

## **Consumer Council's Submission to Legislative Council's Bills Committee on Mass Transit Railway Bill**

1. The Consumer Council is pleased to respond to the invitation by the Bills Committee of the Legislative Council to submit its views concerning the matter of privatization of the Mass Transit Railway Corporation (MTRC) and the related Mass Transit Railway Bill (the Bill).
2. In principle, the Council is not against a partial privatization of the MTRC in the light of the unfolding economic developments in Hong Kong. Nevertheless, there are two areas of concern for the Council, namely consumer protection in terms of fares and service standards, and MTRC's competitive position in the market for transport services. This submission addresses those two issues.
3. The Bill contains a number of provisions that allows a form of intervention. First, by the Secretary for Transport, to seek information from MTRC, and second, the imposition of fines, or the giving of directions by the Chief Executive in Council, for failure to observe the provisions of the franchise, as determined by reference to the Operating Agreement. It appears to the Council that the Bill provides a reasonable legal basis for regulatory intervention by the Government to require an acceptable standard of market conduct by MTRC.
4. The standards of market conduct will be found in the Operating Agreement. It is the contents of that document that the Council wishes to comment in terms of how it will address issues of adequate service levels, including safeguards against unjust fare increases, and the preservation, or promotion of competition.

### ***Consumer welfare and the promotion of competition***

#### *The role of Government*

5. The Government has noted in its brief to Legislative Council that it is important for MTRC to retain fare autonomy which will not only enable it to invest in the development and maintenance of the railway system, but also preserve the marketability of MTRC shares. The brief notes that under the present Ordinance MTRC is empowered to determine its own fares, and that in practice it has to have regard to, amongst other things, the fare levels of its competitors. The brief goes on to note that the Government

".....will continue to have an important role to play in promoting healthy competition between MTRC and other public transport modes so as to ensure that market forces act as a constraint on fare increases. We are committed to maintaining a level playing field and competitive environment to ensure that the commuting public will have a choice of competing transport modes at affordable prices."

6. As a competition advocate, the Council welcomes the Government's commitment to relying on the competitive process to ensure appropriate standards of consumer welfare. However, the Council notes that governments can and often

do affect the way in which competition develops in markets through direct intervention to serve diverse and possibly conflicting policy objectives. Accordingly, a reliance on the competitive process needs to be based on a firm and clearly specified Government commitment to ensure that policies are not introduced that would defeat the benefits that competition can be assumed to deliver.

7. It appears to the Council that the public transport service sector in Hong Kong presently operates in a highly competitive environment. The MTRC operates in districts where other public transport services, franchised bus services in particular, provide parallel and competing services. However, the Government has indicated in its 'Third Comprehensive Transport Study' (released in October 1999) that priority is to be given to railway and that this form of transport will form the backbone of the future passenger transport network. It is anticipated that railway will become the major passenger carrier, handling 40% to 50% of the total public transport journeys by 2016, compared with 33% in 1997. The Council can appreciate that there are important public policy concerns involved, such as improving transport efficiency and reducing environmental pollution. Nevertheless, such concerns need to be considered with a view to ensuring that a level playing field and competitive environment will also be maintained to guarantee that the commuting public will continue to have a choice of competing transport modes at affordable prices, especially in the new railway routes that will emerge in the future.

#### *The role of the private sector*

8. The Council also notes that market participants themselves can and often do operate in ways that affect competition through practices that limit market accessibility or contestability, impair economic efficiency or free trade. The commitment to ensuring a competitive environment also extends to the private sector and the need to ensure they abide by appropriate rules that do not defeat the benefits that competition can bring. As the Bill does not have specific reference to the issues of competition and consumer safeguards, and appropriate rules, it is to be expected that the Operating Agreement would clarify the obligations of MTRC in this regard.

### **The Operating Agreement**

#### *Fare regulation*

9. The Government has noted that the Operating Agreement contents are currently being deliberated between the Government and MTRC. The Council notes that a section under the heading of 'Fare Regulation' at Paragraph 8 of the Operating Agreement will contain provisions which reflect and codify the existing mechanism for determining fares. These will include:

- consideration by MTRC of public acceptance of fare changes, based on passenger surveys;
- consultation with the Transport Advisory Committee;
- consultation with the Transport Panel of the Legislative Council;

- decisions on fare changes to be made by the Board of MTRC;
- notification to the Advisory Committee and Transport Panel of new fare levels; and
- public announcement of new fare levels.

10. It is also intended that the Operating Agreement will have sections requiring the MTRC to publish Customer Performance Pledges (as voluntary targets) publish data on passenger complaints, and develop a system for handling passenger complaints. It is apparent that notwithstanding the requirements to consult the public and to publish information, the Government is largely relying on the disciplining effect that competition from other forms of transport will have on the MTRC with regard to ensuring appropriate price and service levels.

11. The Council supports the use of competition mechanisms to achieve high levels of service for Hong Kong consumers, in conjunction with the scrutiny of fare increases by the Transport Advisory Committee and the Transport Panel of the Legislative Council. However, the Council believes that the benefits competition will bring will only be manifested if, in addition to Government commitment to maintaining a competitive environment, there are adequate rules by which the MTRC is required to abide. Under such circumstances the limited scrutiny of fare increases and the absence of control should not pose a major problem.

#### *Competition concerns*

12. Government policy affects to a large extent competition in the market. Accordingly, the Council has suggested that a formal commitment to preserving and promoting competition in the sector is appropriate. The Council notes that the Operating Agreement does intend to place a competition obligation on MTRC under the heading 'New Projects', which could be categorized as a competition rule. At Paragraph 7 of the Operating Agreement it is intended that MTRC must

"ensure a level playing field and equal treatment with other potential competitors in the award of new railway projects and extensions".

13. This recognizes the position that MTRC occupies in the market, in terms of its market power regarding the award of new railway projects and extensions. However, there is no indication in the Operating Agreement that MTRC will be under any other obligations regarding competition, and avoids the possibility that its actions may have anti-competitive implications other than in regard to 'New Projects'. Therefore, a more comprehensive obligation to adhere to pro-competitive principles should be put in place.

14. In the Government's May 1998 Competition Policy Statement, the Government called on businesses to:

- cease existing, and refrain from introducing, restrictive practices that impair economic efficiency or free trade on a voluntary basis (Clause 12); and
- advanced the concept of self regulation, along sector specific lines, as

a means of having industry adopt pro-competition rules (Clause 10 (f)).

The Government's approach was in response to the Council's request for a general competition authority administering general competition laws to oversee the application of competition policy.

15. The Council has been working with industry associations to adopt provisions in their various codes of practice as a means of advancing the Government's competition policy objectives, and its reliance on self regulation to achieve those aims. However, not all important sectors of the economy fit easily within the ambit of an industry association. MTRC is one notable example.

16. As a result the Council has begun encouraging some individual companies to adopt a unilateral code of practice, where an industry association does not exercise an adequate level of industry oversight, and an individual, rather than collective response by companies is more appropriate. The unilateral codes of practice contain similar provisions to those found in the Council's Benchmark Code of Practice, that obligate the company to observe the Government's call for businesses to "cease existing, and refrain from introducing, restrictive practices that impair economic efficiency or free trade on a voluntary basis".

17. The Government has recognized that MTRC is in a position where its actions may have some anti-competitive implications (i.e. the obligation under the heading 'New Projects' in the Operating Agreement). The Government has also clearly indicated that it would utilize sector specific voluntary codes of conduct to advance competition policy, rather than a general competition law, which would apply to all market participants.

18. It would therefore be in keeping with the Government's self regulatory and sector specific approach for the Operating Agreement to include an obligation on MTRC to observe the general competition principles as found in the Government's Competition Policy Statement. The Council suggests that the Operating Agreement should adopt such an approach.

19. As an example, MTRC should be obligated under the Operating Agreement to comply with a provision along the following lines:

'Having regard to the Government's Competition Policy Statement issued in May 1998, the Corporation is required to refrain from introducing restrictive practices that impair economic efficiency or free trade. If the Corporation intends to engage in practices that come within the examples of restrictive practices given in the Government's Competition Policy Statement, it is required to subject such practices to public scrutiny, thereby enabling both consumers and competitors to gauge:

- whether the practices limit market accessibility or contestability;
- impair economic efficiency or free trade; and
- are not in the overall interests of Hong Kong.'

20. The Council considers that a competition commitment by the Government and a competition rule on the MTRC in the Operating Agreement, similar to the one suggested above, are necessary conditions for the privatization of MTRC. This is in order to provide necessary consumer safeguards in view of Governments' reliance on competition in the market as the rationale behind the limited scrutiny of fare increases. The commitment by the Government, and the inclusion in the Operating Agreement are not only consistent with Government policy, but serve as a practical demonstration of how the Government's competition policy can be put into effect.

#### **Public debate**

21. On a more general note, the Council would also raise the issue of what obligations there are on the Government to ensure public debate on the privatization of a public asset of extreme importance to the economy of Hong Kong. The Council welcomes the opportunity to engage in debate on the manner in which the privatized asset will be required to operate in the market and what safeguards there are for consumers. Accordingly, it has made the suggestions noted above. However, it is of the view there must be an appropriate level of public debate on the decision to privatize the asset, the way in which the asset is to be restructured.

22. There are a number of issues the Council considers should be given wide public exposure, to allow for a high level of transparency to the process, and to provide for public input and application of expertise. Some of those issues are as follows:

- a. Whether it is feasible and desirable for ownership of the physical asset and the operation of services utilizing the asset to be separated. For example, retaining public ownership of the physical asset, and allowing private interests to operate related services on a tenured basis.
- b. What safeguards there are to ensure that the Government, in view of its ability to alter the underlying structural conditions of the market, will abide by its commitment to ensure that policies are not introduced that would defeat the benefits that competition can be assumed to deliver.
- c. What are the costs and benefits of total privatization, compared to retention as a public asset.