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Panel on Economic Services
Meeting on 26 March 2007

Background brief on auto-fuel prices
and fuel surcharges on air passengers

Purpose

This paper provides background information on the mechanisms in respect of adjustment in auto-fuel prices and fuel surcharges levied on air passengers, and summarizes views and concerns expressed by members on related issues at previous meetings of the Panel on Economic Services (the Panel).

Auto-fuel prices in Hong Kong

2. The Panel has all along been concerned that oil companies are quick in raising and slow in reducing retail auto-fuel prices and that there seems to be some form of price fixing practices in the market. The issue of auto-fuel price adjustments has been discussed by the Panel at various meetings in 2002, 2003, 2004 and 2006. In this regard, the Council also passed a motion on 28 January 2005 urging the Government to actively consider introducing a fair competition law and other effective measures for the oil industries with a view to increasing competition and enhancing the transparency of product prices. The wordings of the motion are in **Appendix I**.

Components making up the retail price of oil products

3. The components making up the retail prices at the filling stations could be broadly classified into three categories, namely Government duty, costs and profit before tax. Duty for unleaded petrol is around \$6.06 per litre at present and ultra low sulphur diesel (USLD) was introduced at a concessionary duty rate

of \$1.11 per litre since 2000 on environmental grounds. Costs include variable costs, such as imported product prices, dealers' margin, fleet/card/coupon/discounts, promotional giveaways; and fixed costs, such as land premium or rent, and other fixed operating costs. The balance of the retail price after meeting Government duty and the costs represents the profits.

Factors affecting the oil prices in Hong Kong

4. According to Administration's replies to questions raised at Council meetings on 25 October 2006 and 17 January 2007, the retail price of oil products in a market is subject to various factors, including the followings:

- (a) Prices of refined oil products (such as unleaded petrol and USLD) are not only affected by crude oil prices, but also subject to the supply and demand in the market, the productivity of the refinery, the costs of raw material and refinery process, the transportation costs, discounts offered by oil companies and other operating costs. Therefore, although the adjustments in local retail prices should be broadly in line with trend movements and magnitude of changes in import prices, their respective percentage changes, which are calculated on different bases, will not be exactly the same.
- (b) In compiling the average local retail auto-fuel prices, the Census and Statistics Department (C&SD) has all along included the price concessions reported by oil companies, however, those concession schemes not reported by oil companies on grounds of commercial sensitivity or other reasons could not be covered. Therefore, the level of concessions quoted in C&SD's data may be different from the actual discount being offered by individual oil companies.
- (c) The monthly average import prices of major oil products compiled by C&SD have their limitations. The figures only reflect the average value of imported consignments declared by the oil companies in a particular month, they may differ from the actual prices of the consignments of individual oil companies. Moreover, the consignments involved may not be purchased or sold in the retail market in the month when the declarations are made. As C&SD needs to collect and process the information, there is a time lag of about four weeks between the time of declaration and the availability of such data.

Monitoring trend movements in oil prices

5. C&SD provides information on import and retail prices of major oil products to the Panel on a regular basis. According to the Administration, retail oil prices in Hong Kong are determined by oil companies. In a free market economy, the Administration does not have the power to dictate the retail prices of auto-fuels. However, it has been monitoring trend movements in prices for Brent Crude oil and Singapore FOB prices for unleaded petrol and ULSD to review whether the adjustments in local retail prices are in line with these trend movements. It is the Administration's observation that changes in local auto-fuel retail prices of are broadly in line with trend movements of the international oil prices.

Competition in the oil industry

6. In July 2005, the Government commissioned a consultancy study on the competition situation of the auto-fuel retail market in Hong Kong. The Panel was briefed on the outcome of the study at its meeting on 24 April 2006. The Consultant advised that, among other things, there was no clear evidence of collusion by oil companies in the Hong Kong auto-fuel retail market and the evidence did not show that oil companies increased prices more quickly than they decreased them. Adjustments in retail oil price were closely linked to the trend movements of the international oil prices. However, in view of the inherent characteristics of the local auto-fuel market, there was a risk that collusion could occur. In this connection, the study recommended that the Government should consider preventive measures aimed at prohibiting cartel behaviour, through either general or sector specific competition law. The scope and the key findings of the study are in **Appendix II**.

7. In June 2005, the Competition Policy Advisory Group (COMPAG) appointed the Competition Policy Review Committee (CPRC) to review the competition policy in Hong Kong. The CPRC submitted its report in June 2006 recommending a cross-sector competition law be introduced in Hong Kong to tackle anti-competitive conduct. In November 2006, the Government published the discussion document, "Promoting Competition – Maintaining our Economic Drive" for a three-month public consultation. The Government is considering the views received. The Administration hopes that if it is decided to introduce a cross-sector competition law in Hong Kong, the regulatory authority will be empowered to request oil companies to provide detailed information for investigation into suspected anti-competitive conduct in the auto-fuel retail market.

Major views and concerns expressed by members at Panel meetings

8. The Panel discussed the issues relating to adjustments in oil prices at the meetings held on 28 October 2002, 31 March 2003, 31 May 2004 and 24 April 2006, in two of which members also met with major oil companies in Hong Kong¹. The major views and concerns expressed by members are summarized as follows:

- (a) As C&SD needs to collect and process information, there was a time lag before the data on import oil product prices were available, the oil companies might have taken advantage of the time gap to quickly increase but slowly reduce the retail auto-fuel prices in response to changes in international oil prices.
- (b) To facilitate analysis on adjustments of retail auto-fuel prices, the Administration should request oil companies to increase transparency in the determination of retail prices. For example, oil companies should be urged to provide more information on import prices, inventory levels, cost and profit data; to give advanced notice in raising or reducing retail prices; and to inform the Administration when placing order for new consignment of oil.
- (c) The local retail prices among different oil companies were essentially the same, leading to a lack of competition in the fuel market. The Administration should introduce measures to promote competition in the fuel market.
- (d) The Government should reduce the excise duties on auto-fuel to relieve the burden of the affected economic sectors, in particular the transport sector.
- (e) The Government should provide more sites in the urban area for the provision of fuel storage facilities to encourage retailers to provide a wider choice of fuel types to consumers and to enhance competition in the auto-fuel market.

¹ The Panel met with major oil companies in Hong Kong at the meetings on 28 October 2002 and 16 December 2004. The meeting on 16 December 2004 was held closed door.

Fuel surcharges levied on air passengers

Mechanism for adjusting fuel surcharges

9. Airline operators recover their operating costs through the tariffs they charge for the carriage of passengers and cargo (i.e. ticket fares and cargo rates). However, for short-term fluctuations in aviation fuel prices, airline operators may choose to introduce a fuel surcharge to recover partially the short-term increase in costs. Under bilateral air services agreements (ASAs) which govern the provision of air services to/from Hong Kong, tariffs charged by airline operators require the approval of the relevant aeronautical authorities. For Hong Kong, the Civil Aviation Department (CAD) is the relevant aeronautical authority. Fuel surcharge is also a form of tariff requiring the approval of CAD.

10. In accordance with the existing ASAs, airline operators should consider all relevant factors including their operating costs, the passenger interests and the tariffs charged by other operators on the same routes in determining their tariffs. When approving fuel surcharge applications, CAD will take into account changes in the prices of aviation fuel, the justifications provided by the airline operators and other relevant factors, and ensure that the revenue so generated would not exceed the additional fuel costs borne by the airline operators during the corresponding period. Given the fluctuation in oil prices, CAD only approves fuel surcharges to be levied on a short term basis, in general over a two-month period².

Adjustments in fuel surcharges on air passengers since 2005

11. According to the Administration's reply to a written question raised at the Council meeting on 24 January 2007, the fuel surcharges levied on passengers by airline operators were adjusted on eleven occasions from January 2005 to January 2007, seven of which were upward and four of which were downward adjustments. In the six months from August 2006 to January 2007, CAD processed three rounds of fuel surcharge applications, resulting in a cumulative decrease in surcharge levels by 9%.

Members' views and concerns expressed at the Panel meeting

12. Issues related to fuel surcharges levied by airline operators were raised when the Panel discussed the adjustments in oil prices at the meeting on 31 March 2003. Concern was expressed on the need and justifications for granting an approval for levying fuel surcharges on passengers for a period of two months

² Since June 2004, CAD's approval has been reviewed regularly upon the expiry of the period.

because in case the international oil price dropped drastically during the period, the interests of passengers would be compromised. There were also concerns about the basis of the computation given the broad range of surcharges levied by different airlines and the need to provide a benchmark rate to safeguard the interest of passengers.

Latest development

13. At the Panel meeting on 22 January 2007, members expressed concern that despite the substantial decrease in international crude oil prices in recent months, the local auto-fuel prices had only fallen slightly and airline operators had made little adjustment in fuel surcharges. Members considered it necessary for the Panel to revisit related issues.

14. The Administration will brief the Panel on auto-fuel prices and fuel surcharges on air passengers at the meeting to be held on 26 March 2007.

References

15. The relevant papers relating to the subjects with their hyperlinks are in the **Appendix III**.

Council Business Division 1
Legislative Council Secretariat
21 March 2007

**Wordings of the motion on
"Introducing a fair competition law for the oil industries"
passed at the meeting of the Legislative Council held on 28 January 2005**

“That, as the adjustments of local oil product prices are always quick in going up but slow in coming down and the pace of price adjustments by various oil companies tends to be synchronized, while oil product pump prices often fail to truly reflect import costs, this Council urges the Government to actively consider introducing a fair competition law and other effective measures for the oil industries, including requesting the Competition Policy Advisory Group to take heed of any unfair mode of competition that may emerge in the local oil market, and entrusting the Group to monitor and study the situation, with a view to increasing competition in the oil industries and enhancing the transparency of product prices, thereby avoiding oligopoly, promoting fair competition and safeguarding commercial clients and the public against high oil prices.”

The key findings of the consultancy study on the local auto-fuel retail market

The scope of the study:

- (a) examine whether there is evidence that the oil companies might have engaged in any anti-competitive practices, such as collusion (described as "price fixing" in the Terms of Reference);
- (b) consider how competition in the supply of auto-fuel could be improved and lower retail auto-fuel prices (excluding tax) could be achieved; and
- (c) make recommendations on whether measures, including legislation, might be required to enhance competition in the Hong Kong auto-fuel market.

The key findings of the study

- (a) there is no clear evidence of collusion by oil companies in the Hong Kong auto-fuel retail market – the consultants observe that the actual pricing behaviour of the oil companies is not so different to behaviour in a competitive market, especially when valid Hong Kong-specific factors (such as its dependence on fuel imports and the use of loyalty and discount schemes to set the actual purchase price of fuel at the pump) are taken into account;
- (b) however, given the inherent characteristics of the local auto-fuel market, in particular the fact that the market is dominated by a small number of major suppliers, and the relatively small scale of the market, there is a risk that collusion could occur;
- (c) the Government should consider preventive measures aimed at prohibiting cartel behaviour, either through general or sector specific competition laws; and
- (d) whilst there are clear signs that the pricing of auto-fuel is becoming more competitive, more could be done to facilitate market entry for new competitors, such as improving the transparency of the auction process for public filling station sites.

Background brief on auto-fuel prices and fuel surcharges on air passengers

List of relevant papers

Panel/Committee	Date	Paper
Council Meeting	8 May 2002	LegCo question: Monitoring of oil prices (Hansard p.21) http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm0508ti-translate-e.pdf
Panel on Economic Services Panel (ES Panel)	28 October 2002	Administration's paper on retail prices of major fuels LC Paper No. CB(1)104/02-03(04) http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es1028cb1-104-4e.pdf Minutes of the meeting http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es021028.pdf
ES Panel	31 March 2003	Administration's paper on adjustments in oil prices LC Paper No. CB(1)1198/02-03(05) http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-5e.pdf Administration's paper on fuel surcharge by airlines LC Paper No. CB(1)1198/02-03(06) http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-6e.pdf Minutes of the meeting http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es030331.pdf

Panel/Committee	Date	Paper
ES Panel	31 May 2004	Administration's paper on adjustments in oil prices LC Paper No. CB(1)1890/03-04(01) http://www.legco.gov.hk/yr03-04/english/panels/es/papers/es0524cb1-1890-1e.pdf Minutes of the meeting http://www.legco.gov.hk/yr03-04/english/panels/es/minutes/es040531.pdf
Council Meeting	13 October 2004	LegCo question: Oil prices (Hansard p.63) http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1013ti-translate-e.pdf
Council Meeting	3 November 2004	LegCo question: Measures for monitoring oil prices (Hansard p.84) http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1103ti-translate-e.pdf
ES Panel	16 December 2004 (closed session meeting)	Administration's paper on retail prices of oil products LC Paper No. CB(1)439/04-05(01) http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-439-1e.pdf Background brief on retail prices of oil products prepared by the Legislative Council Secretariat LC Paper No. CB(1)487/04-05 http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-487-e.pdf
Council Meeting	28 January 2005	Motion: Introducing a fair competition law for the oil industries (Hansard p.186) http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0128ti-translate-e.pdf
Council Meeting	16 November 2005	Motion: Reducing and remitting the duty on ultra low sulphur diesel (Hansard p.143) http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1116ti-translate-e.pdf

Panel/Committee	Date	Paper
ES Panel	24 April 2006	<p>Administration's paper on findings of a consultancy study on the local auto-fuel retail market LC Paper No. CB(1)1303/05-06(03) http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1303-3e.pdf</p> <p>Presentation materials on study of the Hong Kong auto-fuel retail market LC Paper No. CB(1)1340/05-06(01) http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1340-1e.pdf</p> <p>Background brief on the auto-fuel retail market prepared by the Legislative Council Secretariat LC Paper No. CB(1)1312/05-06 http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1312-e.pdf</p> <p>Minutes of the meeting http://www.legco.gov.hk/yr05-06/english/panels/es/minutes/es060424.pdf</p> <p>Administration's supplementary information paper on "Findings of a consultancy study on the local auto-fuel retail market" LC Paper No. CB(1)2071/05-06(01) http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2071-1-e.pdf</p> <p>Administration's response to Hon Miriam LAU's request for the Administration to reduce the exercise duties on auto-fuel LC Paper No. CB(1)2131/05-06(01) http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2131-1e.pdf</p>

Panel/Committee	Date	Paper
Council Meeting	25 October 2006	LegCo question: Regulation of pump prices (Hansard p.27) http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm1025-confirm-ec.pdf
Council Meeting	17 January 2007	LegCo question: Monitory of oil prices (Hansard p.52) http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0117-confirm-ec.pdf
Press Release	18 January 2007	Press Release: Adjustments to aviation passenger fuel surcharge http://www.info.gov.hk/gia/general/200701/18/P200701180257.htm
Council Meeting	24 January 2007	LegCo question: Passenger carriage fuel surcharge levy by airline operators (Hansard p.82) http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0124-confirm-ec.pdf

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