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Legislative Council

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Panel on Transport
Meeting on 23 October 2009

Background brief on
fare adjustment arrangement for franchised buses

Purpose

This paper provides background information on the existing fare adjustment arrangement for franchised buses and summarizes the discussions held by Legislative Council (LegCo) Members on the arrangement.

Background

2. Under Section 13(1) of the Public Bus Services Ordinance (Cap. 230) (PBSO), the scale of bus fares is determined by the Chief Executive-in-Council (CE-in-Council). As endorsed by CE-in-Council in 2000, the Administration took into account a basket of factors known as the Modified Basket of Factors (MBOF) approach in assessing bus fare adjustment for the purpose of making recommendations to CE-in-Council. These factors included -

- (a) changes in operating costs and revenue since the last fare adjustment;
- (b) forecasts of future costs, revenue and return;
- (c) the need to provide the operator with a reasonable rate of return;
- (d) public acceptability and affordability; and
- (e) quantity and quality of service provided.

3. However, there had been suggestions that the above bus fare adjustment arrangement should be modified to ensure that bus companies would reduce bus fares in economic downturn. LegCo Members had actively followed up the issue at

meetings of the Council and the Panel on Transport (the Panel) since the first LegCo and had called on the Administration to reduce transport fares and improve the bus fare adjustment arrangement to enable upward and downward fare adjustments. The relevant motions and questions moved/raised at Council meetings are in **Appendix I**.

Modifications to the MBOF approach

4. In order to enhance the responsiveness and objectivity of the bus fare adjustment process, the Administration refined the MBOF approach for considering bus fare adjustment in 2006. The main objectives of the proposed modifications are to enable upward and downward bus fare adjustments in accordance with the prevailing economic conditions, and to enhance the objectivity of bus fare adjustment while maintaining the flexibility to consider the factors embodied in the MBOF approach.

5. Under the revised arrangement, a formula (supportable fare adjustment rate = $0.5 \times \text{Change in Wage Index} + 0.5 \times \text{Change in Composite Consumer Price Index (CCPI)} - 0.5 \times \text{Productivity Gain}$) has been included as an additional factor in the MBOF approach to enable upward and downward fare adjustments. However, the formula does not operate as an automatic determinant of fare adjustment outcome. CE-in-Council retains the ultimate power in determining bus fares and it will take into account all relevant factors including public affordability and the bus operators' financial viability. The modifications made in 2006 also specified that the new fare adjustment arrangement would be reviewed in three years' time (i.e. 2009). A copy of the LegCo Brief on the review of the basis for considering bus fare adjustments issued in 2006 is in **Appendix II**.

Fare reduction initiatives taken by bus companies

6. The four franchised bus companies, viz The Kowloon Motor Bus Company (1933) Limited (KMB), Citybus Limited (Citybus), New World First Bus Services Limited (NWFB) and Long Win Bus Company Limited (LWB) also agreed to implement a series of fare reduction initiatives starting from February 2006. These initiatives included –

- (a) 10% same day return fare reduction on routes where the single fare was \$15 or above (excluding Airport “A” routes, recreation routes and racecourse routes);
- (b) five per cent same day return fare reduction on routes where the single fare was between \$10 and \$14.9 (excluding Airport “A” routes, recreation routes and racecourse routes);
- (c) \$2 flat fare or half fare, whichever was lower, for elderly on Sundays and

public holidays (excluding Airport “A” routes and racecourse routes); and

- (d) an addition of 47 bus-bus interchange (BBI) schemes.

These initiatives (except the additional BBI schemes) would be implemented for three years starting from the date of implementation until the review of the new bus fare adjustment mechanism in 2009. In December 2008, the bus companies announced their decision to extend the fare concession scheme for the elderly on Sundays and public holidays for one year ending 31 January 2010.

Discussion of LegCo Members on implementation of the new bus fare adjustment arrangement

Fare increase applications from franchised bus operators in 2007-2008

7. While the objective of the new bus fare adjustment arrangement is to enable downward bus fare adjustments, all franchised bus operators applied for fare increases in 2007-2008 as a result of soaring fuel prices. At the Council meeting on 17 October 2007, Hon LEE Wing-tat moved a motion on the bus fare adjustment arrangement and the bus fare increase applications. Members generally considered the rate of bus fare increase too high, and various suggestions were made during the motion debate –

- (a) more sectional fares and bus-bus interchange concessions should be provided;
- (b) special elderly concessions on bus services, particularly during Sundays and public holidays should be provided;
- (c) daily, weekly or monthly bus passes should be provided; and
- (d) appropriate assistance to people with disabilities, including the introduction of half-fare concessions to people with disabilities, should be provided.

8. When the Panel was briefed on the fare increase applications from KMB, LWB, New Lantao Bus Company (1973) Limited (NLB), Citybus and NWFB at the meetings on 22 February and 25 April 2008, some members expressed concern that the rates of bus fare increases were always higher than those worked out according to the bus fare adjustment formula, and that the formula had failed to reflect the actual profit situations of the bus operators. The Panel was keen to ensure that public affordability would be adequately taken into account in any bus fare adjustments. Some members also considered it unfair that at time of economic downturn, the bus companies could refuse to adjust the fare downwards whereas, when there was a slight economic recovery, these companies immediately sought bus fare increases. At the meeting on 22 February 2008, the Panel urged the bus operators to, in the spirit of corporate social responsibility, refrain from significantly increasing their fares, and passed the

following motion –

"This Panel objects to the applications for substantial fare increases by franchised bus companies, and urges the Government to, when vetting the applications for fare increases by these companies, fully take into account the fact that they had never reduced fares during the period when a cumulative deflation rate of over 11.4% was recorded, and to reject the applications for fare increases by these companies, including the Kowloon Motor Bus Company Limited, on the basis of this fact; this Panel also urges the Government to further improve the relevant fare adjustment formula."

9. At the above meetings in February and April 2008, the Panel also explored various possible measures to stabilize bus fares, including the provision of fuel subsidy and operation subsidy, operation of bus services by the Government, setting up of a fare stabilization fund, granting of property development rights to bus operators, introduction of improvements to network efficiency, relaxation of restrictions on bus body and shelter advertising, etc.

10. The Panel subsequently noted from the relevant Legislative Council Brief that the Executive Council (ExCo) had discussed six fare increase applications made by five bus companies and had approved five applications to increase fare level with effect from 8 June 2008. All the approved fare increase rates, except that of NLB, were lower than the applied fare increase rates.

Bus Company	Proposed fare increase rate in the application	Approved average fare increase rate
KMB	9%	4.5%
LWB	5.9%	4.5%
NLB	7.24%	7.24%
Citybus (Franchise for Hong Kong Island and Cross-harbour Routes)	5.8%	2%
Citybus (Franchise for North Lantau and Chek Lap Kok Airport)	5.8%	0%
NWFB	5.8%	5%

11. The Administration advised that ExCo had taken balanced consideration of all relevant factors under the new bus fare adjustment arrangement introduced in 2006, including changes in operating costs and revenue since last fare adjustment; forecasts of future costs, revenue and return; the need to provide the operator with a reasonable rate of return; the quality and quantity of service provided; the outcome of the formula; and public acceptability and affordability.

Miscalculation of the wage figures of the transport services sector used in the bus fare adjustment formula

12. With the onset of the financial tsunami towards the end of 2008, there have been calls for reduction of bus fares in consideration of the substantial reduction in operating costs of bus companies as a result of the sustained low level of international oil prices, anticipated increase in bus patronage due to the sustained economic downturn, and general household income decline. The quarterly wage indices are a factor taken into account in the bus fare adjustment formula. The quarterly wage indices for December 2008 released by the Census and Statistics Department (C&SD) on 26 March 2009 raised hopes for bus fare reduction because, based on the relevant nominal wage index for the transport services sector and the CCPI for February 2009, the then quarterly outcome of the bus fare adjustment formula was -3.03%, which exceeded the -2% triggering point for the review of bus fares. However, C&SD announced on 15 April 2009 that there was miscalculation of the wage figures of the transport services sector used in the bus fare adjustment formula. In the light of the rectified nominal wage index for the transport services sector in December 2008, the Government re-calculated the bus fare adjustment formula outcome. The revised quarterly bus fare adjustment formula outcome was -1.26%. The incident had aroused wide public concern.

13. The Panel discussed the matter on 24 April 2009. Members noted that in the Labour Earnings Survey concerned, some establishments provided only raw information which had to be converted by manual computation before they could be used for compiling average wages. The error of C&SD was caused by a mistake committed by its staff concerned in performing manual computation. Members noted that C&SD had implemented a number of enhancement measures, e.g. strengthening the sensitivity of data quality checks as well as enhancing the data verification process and staff training, to avoid recurrence of similar incidents. Some members considered the conversion of raw information by manual computation undesirable and proposed that the Administration should impose a statutory requirement on public transport operators to provide C&SD with computed figures in place of raw information. A member opined that given the economic environment, bus fare adjustment should still be introduced in consideration of such other factors as public affordability and the economic situation.

Latest development

14. As undertaken by the Administration when introducing the new bus fare adjustment arrangement in 2006, the arrangement would be reviewed in three years' time, i.e. 2009. The Administration has completed the review and proposed to brief the Panel on the outcome at the meeting scheduled for 23 October 2009.

15. A list of relevant papers is in **Appendix III**.

Council Business Division 1
Legislative Council Secretariat
20 October 2009

Relevant motions and questions moved/raised at Council meetings

Motions

At the Council meeting on 14 November 2001, Hon LAU Kong-wah moved a motion urging the Government to discuss with various public transport operators with a view to expeditiously reducing the fares of public transport services. (<http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm1114ti-translate-e.pdf>)

2. At the Council meeting on 23 October 2002, Hon Andrew CHENG moved a motion urging the Administration to discuss with various public transport operators with a view to reducing expeditiously the fares of transport services and, at the same time, establishing a fare adjustment mechanism, so as to alleviate the burden on people's livelihood. (<http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm1023ti-translate-e.pdf>)

3. At the Council meeting on 12 November 2003, Hon Andrew CHENG moved a motion urging the Administration to refine the public transport fare system. (<http://www.legco.gov.hk/yr03-04/english/counmtg/hansard/cm1112ti-translate-e.pdf>)

4. At the Council meeting on 14 December 2005, Hon Andrew CHENG moved a motion urging the Administration to expeditiously implement a fare adjustment mechanism that allowed the fares to go upward and downward. (<http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1214ti-translate-e.pdf>)

Questions

5.3.2003	Hon Abraham SHEK raised a written question on the progress of the Administration's study on public transport fare adjustment mechanism (http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm0305ti-translate-e.pdf)
5.5.2004	Hon Andrew CHENG raised an oral question on measures to alleviate the burden of traveling expenses on students (http://www.legco.gov.hk/yr03-04/english/counmtg/hansard/cm0505ti-translate-e.pdf)
8.6.2005	Hon TAM Yiu-chung raised an oral question on public transport fare adjustment mechanism (http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0608ti-translate-e.pdf)

22.6.2005	Hon LAU Kong-wah raised an oral question on fare concessions offered by public transport operators (http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0622ti-translate-e.pdf)
22.3.2006	Hon CHEUNG Hok-ming raised a written question on the delayed implementation of fare discounts on jointly operated cross-harbour routes (http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm0322ti-translate-e.pdf)
25.4.2007	Hon CHEUNG Hok-ming raised a written question on bus fare concession initiatives (http://www.legco.gov.hk/yr06-07/english/counmtg/hansard/cm0425-translate-e.pdf)
2.5.2007	Hon Andrew CHENG raised an oral question on fare adjustments of public transport (http://www.legco.gov.hk/yr06-07/english/counmtg/hansard/cm0502-translate-e.pdf)
19.12.2007	Hon Albert CHAN raised a written question on sectional fares for franchised bus routes (http://www.info.gov.hk/gia/general/200712/19/P200712190155.htm)
11.3.2009	Hon Frederick FUNG raised a written question on fares of KMB and fare adjustment mechanism (http://www.legco.gov.hk/yr08-09/chinese/counmtg/floor/cm0311-confirm-ec.pdf)

LEGISLATIVE COUNCIL BRIEF

REVIEW OF THE BASIS FOR CONSIDERING BUS FARE ADJUSTMENTS

INTRODUCTION

At the meeting of the Executive Council on 10 January 2006, the Council ADVISED and the Chief Executive ORDERED that-

- (a) in assessing franchised bus fare adjustment applications for the purpose of making recommendations to the Chief Executive in Council (“CE-in-Council”), the Administration should continue to take into account a basket of factors in the Modified Basket of Factors (“MBOF”) approach as endorsed in December 2000, which include -
 - (i) changes in operating costs and revenue since the last fare adjustment;
 - (ii) forecasts of future costs, revenue and return;
 - (iii) the need to provide the operator with a reasonable rate of return;
 - (iv) public acceptability and affordability; and
 - (v) quality and quantity of service provided;

- (b) the MBOF approach should be modified as follows -
 - (i) a formula (supportable fare adjustment rate = $0.5 \times \text{Change in Wage Index} + 0.5 \times \text{Change in Composite Consumer Price Index (“CCPI”) - 0.5 \times \text{Productivity Gain}$) should be included as an additional factor in the MBOF approach to enable upward and downward fare adjustments. The formula should not operate as an automatic determinant of fare adjustment outcome; there should be flexibility in applying the MBOF approach in considering bus fare adjustment;

- (ii) in considering the reasonable rate of return to franchised bus operator, reference should be made to the Weighted Average Cost of Capital (“WACC”) of the bus industry;
 - (iii) the triggering point for 50/50 sharing of return between bus operators and passengers should be revised from the rate of return on average net fixed asset (“ANFA”) of 13% to 9.7%;
 - (iv) an arrangement on the use of return shared with passengers (“passenger reward balance”) should be set up so that a bus operator will be given the flexibility to decide, in consultation with the Administration, when to use the passenger reward balance if the amount is less than 1% of its annual revenue for reducing the magnitude of fare increase required in future, or for providing fare concessions. Bus operators are required to use any amount in the passenger reward balance exceeding the equivalent of 1% of the annual revenue for provision of fare concessions within 12 months since the annual disclosure of the passenger reward balance accumulated;
 - (v) in considering public acceptability and affordability of bus fare adjustment, reference should be made to the magnitude of change in median household income, in addition to existing reference to changes in CCPI;
- (c) the introduction of the fare adjustment formula as an additional factor of MBOF approach, the reference to median household income and WACC, the lowering of the triggering point for sharing of return from 13% return on ANFA to 9.7%, and the passenger reward arrangement as set out in paragraph (b) above will take effect on 10 January 2006, and thereafter from the date of the last fare adjustment. All factors under the existing MBOF approach will be applied on a continual basis with reference to the date of last fare adjustment, or, for franchised bus operators who have not adjusted fares before, the date of commencement of its operation; and
- (d) the new fare adjustment arrangement comprising the above improvement measures should be reviewed in three years’ time.

BACKGROUND

2. Under Section 13(1) of the Public Bus Services Ordinance (“PBSO”), the scale of bus fares is determined by the CE-in-Council. In assessing bus fare adjustment for the purpose of making recommendations to the CE-in-Council, the Administration takes into account a basket of factors known as the MBOF approach as endorsed by CE-in-Council in 2000, which include -

- (a) changes in operating costs and revenue since the last fare adjustment;
- (b) forecasts of future costs, revenue and return;
- (c) the need to provide the operator with a reasonable rate of return;
- (d) public acceptability and affordability; and
- (e) quantity and quality of service provided.

3. On top of the above arrangement, any return achieved by a franchised bus operator exceeding the rate of return on average net fixed asset (“ANFA”)¹ of 13% would be shared equally on a 50/50 basis between the operator and passengers. This is a pledge by bus operators to moderate fare increase or grant fare concessions in future up to a value of 50% of the return exceeding 13%. This triggering point of 13% was established in 2000 based on the historical average rate of return on ANFA of the franchised bus industry between 1990 and 1999.

4. The Administration undertook to review the MBOF approach in five years’ time to take into account changes in the operating and economic environment.

Review of the MBOF Approach

5. There have been suggestions that the MBOF approach could be modified to enhance the responsiveness and objectivity of the bus fare adjustment process. Against this background, we have conducted a review of the basis for considering bus fare adjustments.

¹ Both the net profits to shareholders (i.e. profit after taxation) and the borrowing costs incurred by the operator are included in calculating an operator’s return. ANFA is the average value of assets at historical cost net of depreciation, except for land where no depreciation is charged. Under Section 12A of the PBSO, a franchisee is required to provide a Forward Planning Programme (FPP) each year, covering amongst others, its plan to acquire additional assets. The FPP has to be agreed by the Commissioner for Transport. This could safeguard against any unwarranted inflation of operators’ asset.

Modifications to the MBOF Approach

6. The main objectives of the modifications to the MBOF approach are to facilitate adjustment of bus fares upwards and downwards to provide greater responsiveness to prevailing economic conditions, and to improve objectivity of fare adjustment process while maintaining the flexibility to consider the factors embodied in the MBOF approach.

7. To achieve the above goals, we will build on the existing MBOF approach by retaining all factors outlined in paragraph 2 above and introduce a new fare adjustment formula and several new objective benchmarks for fare adjustment assessment. The CE-in-Council will continue to retain the ultimate power in determining bus fares as provided in the PBSO to consider and balance all relevant factors including public affordability and the bus operators' financial viability.

Improve Objectivity and Allow Fares to Go Upward and Downward

8. We will introduce in the existing MBOF approach the following formula to enable upward and downward bus fare adjustments in accordance with the prevailing economic conditions and to enhance the objectivity of bus fare adjustment –

$$\begin{aligned} &\text{Supportable Fare Adjustment Rate ("SFAR")} \\ &= 0.5 \times \text{change in Wage Index} + 0.5 \times \text{change in Composite} \\ &\quad \text{Consumer Price Index ("CCPI")} - 0.5 \times \text{Productivity Gain} \end{aligned}$$

This formula will apply with effect from 10 January 2006 and thereafter from the date of the last fare adjustment.

(a) Wage Index

9. This formula can reflect the rate of change in operating costs for the franchised bus industry. Staff cost constitutes about 50% of the operating costs of franchised bus operators. In the formula, staff cost is reflected by the nominal wage index for the transport sector published by Census and Statistical Department ("C&SD"). The index is a reasonable indicator of the change in staff cost of the bus industry since employees of motor buses constitute the largest group (about 20%) of the workforce of the transport sector covered by this index.

10. Using the wage index to measure the change in staff cost has the merit of improving objectivity because bus operators would not be able to manipulate the SFAR through adjusting the wage of their staff. For instance, under the formula, the effect of a pay rise by the bus operator will not directly result in a supportable fare increase.

(b) Composite Consumer Price Index

11. The remaining cost components of bus operators are to be reflected by CCPI which can serve a dual purpose. On the one hand, CCPI is an easily understood and publicly available indicator to reflect the overall price level change of goods and services. It thus provides a more transparent and objective basis to facilitate public understanding of the case for bus fare adjustments. On the other hand, given that CCPI also reflects deflation and inflation situation of the economy, inclusion of CCPI in the formula will provide a basis for upward or downward fare adjustment in response to prevailing economic conditions.

12. The introduction of a fare adjustment formula as an additional factor is an improvement to the existing MBOF approach because with the wage index and CCPI incorporated into the formula, fare reduction can then be triggered by downward change of the two indices in the future. Furthermore, the wage index and CCPI are open data published by C&SD on a quarterly and monthly basis respectively. Adopting these two indices would minimise reliance on information provided by the bus operators.

(c) Productivity Gain

13. To incentivise franchised bus operators to improve efficiency and productivity, the formula will include a productivity gain element which measures the percentage change in output relative to the percentage change in input. Our approach is to measure the output of the bus industry by total fare and non-fare revenue² and the input by total operating cost. The industry-wide productivity gain is derived by using the ratio of total fare and non-fare revenue to total operating costs. In order to assess the change in productivity of the bus industry during a sufficiently long period of time, we have used the data from a 10-year period, i.e. from 1995 to 2004.

² Under the existing practice, in measuring the rate of return of a franchised bus operator, both fare revenue and non-fare revenue will be taken into account. Non-fare revenue is included because it is related to the bus operation. The major item of non-fare revenue is advertising income (bus body advertising and bus shelter advertising).

14. Comparing the ratio of total fare and non-fare revenue to total operating costs based on the data from 2000 to 2004 with the corresponding value from 1995 to 1999, the productivity gain thus calculated is 0.51% per annum (“p.a.”). In the fare adjustment formula, half of the annual productivity gain will be shared with passengers. In this way, a negative value of 0.3% p.a. (i.e. 0.5 x 0.51% p.a.) has been pre-determined and built into the formula. This value will be fixed for the coming three years until the review of the formula. This element will have the effect of moderating fare increase by 0.3% p.a. when the changes in CCPI and Wage Index point to an upward fare adjustment. Similarly, this will further reduce the fares by 0.3% p.a. if the changes in CCPI and Wage Index give a downward fare adjustment. Taking into account the fixed value of 0.3% p.a. for the productivity gain element, the resultant SFAR formula for the next three years will be -

$$0.5 \times \text{Change in Wage Index} + 0.5 \times \text{Change in CCPI} - 0.3\% \text{ p.a.}$$

Determining Bus Fare Adjustment

(a) Outcome of the Formula

15. The inclusion of the formula will provide a more objective and responsive starting point for considering bus fare adjustments. We will use the outcome of the formula as the reference indicator in considering whether fare adjustment rate is supportable and justifiable at a given juncture. The formula will not operate as an automatic determinant of fare adjustment outcome. The CE-in-Council will continue to retain the ultimate control in determining bus fares as currently provided in the PBSO to ensure all relevant factors under the MBOF approach (including those as set out in paragraph 2 above) will continue to be considered.

(b) Factors under the MBOF Approach

(i) Public Acceptability and Affordability

16. Under the existing MBOF approach, we make reference to the changes in CCPI when considering public acceptability of the rate of bus fare adjustment. While the CCPI aggregates expenditure pattern of 90% of the households, public affordability is also affected by the income of the general public. Under the new arrangement, we will examine the magnitude of change in median household income, as an additional reference indicator to CCPI, to gauge more comprehensively public affordability.

(ii) Financial Viability and Performance of Bus Operators

17. We will continue the existing practice for bus industry of not setting a guaranteed minimum level nor a ceiling of rate of return. Neither will we prescribe a specific rate of reasonable return for all bus operators given circumstances and operating conditions vary among them.

18. In assessing the reasonable rate of return to bus operators, we will change the reference from historical rate of return on ANFA to WACC of the bus industry. The WACC is the average cost of debt and equity weighted by their respective proportion in the bus industry as a whole³. The WACC is derived based on an established and widely used formula which takes into account financial data of the market reflecting the cost of debt and equity. The WACC calculated for the bus industry is 9.7%. As compared with the historical average rate of return on ANFA, the WACC can better reflect the prevailing economic situation and operating environment of the bus industry.

19. To assess the financial performance of the bus operator, our consideration is to ensure bus companies will have sound financial capability in providing efficient and quality public bus services. Following the established practice under the MBOF approach, we will consider the changes in operating costs and revenue since the last fare adjustment as well as the forecast of operating costs and revenue to have a clear and fair assessment of the operator's financial performance.

20. Taking into account the changes in operating costs and revenue since last fare adjustment not only serves to track the historical change in rate of return but will also enable the Administration to consider any prevailing cost factors, e.g. sustained and significant fuel cost hike, that might have serious impact on the overall operating costs and possibly affect the rate of return of individual bus operators. This is important as it can obviate the need to incorporate each and every cost component of bus operation into the fare adjustment formula, thus without giving bus operators a convenient avenue to pass directly all its operating costs to bus passengers through the formula.

(iii) Quality and Quantity of Services

21. We will continue, as now being practised under the MBOF approach, to monitor the quality and quantity of service and examine this

³ The WACC can be regarded as the expected rate of return of the investors in general for the bus industry under the prevailing economic conditions.

impact on the return of the bus operator. In this regard, we will take into account objective indicators including the findings of passenger satisfaction surveys and site surveys, complaint figures and accident rates, to see whether the quality and quantity of service have affected the patronage and in turn the rate of return on ANFA of the bus operator. As pointed out in paragraph 18 above, we will make reference to WACC in assessing the reasonable rate of return of the operators.

(d) Balancing All the Relevant Factors

22. The outcome of the formula will serve as a starting point for the fare adjustment process. Having balanced all relevant factors mentioned in paragraphs 15 to 21, the Administration will consider whether there is a need to make adjustment to the SFAR. If so, the extent of the adjustment will be considered on the basis of the merit of the case.

23. The Administration will also continue the existing practice of consulting the Transport Advisory Committee (“TAC”) and the Legislative Council (“LegCo”) Panel on Transport (“Transport Panel”) before submitting its recommendation on the rate of fare adjustment to the CE-in-Council. The Administration will explain to the public and LegCo Members on how the approved rate of bus fare adjustment is arrived at by considering the set of objective indicators during the process, and how the approved rate of fare adjustment will affect the financial performance of the bus operators concerned.

Passenger Reward Arrangement

24. Under the MBOF approach, there is an existing arrangement whereby any return achieved by a bus operator on top of 13% rate of return on ANFA would be shared between the operator and passengers to relieve the pressure for future fare increase and to facilitate the offer of bus fare concessions.

25. To better reflect the changes in capital market environment, we will lower the existing triggering point for sharing of return with passengers from 13% return on ANFA to 9.7%. The revised triggering point is based on the WACC calculated for the bus industry in the light of the prevailing economic conditions.

26. To enhance transparency, we will introduce measures to enable the public to monitor the use of passenger reward balance. The franchised bus operators will publish the passenger reward balance accumulated and their

plan to utilise the amount in their booklet of “Fuller Disclosure” on an annual basis⁴. For the amount up to the equivalent of 1% of its annual revenue for the last accounting period in the passenger reward balance, operators will be given the flexibility to decide, in consultation with the Administration, when to use it for reducing the magnitude of fare increase required in future, or for providing fare concessions. Operators will need to use any amount in the passenger reward balance exceeding the equivalent of 1% of the annual revenue for provision of fare concessions within 12 months since the disclosure of the passenger reward balance accumulated.

Procedure of Bus Fare Increase and Reduction

27. C&SD publishes, on a monthly basis, the CCPI, and on a quarterly basis, the wage index and median household income. A negative value of 0.3% p.a. representing the productivity gain element will be pre-determined for three years and built into the formula. With the above publicly known data, any changes in the outcome of the formula is open to the public and can be easily monitored.

28. The Administration will monitor the supportable fare change by applying the fare adjustment formula on a quarterly basis and will consider initiating a downward fare adjustment after having considered the outcome of the formula and all relevant factors under the MBOF approach.

29. As regards fare increase, it will be up to the bus operators to apply as at present if they see a need for upward adjustment of bus fares. The power to determine the fare adjustment applications remains with the CE-in-Council. In considering both upward and downward fare adjustment, we will consider the changes of the various indices included in the formula since the effective date of implementation of the new arrangement and consider other factors under the MBOF approach. Processing of any fare adjustment is envisaged to take about six months.

30. To avoid frequent fluctuation in bus fares which will cause inconvenience to passengers, fare change, be it upward or downward adjustment, will only be implemented if it amounts to 10 cents or more per bus trip on average. Any adjustments lower than this level will be difficult to implement.

⁴ This booklet will be published within five months after the end of an accounting year of the respective bus operators.

Benefits of the Improvement Measures

31. Adopting the improvement measures will bring the following benefits –

- (a) fare levels would be able to fall or rise in future to better reflect changes in economic circumstances and the Government can initiate fare reduction having regard to the prevailing economic conditions;
- (b) the introduction of productivity gain element allows passengers to share the benefit arising from productivity improvement of bus operators through increasing the magnitude of fare reduction or moderating fare increase when one is required. It also provides incentive for an individual operator to outperform the industry-wide productivity improvement;
- (c) the design of the formula, which does not include fluctuating and volatile cost elements, can avoid as far as practicable passengers having to bear directly the impact of drastic changes in operating costs without reference to the impact of such changes on the operators and the effect of mitigation measures taken by the bus companies;
- (d) the modified approach embodies objective indicators which could enhance objectivity of the basis for initiating the fare adjustment process and reduce reliance on information provided by bus operators;
- (e) the reference to changes in median household income and the WACC of the bus industry will strike a balance between public affordability and bus operation; and
- (f) the lowering of triggering point for activating the passenger reward arrangement from 13% return on ANFA to 9.7% is more in line with the prevailing economic conditions.

Effective Date of the New Arrangement

32. We will implement the new bus fare adjustment arrangement on 10 January 2006. The new arrangement will be applied to all six franchisees on the same day. That said, all factors under the existing MBOF approach

would be applied on a continual basis with reference to the date of last fare adjustment, or commencement of operation for bus operators which have not adjusted fares before. For the new elements of the new arrangement, i.e. introduction of the fare adjustment formula as an additional factor, the making reference to median household income and WACC, the lowering of the triggering point for sharing of return from 13% return on ANFA to 9.7%, and the passenger reward arrangement, will be applied from 10 January 2006 onwards.

Future Review

33. We will review the new arrangements in three years' time, as it is a new approach which warrants a closer monitoring of its effectiveness.

IMPLICATIONS OF THE NEW ARRANGEMENT

34. The new arrangement has no civil service, environmental, financial or productivity implications. The economic and sustainability implications of the new arrangement are set out in Annex.

PUBLIC CONSULTATION

35. We have fully engaged the bus operators in formulating the new arrangement and they generally support the new fare adjustment arrangement and its review in three years' time. We also consulted the Transport Panel on 17 and 25 November 2005 and 16 December 2005 and the TAC on 22 November 2005. LegCo and TAC Members were supportive of the new fare adjustment arrangement.

PUBLICITY

36. We will issue a press release, and a spokesman will be made available to answer press enquiries.

ENQUIRIES

37. Enquiries concerning the brief should be directed to the following

officer-

Miss Angela Lee

Principal Assistant Secretary for the Environment, Transport and Works

Tel No: 2189 2081

Environment, Transport and Works Bureau
January 2006

ECONOMIC IMPLICATIONS

Franchised buses account for over one-third of the public transport passenger flow in Hong Kong, and their services is an important determinant of cross-district labour movements and in turn a series of economic activities. A transparent and objective regulatory framework that ensures affordable high-quality franchised bus services would be conducive to higher labour mobility and more balanced economic growth in Hong Kong.

2. Under the new fare adjustment arrangement, reference to the changes in CCPI and nominal wage index for the transport sector could help ensure that bus fares are responsive to the change in operating costs of the franchised bus industry. Also, median household income is used as an additional reference to gauge affordability in bus fares adjustment and the bus fares could thus better reflect the prevailing economic conditions. The inclusion of 50/50 sharing of productivity gain in the formula would benefit the consumers as a whole.

SUSTAINABILITY IMPLICATIONS

3. As far as sustainability implications are concerned, the new arrangement would improve the transparency and objectivity of the existing fare adjustment mechanism for franchised buses, and allow bus fares to be adjusted more responsively to the prevailing economic conditions. Nevertheless, particular attention should be paid to the possible impact on the low-income population in considering fare adjustments during a period of inflation.

-END-

Fare adjustment arrangement for franchised buses

List of relevant papers

Date of meeting	Meeting	Minutes/Paper	LC Paper No.
27.10.2000	Panel on Transport	Minutes of the meeting	CB(1)208/00-01 http://www.legco.gov.hk/yr00-01/english/panels/tp/minutes/tp271000.pdf
		Administration's paper on Review of the basis for considering bus fare adjustments	http://www.legco.gov.hk/yr00-01/english/panels/tp/papers/a100e03.pdf
23.2.2001	Panel on Transport	Minutes of the meeting	CB(1)1260/00-01 http://www.legco.gov.hk/yr00-01/english/panels/tp/minutes/tp230201.pdf
		Administration's paper on New World First Bus Services Limited's Application for Fare Increase - Background Information	http://www.legco.gov.hk/yr00-01/english/panels/tp/papers/a622e03.pdf
14.1.2003	Panel on Transport	Minutes of the meeting	CB(1)940/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030114.pdf
21.3.2003	Panel on Transport	Minutes of the meeting	CB(1)1456/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030321.pdf
		Administration's paper on the	http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0321cb1-1132-3e.pdf

		progress of the implementation of bus-bus interchange schemes	
		Administration's information note on deduction of bus-bus interchange fares	http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0321cb1-26-1e.pdf
1.8.2003	Panel on Transport	Minutes of the meeting	CB(1)2435/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030801.pdf
		Administration's paper on public transport fares	http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0801cb1-2291-2e.pdf
		Administration's supplementary note on public transport fares	http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0801cb1-2335-2e.pdf
28.11.2003	Panel on Transport	Minutes of the meeting	CB(1)589/03-04 http://www.legco.gov.hk/yr03-04/english/panels/tp/minutes/tp031128.pdf
14.1.2004	Panel on Transport	Minutes of the meeting	CB(1)1021/03-04 http://www.legco.gov.hk/yr03-04/english/panels/tp/minutes/tp040114.pdf
17.11.2005 25.11.2005 16.12.2005	Panel on Transport	Minutes of the meetings	CB(1)549/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051117.pdf CB(1)694/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051125.pdf CB(1)713/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051216.pdf

		Administration's paper on review of the basis for considering bus fare adjustments	http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-309-1e.pdf
		Administration's paper on "Application for New Franchises by Citybus Limited (Franchise for Hong Kong Island and Cross Harbour Routes), New Lantao Bus Company (1973) Limited and Kowloon Motor Bus Company (1933) Limited"	http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-309-2e.pdf
		Background brief on "Review of the basis for considering bus fare adjustments"	http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-310-e.pdf
1.2006		Legislative Council brief on "Review of the basis for considering bus fare adjustments"	http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/etwb0601e.pdf
22.2.2008	Panel on Transport	Administration's paper on fare increase applications by franchised bus	CB(1)639/08-09(03) http://www.legco.gov.hk/yr07-08/english/panels/tp/papers/tp0128cb1-828-1-e.pdf

		companies	
		Minutes of the meeting	CB(1)1123/07-08 http://www.legco.gov.hk/yr07-08/english/panels/tp/minutes/tp080222.pdf
25.4.2008	Panel on Transport	Administration's paper on fare increase applications by Citybus Limited and New World First Bus Services Limited	CB(1)1317/07-08(05) http://www.legco.gov.hk/yr07-08/english/panels/tp/papers/tp0425cb1-1317-5-e.pdf
		Minutes of the meeting	CB(1)1975/07-08 http://www.legco.gov.hk/yr07-08/english/panels/tp/minutes/tp080425.pdf
24.4.2009	Panel on Transport	Administration's paper on rectification of the wage indices and consequential revision to fare adjustment formula outcomes	CB(1)1337/08-09(06) http://www.legco.gov.hk/yr08-09/english/panels/tp/papers/tp0424cb1-1337-6-e.pdf
		Minutes of the meeting	CB(1)2541/08-09 http://www.legco.gov.hk/yr08-09/english/panels/tp/minutes/tp20090424.pdf