivers of fuel prices are overseas prices, the exchange rate (since overseas prices are generally quoted in US dollars), 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 price changes over a reasonable period to determine whether cost savings and the grant had been passed on to customers in accordance with the guidelines. The Commission publicly reported on price movements over the September quarter 2000. It concluded that prices had not increased by as much as might be expected especially in view of 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. This was extensively investigated after complaints were received from some franchisees suggesting that oil companies had modified their price support arrangements to capture the grant.

The public is highly sceptical about the competitiveness of the petroleum industry. It is also dissatisfied with the volatility of prices in capital city markets and the substantial gap that 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 GST was introduced, largely because of international factors. This prompted the Government to reduce excise and abolish future automatic indexation of excise rates in March 2001. The Commission again monitored the impact of these changes on prices. The Commission 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 Commission cautioned against intervention that would dampen competition in the industry. This was in the context of some 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 continuing 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 conduct investigations. A national perspective means minimising regulatory distortion across the country and so avoiding unnecessary regulation. Some in the community may have greater confidence in the industry given that the Commission 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 Commission on this than the industry itself.

Enforcement

The Commission emphasised 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 problems. But to ensure effective compliance, a credible threat that non-compliance will have adverse consequences for the perpetrator is needed. 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 Commission 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 and seek appropriate court outcomes when necessary to ensure deterrence. Cost-effectiveness of the enforcement action and the speed with which outcomes can be obtained may be taken into account. Priorities for action are strongly influenced by the blatancy of any breach, the economic detriment resulting and the likely precedent setting than may arise from the action.

Other actions the Commission could take for NTS matters include:

- doing nothing, other than perhaps drawing a matter to the attention of the business involved for appropriate action;
- resolving a matter informally by agreement on appropriate action, more formally accepting undertakings pursuant to s. 87B of the Act;
- issuing a notice of price exploitation or a notice to prevent price exploitation; or
- taking court action to obtain injunctions, pecuniary penalties or other orders.

Overwhelmingly in its NTS enforcement work the Commission 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 had in coming to terms with the NTS in a relatively short time frame. However, there were also a significant number of matters that arose because of poor attention to detail by businesses and in some cases simply carelessness. While 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 their way to court generally reflected the unwillingness of the business concerned to correct the matter.

Only in one case was a s. 75AW notice issued. It was alleged that a video hire firm had increased prices at some of its outlets in anticipation of the GST. The Commission took this matter to court but it was eventually settled between the parties. There is no doubt that the Commission's actions on this matter greatly heightened business awareness of the price exploitation laws in the period immediately before the introduction of the GST. The Commission has issued no notices under s. 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 been for the misleading and deceptive conduct provisions of Part V of the Act rather than the price exploitation ones.

The Commission has sought to achieve existing enforcement objectives in a balanced way recognising the difficulty many businesses, particular small ones, had in implementing the new taxation arrangements — and the uncertainty sometimes about what the arrangements actually were.

A brief summary of relevant enforcement statistics is provided below. These indicate that the Commission has been active in its enforcement role. They are:

- 177 000 calls to the GST Priceline and Commission Infocentre (123 000 inquiries and 54 000 complaints) between 1 July 1999 and 30 June 2001;
- 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 of s. 87B court enforceable undertakings;
- more than 600 informal administrative undertakings;
- more than $10 million in total refunds paid to nearly one million consumers (in a few cases when consumers could not be contacted, or when amounts were small, donations were provided to charities instead of refunds); and
- 71 businesses implementing or upgrading trade practices compliance programs or trade practices compliance training.

Price exploitation matters identified by the Commission included:

- 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 before the GST was introduced. Afterwards, 'GST-free' claims have been common. As the legislation did not require prices to be specified as GST-inclusive, businesses could quote prices in misleading and sometimes deceptive ways by not quoting the full price or using small print disclaimers, especially to final consumers. The Commission has expressed the view that it is better for prices to be quoted as GST-inclusive to avoid potential problems of this sort and confusion. Many businesses, however, apparently think that they are able to gain a competitive edge 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 Commission and particularly its Chairman Professor Fels have a high media profile. This largely reflects the nature of the work of the Commission 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 Commission advertised extensively on radio and in newspapers about the re-pricing, including the shopping guide estimates. The media campaign complemented other information activities including publications directed at consumers (*GST Talk* series), business (*News For Business* series) and the general community (*GST Bulletin* series). Targeted communications campaigns were also directed to major ethnic groups and Aboriginals and Torres Strait Islanders. It was appropriate, as an independent agency, that the Commission was able to conduct its media and communication campaigns independently and not as part of the broader Government campaign on tax changes.

In general, the business community criticised the use of the media by the Commission, especially when particular businesses have been highlighted. The damage to reputation can be significant if consumers are made aware of some contravention of the law or ethical standard. The Commission 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 and court actions are made public by the Commission so that other businesses will be aware of the matters and can, if necessary, amend their own conduct. Consumers are also entitled to know the outcome of matters dealt with by the Commission. They may wish to take follow-on action, for example to pursue other remedies or simply to change their buying behaviour.

For 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 ss. 75AW and 75AX of the Act.

Evaluation of the Commission's role

The macro-economic context

Before commenting specifically on the impact of the Commission 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 affected 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 GDP growth 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 per cent. Domestic and overseas demand were both growing strongly, the latter especially encouraged by increased competitiveness because of 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 per cent during 1999 well below the Reserve Bank of Australia's 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.[25]

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 declined slightly while inflation fell sharply.

In 2001 there has been a further easing of GDP growth. Inflation has increased slightly to about the 3 per cent level. The RBA eased monetary policy early in the year after revised lower growth forecasts for major overseas countries and the lower than expected CPI outcomes in the September and December quarters in 2000.[26] The September quarter figure was 3.7 per cent and the December quarter 0.3 per cent.

The Treasury's 2000–01 budget estimate was for a total increase in the 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 1.75–4.00 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 3 per cent estimated in the Budget.[27]

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 2.5–3.0 percentage points.

As was expected the NTS affected the demand for particular products differently. 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.

For 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 164 000 in the March and June quarters of 1999. They fell during the next two quarters by about 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. While industry representatives suggested there had been significant pre-GST price discounting, the evidence available to the Commission 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 began 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 Commission expectations.

Clothing and soft-goods retailing were similar to housing in that WST generally did not apply but

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25 IJ Macfarlane, 'Managing the expansion', talk to Economic Society of Australia (Victorian Branch), 11 February 2000, p. 8.

26 IJ Macfarlane, 'The Economy and Monetary policy', talk to Economic Society of Australia (Victorian branch), 10 April 2001.

27 The Hon. John Fahey, Acting Treasurer, press release No. 100, 25 October 2000.

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.

Commission 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. 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.[28]

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.[29]

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

[28] ibid.

[29] Reserve Bank of Australia, 'The Australian Economy', *The Bulletin*, April 2001, pp. 8–9.

Business critics of the Commission'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.[30]

Given that the economy was slowing before the NTS was introduced 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 Commission was a direct source of the business profit squeeze. However, in some ways the Commission helped minimise inflation.

First, the Commission's activities 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 before they were introduced. Surveys indicated they expected prices to rise much more than the estimates provided by the Treasury and economic commentators.[31] 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.[32] This was despite the zero rating of food under the GST and the abolition of WST at 22 per cent on many major consumer durables and motor vehicles.

The Commission launched its shopping guide in late May 2000. This was distributed to every household

[30] Australian Chamber of Commerce and Industry, 'Prices Surveillance and the ACCC', media release, 12 June 2001.

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

[32] ibid., *Consumer Inflationary Expectations*, 13 July 2000, p. 1.

in Australia and accompanied by a national media information campaign. In essence the message 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 lowered inflation expectations considerably. The median expected inflation rate of the Consumer Inflationary Expectations survey sample peaked in May and fell to 7.1 per cent in June, before consumers had directly experienced 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.'[33]

Second, the guidelines clearly acted to restrain some 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 that 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 Commission 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 affected by the tax changes.

Third, it is likely that the timing of some price changes was influenced by Commission 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 to comply with the dollar margin rule. Some businesses went beyond this. Also, many businesses later claimed that anticipated cost savings had not been realised, although it was generally very difficult to assess this precisely.

[33] Harding, D and Hammill, M, *Monitoring the GST*, Melbourne Institute of Applied Economic and Social Research, 20 July 2000, p. 3.

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 allowed them to introduce appropriate systems and to avoid confusing customers, and no doubt the Commission, about whether price changes appropriately reflected the tax changes. While this was happening some margins may have been squeezed, especially if market pressures to hold prices were stronger later on.

Fourth, some businesses probably chose not to alter prices to the extent they would have been permitted. This was to avoid attracting adverse public comment and possible investigation by the Commission. 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 Commission did not consider the guidelines had 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 sensitive to the strong powers of the Commission to enforce the price exploitation law and its high level of resources to do so. Again the natural reaction would be to err on the side of conservatism. For this reason they chose to make use of the 'safe harbours' provided by pricing within the Commission 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 officially forecast. The March quarter increase was 1.1 per cent and the June quarter 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.[34]

Earlier in the year the RBA expressed a stronger view on 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.[35]

While some businesses may have sought to increase prices to recover tax-related cost increases previously not recovered there are factors that suggest this may not be the case. First there is the Commission 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. Second, by mid-2001, most companies that had made public compliance commitments had provided written assurances to the Commission that they would not be increasing prices further on account of the NTS changes. On the strength of these assurances the Commission has not insisted on further six-monthly reports from business. Third, any business seeking to increase product prices by more than 10 per cent cumulatively on account of the NTS changes alone would breach the price rule.

The Commission has seen plenty of evidence that non-tax-related cost pressures are affecting prices. However, there does not seem to be much evidence as yet that profit margins are being restored to the levels that may have existed before 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.

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[34] Reserve Bank of Australia, Statement on Monetary Policy, *The Bulletin*, August 2001, p. 54.

[35] Ibid., Statement on Monetary Policy, *The Bulletin*, May 2001, p. 45.

Compliance costs

The beneficial impacts of prices oversight need to be assessed in light of the costs of implementing that oversight. One aspect of this is the compliance costs including administrative costs for the Commission and those imposed on business by this oversight over and above what business would normally incur.

The substantial funding for the Commission reflected a Government determination to ensure that the oversight role was performed effectively. The bulk of the $56 million available to the Commission 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. On 1 July 2000 the Commission had about 70 internally trained call-centre operators. This number rapidly declined as the volume of calls subsided. Peak staffing in the Commission's GST Division reached about 120 — current staffing is about 20.

Business compliance costs are difficult to assess and separate from costs that would have been incurred anyway, for example, from having to introduce new accounting practices to cope with the taxation requirements and dealing appropriately with customer relations issues. The Commission tried to minimise the costs its own activities imposed on business and this objective was emphasised in the guidelines. But businesses often went beyond what was required. 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. Significant costs were also incurred by many retailers in ensuring appropriate audit trails were established to deal with complaints.

The Commission was sometimes the catalyst for businesses undertaking work that increased costs but also produced benefits. For example, businesses sometimes 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 improve pricing procedures. Often prices are set by businesses in a very ad hoc manner with considerable discretion about timing of changes. Businesses often welcomed Commission advice on 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. These costs were often 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, helped at least in a small way by the Commission's 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.

Conclusion

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

The Commission adopted a comprehensive strategy to ensure compliance. This emphasised awareness raising and information provision. A crucial element of this was developing, in close consultation with industry groups, simple pricing guidelines. The guidelines were implemented flexibly to minimise compliance costs. The shopping guide aimed to influence 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 make pricing calculations easier. Awareness, information and assistance measures were supported by active monitoring and enforcement activity.

Many 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. When satisfactory administrative resolutions could not be achieved, however, the Commission had no hesitation in taking matters to court.

The evidence suggests that the spike in the CPI caused by the tax changes was lower than expected. The slowing of economic growth, which coincided with the introduction of the NTS may have helped, 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 Commission's active oversight, are seen as affecting the inflation outcome. The Commission had a pro-competitive influence as well as exercising significant moral suasion. Its activities have prevented businesses from engaging in price exploitation.

Conservative approaches to pricing may have caused some small reductions in profit margins around the time of the changeover. Commission 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.