

**立法會**  
**Legislative Council**

LC Paper No. CB(1)85/08-09(02)

Ref : CB1/PL/EDEV

**Panel on Economic Development**  
**Meeting on 24 October 2008**

**Updated background brief on auto-fuel prices**

**Purpose**

This paper provides background information on the mechanism in respect of adjustment in auto-fuel prices, and summarizes views and concerns expressed by Members.

**Auto-fuel prices in Hong Kong**

Components making up the retail price of oil products

2. The components making up the retail prices of auto fuel at the petrol filling stations (PFS) can be broadly classified into three categories, namely Government duty, costs and profit before tax. While duty is levied on unleaded petrol, duties on Euro V diesel and Auto-liquefied petroleum gas (LPG) are exempted. 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

3. According to Administration, the retail prices of auto-fuel in Hong Kong are determined by oil companies having regard to international prices, commercial practices and their operating costs. Prices of refined oil products are affected by crude oil prices, 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. 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.

4. According to the oil companies, all oil products in Hong Kong are imported and for environmental and other reasons, the quality of auto-fuel used in Hong Kong is generally better than other places. In addition, the land and labour costs of local PFSs are relatively higher. Market demand for auto-fuel has declined continuously in recent years due to various factors such as the development of mass transit infrastructure and the replacement of diesel by Auto-LPG as fuels for taxis and minibuses. With increased competition in a shrinking market, oil companies are offering more discounts in one form or another (such as loyalty points, rebates, discount coupons) and the discount levels have also increased significantly. So consumers are paying considerably less than the pump prices. The fixed costs of the oil companies, including land premium and rent, advertising and promotional costs and safety and environmental costs, have increased considerably, while economies of scale have been eroded with the decline in sales volume.

### **Monitoring trend movements in oil prices**

5. C&SD provides information on import and retail prices of major oil products to the Panel on Economic Development (the Panel) on a regular basis. In a free market economy, the Administration does not have the power to dictate the retail prices of auto-fuel. However, it has been monitoring trend movements in prices for Brent Crude oil and Singapore free-on-board (FOB) prices for auto-fuel 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 are broadly in line with trend movements of the international oil prices. The Administration has been keeping in contact with the oil companies and urged them to reduce their prices once there is room for downward adjustment. The Government's objectives are to maintain a stable fuel supply, encourage transparency and enhance competition by removing barriers to entry into the fuel market.

## **Competition in the retail auto-fuel market**

6. In July 2005, the Government commissioned a consultancy study on the competition situation of the retail auto-fuel 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 laws. The scope and the key findings of the study are in **Appendix I**.

7. In June 2006, the Competition Policy Review Committee (CPRC) recommended that the Government introduce a cross-sector competition law and establish an independent Competition Commission to tackle anti-competitive conduct. The results of the public consultation on the discussion document "Promoting Competition – Maintaining our Economic Drive" published in November 2006 revealed broad public support for the above recommendation of CPRC. In May 2008, the Government issued a consultation paper setting out the proposed major provisions of a Competition Bill. According to the report on the consultation released on 30 September 2008, there is general support for most of the proposals outlined in the consultation paper. The Government will work towards the target of introducing the Competition Bill into the Legislative Council in the 2008-2009 session. The Competition Commission under the new competition law would be empowered to require the oil companies to provide detailed information for investigation into suspected anti-competitive conduct in the retail auto-fuel market.

## **Major views and concerns expressed by Members**

8. The public have all along been concerned that oil companies are quick in raising and slow in reducing auto-fuel prices and that there seems to be some form of price fixing practices in the market. The subject of auto-fuel prices has been discussed by the Panel at various meetings since the 2002-2003 session. Members have also raised questions relating to high oil prices, monitoring of retail fuel prices, competition in the retail fuel market, and tendering arrangements for PFS sites at Council meetings in the past two terms. The Council 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, and another motion on 19 June 2008 urging the Government to reduce the duty on unleaded petrol by half and completely remit the duty on Euro V diesel, and to ensure that oil companies will fully reflect the duty concessions in the retail prices. The wordings of the motions are in **Appendix II**. The Council also passed a resolution under the Dutiable Commodities Ordinance (Cap. 109) to exempt the duty on Euro V diesel on 12 July 2008.

9. 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, 16 December 2004, 24 April 2006, and 3 March 2007, in three of which members also met with major oil companies in Hong Kong<sup>1</sup>. The Panel also received a briefing on the Administration's proposal to exempt the duty on Euro V diesel at the meeting on 23 June 2008. The major views and concerns expressed by Panel members are summarized as follows:

- (a) The oil companies are prompt in increasing their pump prices but slow in reducing them in response to the corresponding changes in international oil prices. There is urgent need for the Government to devise effective measures to monitor fuel prices.
- (b) As C&SD needs to collect and process information, there is a time lag before the data on import oil product prices were available, the oil companies may 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.
- (c) 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.
- (d) The local retail prices among different oil companies are 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.
- (e) The Government should reduce the duties on auto-fuel to relieve the burden of the affected economic sectors, in particular the transport sector.

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<sup>1</sup> The Panel met with major oil companies in Hong Kong at the meetings on 28 October 2002, 16 December 2004, and 26 March 2007. The meeting on 16 December 2004 was held closed door.

- (f) 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.
- (g) The high land premium for petrol filling stations (PFS) sites in Hong Kong and high Government duties on auto-fuel have add pressure on the retail prices of auto-fuel. The Government should consider exempting the duty on petrol or providing subsidy on the retail prices of auto-fuel to relieve the burden on the hard hit sectors and private car owners amid the upsurge in international oil prices.
- (h) The introduction of a competition law could help combat possible collusion among oil companies by enhancing the level-playing field in the retail fuel market.

### **Latest development**

10. At the Panel meeting on 14 October 2008, members expressed concern that despite the substantial reduction in international crude oil prices in recently, the local auto-fuel prices had only fallen slightly. Members considered it necessary for the Panel to revisit related issues with the Administration, oil companies and the Consumer Council at the special meeting to be held on 24 October 2008. In the Chief Executive's Policy Address 2008-2009, the Government re-iterates that it has asked the oil companies to promptly adjust prices in tandem with international oil price movements, and be more transparent in price setting so that the public can monitor their retail prices. It further points out that if it is found that fuel prices are indeed "quick going up, slow coming down", the Government will consider further measure to protect the public interest which may include tightening the monitoring of fuel prices through the petrol station tendering process.

### **References**

11. The relevant papers relating to the subject with their hyperlinks are in **Appendix III**.

### **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.

**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."

**Wordings of the motion on  
"Reducing the duties on motor vehicle fuels"  
passed at the meeting of the Legislative Council held on 18 June 2008**

"That, the Government has, since 1 December last year, lowered the concessionary duty rate for Euro V diesel to \$0.56 per litre, yet international oil prices have repeatedly reached record highs, thereby substantially increasing the cost of the transportation industry and the burden on people's livelihood, this Council urges the SAR Government to reduce the duty on unleaded petrol by half and completely remit the duty on Euro V diesel, and at the same time ensure that oil companies will fully reflect the duty concessions in the retail prices, so as to relieve the pressure of inflation and persistently high oil prices on the public and the relevant industries."

## Updated background brief on auto-fuel prices

## List of relevant papers

Panel/Committee	Date	Paper
Council Meeting	8 May 2002	LegCo question: Monitoring of oil prices (Hansard p.21) <a href="http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm0508ti-translate-e.pdf">http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm0508ti-translate-e.pdf</a>
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) <a href="http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es1028cb1-104-4e.pdf">http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es1028cb1-104-4e.pdf</a>  Minutes of the meeting <a href="http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es021028.pdf">http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es021028.pdf</a>
ES Panel	31 March 2003	Administration's paper on adjustments in oil prices LC Paper No. CB(1)1198/02-03(05) <a href="http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-5e.pdf">http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-5e.pdf</a>  Administration's paper on fuel surcharge by airlines LC Paper No. CB(1)1198/02-03(06) <a href="http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-6e.pdf">http://www.legco.gov.hk/yr02-03/english/panels/es/papers/es0331cb1-1198-6e.pdf</a>  Minutes of the meeting <a href="http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es030331.pdf">http://www.legco.gov.hk/yr02-03/english/panels/es/minutes/es030331.pdf</a>
ES Panel	31 May 2004	Administration's paper on adjustments in oil prices LC Paper No. CB(1)1890/03-04(01) <a href="http://www.legco.gov.hk/yr03-04/english/panels/es/papers/es0524cb1-1890-1e.pdf">http://www.legco.gov.hk/yr03-04/english/panels/es/papers/es0524cb1-1890-1e.pdf</a>

Panel/Committee	Date	Paper
		Minutes of the meeting <a href="http://www.legco.gov.hk/yr03-04/english/panels/es/minutes/es040531.pdf">http://www.legco.gov.hk/yr03-04/english/panels/es/minutes/es040531.pdf</a>
Council Meeting	13 October 2004	LegCo question: Oil prices (Hansard p.63) <a href="http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1013ti-translate-e.pdf">http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1013ti-translate-e.pdf</a>
Council Meeting	3 November 2004	LegCo question: Measures for monitoring oil prices (Hansard p.84) <a href="http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1103ti-translate-e.pdf">http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm1103ti-translate-e.pdf</a>
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) <a href="http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-439-1e.pdf">http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-439-1e.pdf</a>  Background brief on retail prices of oil products prepared by the Legislative Council Secretariat LC Paper No. CB(1)487/04-05 <a href="http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-487-e.pdf">http://www.legco.gov.hk/yr04-05/english/panels/es/papers/es1216cb1-487-e.pdf</a>
Council Meeting	28 January 2005	Motion: Introducing a fair competition law for the oil industries (Hansard p.186) <a href="http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0128ti-translate-e.pdf">http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0128ti-translate-e.pdf</a>
Council Meeting	16 November 2005	Motion: Reducing and remitting the duty on ultra low sulphur diesel (Hansard p.143) <a href="http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1116ti-translate-e.pdf">http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1116ti-translate-e.pdf</a>
ES Panel	24 April 2006	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) <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1303-3e.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1303-3e.pdf</a>

Panel/Committee	Date	Paper
		<p>Presentation materials on study of the Hong Kong auto-fuel retail market LC Paper No. CB(1)1340/05-06(01) <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1340-1e.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1340-1e.pdf</a></p> <p>Background brief on the auto-fuel retail market prepared by the Legislative Council Secretariat LC Paper No. CB(1)1312/05-06 <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1312-e.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-1312-e.pdf</a></p> <p>Minutes of the meeting <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/minutes/es060424.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/minutes/es060424.pdf</a></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) <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2071-1-e.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2071-1-e.pdf</a></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) <a href="http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2131-1e.pdf">http://www.legco.gov.hk/yr05-06/english/panels/es/papers/es0424cb1-2131-1e.pdf</a></p>
Council Meeting	25 October 2006	<p>LegCo question: Regulation of pump prices (Hansard p.27) <a href="http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm1025-confirm-ec.pdf">http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm1025-confirm-ec.pdf</a></p>
Council Meeting	17 January 2007	<p>LegCo question: Monitoring of oil prices (Hansard p.52) <a href="http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0117-confirm-ec.pdf">http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0117-confirm-ec.pdf</a></p>

Panel/Committee	Date	Paper
Panel on Economic Development (ED Panel)	26 March 2007	<p>Background brief on auto-fuel prices and fuel surcharges on air passengers prepared by the Legislative Council Secretariat LC Paper No. CB(1)1193/06-07(06) <a href="http://www.legco.gov.hk/yr06-07/english/panels/es/papers/es0326cb1-1193-6-e.pdf">http://www.legco.gov.hk/yr06-07/english/panels/es/papers/es0326cb1-1193-6-e.pdf</a></p> <p>Administration's paper on auto-fuel prices and fuel surcharges on air passengers LC Paper No. CB(1)1183/06-07(01) <a href="http://www.legco.gov.hk/yr06-07/english/panels/es/papers/es0326cb1-1183-1-e.pdf">http://www.legco.gov.hk/yr06-07/english/panels/es/papers/es0326cb1-1183-1-e.pdf</a></p> <p>Minutes of the meeting <a href="http://www.legco.gov.hk/yr06-07/english/panels/es/minutes/es070326.pdf">http://www.legco.gov.hk/yr06-07/english/panels/es/minutes/es070326.pdf</a></p>
Council Meeting	23 May 2007	<p>LegCo question: Regulation of LPG Prices at Dedicated LPG Filling Stations (Hansard p.73) <a href="http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0523-confirm-ec.pdf">http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm0523-confirm-ec.pdf</a></p>
Council Meeting	14 November 2007	<p>LegCo question: High oil prices (Hansard p.52) <a href="http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm1114-confirm-ec.pdf">http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm1114-confirm-ec.pdf</a></p> <p>Resolution under the Dutiable Commodities Ordinance (Cap. 109) to impose a Concessionary Duty Rate on Euro V Diesel (Hansard p. 85) <a href="http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm1114-confirm-ec.pdf">http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm1114-confirm-ec.pdf</a></p>
Council Meeting	21 May 2008	<p>LegCo question: Tendering Arrangements for Petrol Filling Station Sites (Hansard p.44) <a href="http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0521-confirm-ec.pdf">http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0521-confirm-ec.pdf</a></p>
Council Meeting	28 May 2008	<p>LegCo question: Impact of Rising Prices of Motor Vehicle Fuels on Relevant Trades (Hansard p.33) <a href="http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0528-confirm-ec.pdf">http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0528-confirm-ec.pdf</a></p>

Panel/Committee	Date	Paper
Council Meeting	19 June 2008	Motion: Reducing the duties on motor vehicle fuels (Hansard p.356) <a href="http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0619-confirm-ec.pdf">http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0619-confirm-ec.pdf</a>
ED Panel	23 June 2008	Administration's paper on rising fuel cost LC Paper No. CB(1)1979/07-08(03) <a href="http://www.legco.gov.hk/yr07-08/english/panels/es/papers/edev0623cb1-1979-3-e.pdf">http://www.legco.gov.hk/yr07-08/english/panels/es/papers/edev0623cb1-1979-3-e.pdf</a>  Minutes of the meeting <a href="http://www.legco.gov.hk/yr07-08/english/panels/es/minutes/ev080623.pdf">http://www.legco.gov.hk/yr07-08/english/panels/es/minutes/ev080623.pdf</a>
Council Meeting	12 July 2008	Resolution under the Dutiable Commodities Ordinance (Cap. 109) to exempt the duty for Euro V diesel (Minutes p.569) <a href="http://www.legco.gov.hk/yr07-08/english/counmtg/minutes/cm080709.pdf">http://www.legco.gov.hk/yr07-08/english/counmtg/minutes/cm080709.pdf</a>

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22 October 2008