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Panel on Economic Development
Meeting on 27 April 2015

Background brief on prices of
auto-fuel and domestic liquefied petroleum gas

Purpose

This paper provides background information on the mechanism in respect of prices adjustment of auto-fuel and domestic liquefied petroleum gas ("LPG"), and summarizes views and concerns expressed by Members.

Background

Auto-fuel in Hong Kong

Pricing

2. Hong Kong has no oil refinery. All auto-fuel sold locally are refined oil products (such as unleaded petrol and motor vehicle diesel) imported from Singapore, Japan, Korea and Mainland China. Auto-fuel prices have a major impact on the Hong Kong economy, affecting household and commercial drivers directly. The transportation cost will be passed onto the prices of all goods and hence affect most of the economic activities.

3. Local retail prices of auto-fuel (also commonly known as pump prices (i.e. the retail prices after tax and before cash discount)) are broadly made up of the following cost components –

- (a) import prices of refined oil products (which are affected by international crude oil prices but the change of them are not necessarily the same as the change in pump prices. The international crude oil prices are in turn affected by supply and demand in the market, the productivity of the refinery, the cost of raw material and refinery process and the transportation cost);

(b) operating cost (including land and labour, marketing and promotional discounts, local transportation and operation of oil terminals, etc.); and

(c) Government duty (\$6.6 per litre for unleaded petrol and tax free for diesel).

4. The balance of the retail price after meeting Government duty and the operating cost represents the profits.

Monitoring

5. In a free market economy like Hong Kong, the Government does not have the power to dictate the pump prices which are determined by local oil companies, having regard to commercial practices and their operating cost. However, the Administration has been monitoring changes in pump prices and comparing them with the trend movements of international oil prices (benchmarked against the Singapore free-on-board ("FOB") prices), i.e. Means of Platts Singapore ("MOPS"). It has kept in close contact with the oil companies and in time of international oil price reduction, and urged them to adjust prices promptly to lessen the burden on the public.

6. According to the Administration's observation, the trend movements of pump prices and MOPS prices are generally in line, although the timing and magnitude of changes may not be exactly the same due to the following reasons:

(a) MOPS prices fluctuate day to day, but oil companies do not adjust their pump prices daily;

(b) changes in other cost component further to import prices of refined oil products are taken into account during adjustment of pump prices;

(c) actual selling prices of auto-fuel are lower than the listed pump prices having regard to various discounts and promotions; and

(d) as auto-fuel currently sold are imported a few weeks' ago, there is a time lag for the adjustment of international oil prices to be reflected in the pump prices.

7. The Census and Statistics Department ("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. The latest update was issued on 2 April 2015 vide LC Paper No. CB(4)741/14-15. The monthly average import

prices of major oil products compiled 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. When compiling figures for the statistical months of December 2014 and January 2015, C&SD noted the late lodgment of declarations by importers/exporters and lengthy process in clarifying some dubious data on declaration, a small proportion of declarations pertaining to a shipment month may not be included in time in the statistics of the relevant month but will be included in subsequent statistical months.

8. The Government has also endeavoured to, among others, maintain an open market and enhance competition by facilitating new market entrants. Since the introduction of new tendering arrangements for petrol filling station ("PFS") in 2003, two new operators have obtained 31 out of the 52 PFS sites and successfully entered the market. The share of the three biggest operators in terms of the number of PFS has dropped from over 90% to about 70%. As at April 2015, there are five oil companies¹ in Hong Kong. According to the Administration, price competition exists in the auto-fuel market because consumers can obtain different discounts from different oil companies through various means.

Monitoring of auto-fuel prices in 2014

9. During the lower half of 2014, international crude oil prices have accumulated a reduction of about 50%. Hon Frankie YICK Chi-ming and Hon TANG Ka-piu wrote to the Panel on 23 December 2014 and 19 January 2015 respectively to express their concerns that the pump prices were not adjusted in tandem with that of international oil prices. The Government and the Consumer Council ("CC") have analyzed data on the international crude oil and local retail auto-fuel prices separately. Their observations and findings are summarized in the ensuing paragraphs.

10. According to the Administration's reply to a Legislative Council ("LegCo") question on 4 February 2015, trend movements of MOPS for unleaded petrol and diesel are roughly the same during the period. During the lower half of 2014, the oil companies have adjusted downward the pump prices, each as many as 19 times, with maximum accumulated reduction of over

¹ The five local oil companies are: Caltex (under the Chevron Hong Kong Limited), Esso (under the ExxonMobil Hong Kong Limited), Shell Hong Kong Limited, PetroChina Company Limited and Sinopec Group.

\$3.2 per litre, which was generally in line with the trend movements of international oil prices and represents around 50% of the import price of refined oil products. That is, the cost component of import price of refined oil products in the pump prices goes down in tandem with the reduction of international oil prices.

11. CC has conducted a price monitoring analysis to study the relationship between the pump prices of the five oil companies and the international crude oil price (i.e. price of Brent oil) from January 2013 to December 2014. According to CC's analysis, the magnitude of percentage change was larger in Brent crude oil price (i.e. 53.9 points drop) than the average pump price² (i.e. 24.1 points drop) between 1 July and 31 December 2014. Although it could not be proved that oil companies had "more going up", the data reflected that there were "less coming down" situations as the magnitude of pump price cut was relatively small. In fact, according to data of C&SD, the price gap between import and pump prices widened continually with the average price increasing from \$4.36 per litre in the first half of 2013 to \$4.9 per litre in end of 2014. As regards "quick going up, slow coming down", in the first half of 2013, there was a delay of four days between a rise in the Brent oil price increases and a rise in pump prices, whilst in second half of 2014, there was a 8-day gap between a fall in crude prices and the fall in pump prices. Within a period of 24 months, each oil company had adjusted (both upward and downward) pump prices 55 to 60 times.

12. CC has endeavoured to monitor the pump prices to protect consumer interest. It urged the Government and oil companies to enhance transparency and make available more information, such as detailed data on import prices of oil, rental of PFS and other industry operating cost indexes so that consumers could be better informed to analyze trends and to determine if the increases or decreases in the pump prices are justified. In February 2015, CC has launched a mobile application "Diesel Price Calculator" to provide information on latest auto-fuel prices.

Domestic LPG in Hong Kong

Pricing

13. The retail market of LPG mainly consists of domestic LPG and auto LPG. Amongst these, domestic LPG also comprises piped LPG supplied to housing estates and cylinder LPG distributed to consumers through retail operators. Three local oil companies provide both piped and cylinder LPG in Hong Kong, namely Shell Hong Kong Limited ("Shell"), ExxonMobil Hong Kong Limited and Sinopec Group; while Concord Oil (Hong Kong) Limited and

² The average pump price is the aggregate average of the five oil companies in Hong Kong.

New Ocean Energy Holdings Limited supply only cylinder LPG. In 2012, there were about 230 000 domestic households in Hong Kong using piped LPG and 250 000 households using cylinder LPG. The same as auto-fuel prices, prices of domestic LPG in Hong Kong are determined by individual companies whilst the Government has no power to mandate the prices.

14. The existing pricing mechanism of domestic LPG consists of two main components, that is, LPG import prices and operating cost cum profit margin. Shell, the leading local LPG supplier in Hong Kong, has voluntarily established since 1999 a price adjustment mechanism of domestic LPG to enhance the transparency of price setting. In accordance with this mechanism, Shell, once every three months (i.e. at end of January, April, July and October), sets the prices for the coming three months by forecasting the import prices in light of the latest international LPG prices, and makes positive or negative adjustment for any difference between the actual import prices and the forecast import prices in the last review. The operating cost will be reviewed once every year at the end of January. This price adjustment mechanism is applicable to both retail prices of domestic piped LPG and wholesale prices of cylinder LPG. After each price review, Shell will announce and explain to the public the outcome. Adjustments of other oil companies in the market are basically the same as Shell.

Monitoring

15. In monitoring domestic LPG prices, the Administration makes reference to the movement of international LPG prices (calculated using Saudi Arabia monthly exporting Contract Price) and local LPG import prices, check whether the oil companies' price forecasts are reasonable, follow up with the oil companies the positive and negative price adjustments due to actual and forecast price difference in the last review, and assess if the annual adjustment in operating cost is reasonable.

16. According to existing adjustment mechanism, prices of domestic LPG are adjusted once every quarter, during which the international LPG prices may go up and down, the actual adjustment for the coming quarter will be determined after first offsetting the previous movements. The Administration considered that the related arrangement has served the purpose of stabilizing the LPG prices.

Monitoring of domestic LPG prices in 2014

17. Hon TANG Ka-piu wrote to the Administration on 19 January 2015 to express his concerns on prices of domestic LPG. In reply, the Administration advised that, under the present price adjustment mechanism, Shell had since mid 2014 adjusted the prices of domestic LPG three times, at end July, end October 2014 and end January 2015. The listed price of domestic piped LPG has been reduced by around 20% from \$38/cubic meter at the beginning of

July 2014 to the latest price of less than \$31/cubic meter. The wholesale price of cylinder LPG has been adjusted by the same magnitude. Comparing to the LPG import prices of the same period (\$7.29/kg for July 2014 and \$5.39/kg for November 2014); the relevant adjustment magnitude was in tandem with the downward movement of the LPG import prices. According to ExxonMobil, the listed prices of domestic LPG are for distributors' reference only and the retail prices are decided by individual distributors based on the cost of operations and market dynamics. Shell advised that it held meetings with the Environment Bureau and CC before every adjustment to explain the rationale, and then notified all LPG distributors and users about the adjustment.

Major views and concerns expressed by Members

Deliberations on auto-fuel prices

18. The public have all along been concerned about auto-fuel prices. The Panel discussed the issue in previous terms, and the major views and concerns expressed by members of the panel from 2002 to 2008³ are summarized as follows:

- (a) the oil companies were "quick going up, slow coming down" in adjustment of the pump prices in response to the corresponding changes in international oil prices. The oil companies may have taken advantage of the time gap for C&SD to collect and process data on import oil product prices and to reduce pump prices slowly;
- (b) to facilitate analysis on adjustments of the pump prices, oil companies should be urged to provide more information on import prices, inventory levels, cost and profit data; to give advance notice in raising or reducing the pump prices; and to inform the Administration when placing order for new consignment of oil;
- (c) the Government should reduce the duties on auto-fuel to relieve the burden of the affected sectors, in particular the transport sector; and
- (d) 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.

³ Between 2002 and 2007, the Panel discussed issues relating to adjustments in auto-fuel prices at six meetings, in three of which members also met with major oil companies. It received a briefing on the Administration's proposal to exempt the duty on Euro V diesel at the meeting on 23 June 2008.

19. At the Panel meetings on 14 and 24 October 2008, members expressed concern that despite the substantial reduction in international crude oil prices by 50%, the local auto-fuel prices had only fallen slightly for 10%. Consumers should have reasonable expectation for oil companies to cut the pump prices in tandem with the drop in international oil prices. Members considered that a formula should be worked out to monitor the pump prices. Other members were worried that the oil companies might collude among themselves and engage in price fixing.

20. In reply, the Administration advised that, starting from 22 October 2008, the Environment Bureau had published on its website, on a weekly basis, the local import prices and the pump prices in comparison with the trend movements of Singapore FOB prices, so that the public could assess whether the oil companies had made reasonable adjustment in the retail prices. However, information provided by individual oil companies for customs clearance on the imported oil products could not be available for public monitoring because the data was not collected for such a purpose. The Administration assured members that the Government would continue to play its gate-keeping role in monitoring the pump prices.

21. At the policy briefing on 2 February 2015, members expressed concerns about possible signs of "quick going up, slow coming down" in the pump prices. Members relayed the request of the Alliance of Land Transportation for the Competition Commission ("the Commission") to conduct investigation of the alleged price fixing among the oil companies, and noted the subsequent response of the Commission that the Competition Ordinance (Cap. 619) ("the Ordinance") had yet to enter into force.

22. In response, the Administration advised that it would bring the Ordinance into full operation when all relevant preparatory work was completed by the end of 2015 when the Commission would then be vested with investigation and enforcement power to look into cases such as those related to auto-fuel prices.

Deliberations on domestic LPG

23. In the light of cases handled by the LegCo Redress System about the high cost of LPG supplied in public housing estates, the Panel on Housing deliberated on this issue at the meeting on 1 June 2009. Noting that Shell was the only LPG supplier which adopted a voluntary pricing review mechanism, members considered that other LPG suppliers should adopt a similar mechanism as well. In addition, as the tenants did not have much choice on gas supply, members commented that there should be adequate price control over central LPG supply in public housing estates.

24. The Administration advised that while other LPG suppliers had not established any mechanism to regularly and openly review LPG prices and release relevant information, the adjustment made by these suppliers in the prices of piped LPG had been close to that of Shell. As LPG prices were subject to market forces and was applicable across the board to both public and private housing estates, it was not appropriate to request LPG suppliers to charge a lower price for public housing estates.

Council questions

25. At the Council meeting of 30 January 2013, Hon Gary FAN and Hon LEUNG Kwok-hung raised questions on regulation of LPG prices. The Administration advised that implementation of any form of price regulatory regime would be inconsistent with the principle of free market and it had no plan to use public money to subsidize domestic LPG users.

26. At the Council meeting of 4 February 2015, Hon Emily LAU raised a question about, among others, the retail prices of auto-fuel in response to the drop in oil prices. The Administration pointed out that, according to its observation, the trend movements of local retail prices of auto-fuel and MOPS were generally in line, although the timing and magnitude of changes might not be exactly the same.

27. Hyperlinks to the relevant written replies from the Administration are provided in the **Appendix**.

Latest development

28. On 30 March 2015, Hon TANG Ka-piu wrote to the Panel requesting the Administration to provide detailed information about auto-fuel and domestic LPG prices so as to facilitate members' consideration when the Panel exchanges views with the Administration at the meeting on 27 April 2015.

Relevant papers

29. A list of relevant papers which are available on the LegCo Website (<http://www.legco.gov.hk>) is in the **Appendix**.

List of relevant papers

Issued by	Meeting date/ Issue date	Paper
Panel on Economic Development	24 October 2008	Agenda Minutes Background brief Information note Information paper issued by the Administration
	2 February 2015	Agenda Minutes Information paper issued by the Administration
Panel on Housing	1 June 2009	Agenda Minutes Information note Information paper issued by the Administration
Council meetings	30 January 2013	Written reply by the Secretary for the Environment to a question on "Regulation of LPG price" raised by the Hon Gary FAN
		Written reply by the Secretary for the Environment to a question on "LPG price" raised by the Hon LEUNG Kwok-hung
	4 February 2015	Written reply by the Secretary for the Environment to a question on "Reduction in bus fares and retail prices of auto-fuel in response to the drop in oil prices" raised by the Hon Emily LAU
Consumer Council	5 February 2015	Auto-fuel price calculator Auto-fuel price monitoring analysis Oil price data archive
Environment Bureau	---	Monitoring of retail prices of auto-fuel