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Panel on Transport
Meeting on 12 April 2012

Updated background brief on adjustment to MTR fares
and the Fare Adjustment Mechanism of the
MTR Corporation Limited

Purpose

This paper provides background information on the MTR Corporation Limited (MTRCL)'s Fare Adjustment Mechanism (FAM) and the outcomes of its operation since adoption, and summarizes the major concerns expressed by the Panel on Transport (the Panel) about MTR fare adjustments and FAM in its past discussions.

Background

2. Before the merger of MTRCL and Kowloon-Canton Railway Corporation (KCRC), both MTRCL and KCRC had fare autonomy, and they set their fares in accordance with prudent commercial principles, having regard to, inter alia, economic conditions, competition from other transport modes and whether the services were value for money. In the context of the rail merger exercise, MTRCL and KCRC agreed that the post-merger corporation would adopt a formulaic approach, namely the FAM, for determining future fare adjustments to replace fare autonomy.

3. It was then decided that under the FAM, fare adjustments would be made in accordance with a direct-drive formula linked to changes in the Composite Consumer Price Index (CCPI), Nominal Wage Index (Transport Services Sector) (Wage Index)¹ and a fixed productivity factor. The CCPI used in the FAM reflects public affordability. Wage index reflects staff cost. Based on the latest data of these objective

¹ Nominal Wage Index (Transportation) replaced Nominal Wage Index (Transport Services) in 2010.

indices under the FAM, fares would be maintained, or adjusted upwards or downwards. The formula which determines the overall rate of fare adjustment is :

$$\text{Overall fare adjustment rate} = 0.5 \times \Delta\text{CCPI} + 0.5 \times \Delta\text{Wage Index} \\ - \text{Productivity Factor,}$$

where ΔCCPI is the year-on-year percentage change in the CCPI and $\Delta\text{Wage Index}$ is the year-on-year percentage change in the Wage Index published by the Census and Statistics Department (C&SD). The productivity factor is zero for the first five years starting from the rail merger in 2007 and would have a value of 0.1% starting from the 6th year in 2013.

4. If, in a given year, the overall fare adjustment rate under the FAM is within the range of $\pm 1.5\%$, there shall be no fare adjustment and the unadjusted percentage shall be rolled over to the next annual fare review for implementation.

Adjustments to MTR fares in 2010 and 2011

5. The FAM was implemented for the first time in 2009. At that time, the overall fare adjustment rate calculated was $+0.7\%$. As it was smaller than $\pm 1.5\%$, no fare adjustment was made in 2009 and the $+0.7\%$ was carried over to be incorporated into the 2010 overall fare adjustment rate.

6. In 2010, the outcome of the fare adjustment under the FAM was $+1.35\%$. Together with $+0.7\%$ carried forward from 2009, the overall fare adjustment rate for 2010 was $+2.05\%$, greater than $\pm 1.5\%$. Adjustments to MTR fares took effect from 13 June 2010. As a result of the fare adjustment, 83.3% of MTR passenger trips had a fare adjustment of 20 cents or less, including about 10% which had not seen any change in their fares.

7. 2011 was the second year of fare increases under the FAM. The overall fare adjustment rate for 2011 was calculated to be $+2.2\%$. Adjustments to MTR fares took effect from 19 June 2011. As a result of the fare adjustment in 2011, 79% of MTR passenger trips had a fare adjustment of 20 cents or less, including about 6% which had not experienced any fare change.

Panel discussion on the 2010 and 2011 MTR fare adjustments

Concerns about the implications of the 2010 fare adjustment

8. The Panel discussed the 2010 fare adjustment at its meetings on 23 April and 29 June 2010. Panel members considered that the 2010 fare adjustment would add to the pressure of living costs borne by the general public, particularly the grassroots, and would cause public resentment. The fare increase was most inappropriate given that MTRCL had accumulated a net profit of over \$77 billion, and that in 2009, MTRCL's net profit was over \$9.6 billion. Some members suggested that the Administration should review the FAM which failed to take into account public affordability, or consider using the dividends it received as a MTRCL shareholder to set up a fare stabilization fund to moderate MTRCL's rate of fare increase.

9. The Administration explained that the proposal to set up a fare stabilization fund was not in keeping with the general framework of public finance management, according to which income received for the purposes of the Government should be paid into the general revenue, and withdrawal of money from the general revenue should be subject to the approval of the Finance Committee of the Legislative Council. To mitigate the impacts of the 2010 fare adjustment, the Panel urged MTRCL to provide more fare concessions. In particular, members called upon MTRCL to provide the \$2 concessionary elderly fare on all days instead of only on Wednesdays, and to introduce monthly and weekly passes for residents of remote new towns. MTRCL subsequently announced a series of additional promotions to be offered, including enhanced \$2 fare promotion for the elderly, extension of the Monthly and Day Pass promotions, enhanced interchange discount in Tung Chung, etc.

10. Regarding the concern that the MTR Single Journey fares for about 100 journeys would be slightly lower than Octopus fares, MTRCL explained to the Panel that only a small number of Single Journey fares were 10 to 20 cents lower than the Octopus fares of the same journey. Passengers using Octopus would still pay a lower fare than using Single Journey tickets in most journeys and could benefit from a wide variety of promotions offered by MTRCL.

Concerns about the implications of the 2011 fare adjustment

11. The Panel discussed the 2011 MTR fare adjustment on 15 April 2011 and received public views on 16 May 2011. At the meeting on 15 April 2011, some members expressed grave dissatisfaction that, while railway incidents were frequent and substantial profits had been recorded by the MTRCL, the Corporation still insisted on increasing its fares in June according to FAM. Panel members considered that the fare increases would add to the pressure of living costs borne by the general public especially during inflation. To alleviate the pressure, some Panel members reiterated that the Government should use the dividends it received as a MTRCL shareholder to set up a fare stabilization fund to moderate the rate of MTR fare increases.

12. At the meeting on 16 May 2011, Panel members shared the view expressed by many deputations that the Administration should review FAM and consider including new factors, such as public acceptability and affordability as well as profits derived by MTRCL from property development, into the FAM formula. Some members also suggested that a demerit point system should be introduced under FAM whereby MTR's fare adjustments were linked to its standard of service with a view to motivating MTRCL to improve its service and reducing the frequency of railway incidents. The Administration advised that the arrangement for review of the mechanism every five years had been laid down during the Rail Merger. The Administration considered it appropriate to review FAM in the second half of 2012 after more experience of its operation was accumulated.

Latest developments

13. On 26 March 2012, following the publication by C&SD of the change in the Wage Index for December 2011 over the same month in the previous year, MTRCL announced that MTR fares would be adjusted by an overall +5.4% upon implementation of the FAM in June 2012. The relevant FAM calculation is as follows:

Year-on-year percentage change in CCPI for December 2011	Year-on-year percentage change in the Wage Index for December 2011	2012 overall fare adjustment rate
(0.5 x 5.7%)	+ (0.5 x 5.1 %)	= + 5.4%

14. The Administration and MTRCL would brief the Panel on the 2012 MTR fare adjustments at the next Panel meeting on 12 April 2012.

Relevant papers

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

Council Business Division 1
Legislative Council Secretariat
5 April 2012

Appendix

Adjustment to MTR fares and the Fare Adjustment Mechanism of the MTR Corporation Limited

List of relevant papers

Committee	Date of meeting	Paper
Panel on Transport	23.4.2010 (Item VI)	<u>Agenda</u> <u>Minutes</u>
Panel on Transport	29.6.2010	<u>Agenda</u> <u>Minutes</u>
Panel on Transport	15.4.2011 (Item IV)	<u>Agenda</u> <u>Minutes</u>
Panel on Transport	16.5.2011	<u>Agenda</u> <u>Minutes</u>