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Panel on Economic Development Meeting on 28 June 2021

Background brief on auto-fuel prices in Hong Kong

Purpose

This paper provides background information on auto-fuel prices in Hong Kong, and summarizes the major views and concerns expressed by members of the Panel on Economic Development ("the Panel") on relevant matters in previous discussions.

Background

Monitoring of auto-fuel prices

2. Hong Kong has no oil refinery. All auto-fuels sold locally are imported refined oil products (such as unleaded petrol and motor vehicle diesel). According to the Administration, retail prices of auto-fuels in Hong Kong are determined by oil companies having regard to commercial practices and their operating costs. The Government currently levies a duty of \$6.06/litre on unleaded petrol while that for Euro V diesel is zero at present.

3. The role of the Government is to endeavour to ensure a stable fuel supply, enhance transparency of the prices of auto-fuel products and promote competition by removing barriers to market entry. It has been monitoring the changes in local retail prices of auto-fuels and comparing them with the trend movements of international oil prices (benchmarked against the Singapore free-on-board prices, i.e. Means of Platts Singapore ("MOPS"), for unleaded petrol and motor vehicle diesel).

4. To improve the transparency of prices of fuel products, the Administration posts onto the website the movements in local import prices and retail prices of auto-fuel in comparison with movements in MOPS on a weekly basis. It has commissioned the Consumer Council to post onto its

website the local auto-fuel retail prices and information on various types of discounts offered by oil companies weekly, and to launch the "Oil price Calculator" and smart phone application to enhance price competition among oil companies and to help consumers make informed choices. The Census and Statistics Department also provides statistics on import and retail prices of major oil products to the Panel on a regular basis. The latest update was issued on 31 May 2021 vide LC Paper No. CB(4)1048/20-21(01).

Tendering arrangements of petrol filling station sites

5. Most auto-fuel in Hong Kong is sold through retail stations. Sites for stations are designated for petrol filling station ("PFS") use by the Government after the consideration of factors including potential demand, environmental impacts, and road and fire safety concerns. Currently, PFS sites in Hong Kong are awarded to the tenderer which offers the highest tender amount on land premium. The lease term of land approved for sale by the Government for PFS use is 21 years.

6. To facilitate new market entrants, the Administration has introduced improvement measures to the tendering arrangement for PFS sites over the years. The measures taken included:

- (a) removing the requirement for bidders of PFS sites to hold import licence or supply contract;
- (b) re-tendering all existing PFS sites upon expiry of their leases instead of renewing the leases to the existing operators; and
- (c) introducing the "super bid" tendering arrangement (whereby tenderers can submit a "super bid" for all the sites in the batch or individual bids for each of PFS sites in the batch) to facilitate new entrants in acquiring a critical mass of PFS sites.

7. To further enhance competition in auto-fuel market and in response to the recommendations¹ made in the "Report on Study into Hong Kong's Auto-fuel Market" ("the Report") released by the Competition Commission ("the Commission") on 4 May 2017, the Administration has also introduced the following measures:

- (a) improving the display of price information at PFSs. For PFS sites being/to be tendered/retendered, the Administration will require,

¹ The Report sets out five recommendations on enhancing competition in Hong Kong's auto-fuel market: (i) increase of PFS sites; (ii) review of tendering system for PFS sites; (iii) prominent display of pump prices and walk-in discounts at PFS; (iv) re-introduction of 95 RON petrol; and (v) reduction of entry and expansion barriers.

through making it a lease condition, that a price information board as approved by the Administration indicating the price of petrol, diesel, liquefied petroleum gas and other petroleum products (if applicable) sold in the PFS shall be erected within the PFS; and

- (b) facilitating the private sector to convert privately-held land to PFS use with a view to enhancing competition. The Administration will provide one-stop service, which includes coordinating communications between applicants and the relevant government departments; as well as the provision of technical advice by government departments to the applicants during the process of planning permission/amendment of plan application (if applicable) of private land for PFS use and the relevant land procedures.

Previous discussions

8. The Panel has all along been concerned about the high auto-fuel prices in Hong Kong. On 22 May 2017, the Panel was briefed on the Report. On 17 July 2018, the Administration briefed the Panel on the update on the tendering system for PFS sites and follow-up to the Report. At the meeting held on 27 April 2020 when the Commission gave an annual briefing to the Panel on its work, members also took the opportunity to deliberate matters relating to auto-fuel prices in Hong Kong.

Retail prices of auto-fuels

9. Members in general considered it unacceptable that there was no significant drop in local retail prices of auto-fuels given that international crude oil prices had plummeted in the past. To reduce the commuting costs of members of the public and the operating costs for commercial vehicles, members called on the Administration and the Commission to look into the problem of high auto-fuel prices in Hong Kong.

10. The Administration advised that in considering the policy on auto-fuels, the Government would take into account the unique situation of Hong Kong and address various matters, such as traffic congestion, air pollution, safe and stable energy supply and affordability of the trades, in a holistic manner. To assess whether the extent and schedule of adjustments of local auto-fuel retail prices had been reasonable, the following factors should be taken into account –

- (a) Hong Kong had no oil refinery. All auto-fuels sold locally were imported, and they were refined oil products instead of crude oil. It

was not appropriate to simply compare the difference between the international crude oil price and local retail prices;

- (b) the comparison between the import prices of auto-fuel and local auto-fuel retail prices was an appropriate indicator to accurately assess whether there has been any deviation from the trend movements of international oil price;
- (c) apart from the import price and Government duties, the local auto-fuel retail price also covered other operating costs such as labour, land, transportation and promotion costs. Adjustments in these operating costs might not be in tandem with international oil price movements; and
- (d) local oil companies in general replenished their oil stock once to three times a month. They usually maintained an oil stock of around 30 days. According to the analysis on the replenishment frequency data, the actual import price of auto-fuel currently sold reflects the average import prices of the past few weeks.

11. Regarding the trend movements of retail prices of auto-fuel, the Administration had compared the changes in local retail prices of auto-fuel and the average monthly import prices since January 2003. In view of the import and stock-piling pattern of oil companies, there was a time lag for the adjustment of the auto-fuel import prices to be reflected in local retail prices. Therefore, the comparison had been made between the average import prices of the previous month and the local retail prices in the current month. Result of the comparison showed that, the trend movements and the extent of adjustments in local retail prices had been broadly in line with the average import prices in the previous month.

12. The Administration also advised that according to the Report, the two features of which oil prices were higher in Hong Kong than anywhere else and that they were always the same across companies could not be taken as hard evidence of anti-competitive conduct on their own. The Report also indicated that there was no evidence that the retailers were increasing their retail margins by passing-through increases in import costs more quickly than reductions, i.e. engaging in "rockets and feathers" pricing. Besides, since customers could obtain various discounts and offers in different ways, the actual price after discount was lower than the retail price and was not a uniform price, suggesting that price competition existed in the market.

13. To lower the import prices of auto-fuel, a member suggested that the Administration should conduct a study on the reasons for oil companies

importing refined oil products mainly from Singapore and devise a mechanism to ensure that the oil companies would import from the cheapest source. The Administration advised that oil companies sourced their auto-fuel based on their own commercial considerations, and the Government did not have any regulation on the import source of auto-fuel. In a free market economy, the Government should not interfere with the source of products of the auto-fuel industry as far as possible just like other consumer goods industry. Based on the information provided by the oil companies, at present they mainly sourced their auto-fuel products from Singapore, the Mainland, Korea and Japan, etc. The oil companies would take into account a number of factors when choosing their source of auto-fuel products, including product cost, quality and stability of supply, and the oil companies would also adjust their source of import from time to time having regard to changes in market conditions.

Suggestions on enhancing competition in auto-fuel market

14. To enhance competition in auto-fuel market, members in general supported the recommendations made in the Report, in particular the review of tendering system for PFS sites and re-introduction of RON 95 petrol, to promote market competition and lower auto-fuel prices. A motion to this effect was passed at the meeting on 17 July 2018. The Administration's response to the motion passed was issued to members vide LC Paper No. CB(4)1489/17-18(01).

15. Regarding the suggestion on increasing PFS sites, the Administration advised that it did not see a strong case for providing more land for PFS use at this stage, given that the existing PFSs could meet the current market demand for auto-fuel, and also in view of the land shortage in Hong Kong and the Government's policy to encourage the public to use public transport more and reduce reliance on private cars. In the light of the Commission's view that there were difficulties in converting privately-held land to PFS use, the Administration had introduced facilitative measures as mentioned in paragraph 7(b) above to help the private sector convert privately-held land to PFS use. In addition, where appropriate, the Administration planned to split some of the larger PFS sites into smaller ones, so as to increase the number of PFSs and promote competition.

16. Regarding the suggestion on re-introduction of 95 RON petrol, the Administration advised that although the existing legal requirements as well as lease conditions of PFS sites did not prohibit the supply of 95 RON petrol, the mandatory supply of 95 RON petrol at PFSs might not necessarily bring about more and cheaper choices for drivers, rather it might bring about other possible adverse impacts. It might even affect the response to the re-tendering

exercise for PFSs and there might be fewer number of market players in the long run in Hong Kong's auto-fuel market.

17. The Administration further explained that with reference to the only prevailing pricing benchmark for oil products in the Asia-Pacific region (i.e. MOPS petrol price), it estimated that the wholesale price difference between 95 RON and 98 RON petrol was likely to be around HKD 10 cents per litre, which was less than 1% of the average retail prices of the two prevailing 98 RON petrol products provided in Hong Kong. Since different storage tanks would be required for storing petrol products of different octane ratings, oil companies might need to construct additional petrol storage tanks along the whole supply chain (i.e. from the terminal down to PFSs), as well as modify other facilities (such as pipelines, nozzles and oil tankers, etc.) if oil companies supply 95 RON petrol in addition to the existing 98 RON petrol products. The additional operating and capital costs to be incurred by such installations might likely offset or even outweigh the small wholesale price difference between 95 RON and 98 RON petrol.

18. In response to some members' suggestion of lowering the retail prices of petrol by reducing the Government duty imposed on petrol, the Administration advised that fuel duty did not only provide revenues to the Government, but also helped reduce private vehicle owners' desire to drive as well as alleviate problems of traffic congestion and air pollution, etc. The Government would continue to strike a balance among various factors, including tax revenue, environmental protection, transportation and the level of public acceptance when setting the rate of fuel duty.

19. There was a suggestion that the Administration should consider introducing into the market a pricing adjustment mechanism similar to the ceiling prices adjustment mechanism adopted for liquefied petroleum gas ("LPG") at dedicated auto-LPG filling stations. Under such a mechanism, the award of PFS tender should be primarily based on the lowest fuel prices offered to customers instead of the highest land premium offered to the Government. In response, the Administration advised that in terms of tendering arrangements, PFS sites were largely the same as government land in general. LPG filling stations adopted a different approach because it was necessary to achieve the policy objective of converting diesel taxis and public light buses to auto-LPG ones as soon as possible in order to improve air quality. Therefore, a pricing formula and "zero-land-premium" were adopted to quickly set up an LPG filling network with a reasonable coverage, and to keep the price of auto-LPG at a competitive level.

20. In response to a member's suggestions on building public oil storage facilities, allowing more flexible sales models, relaxing the non-fuel retail

business in PFSs, and allowing individual fuel trucks to provide retail services in safe conditions, the Administration advised that although the limited terminal storage facilities in Hong Kong might not help new competitors enter the market, constructing these facilities would require a substantial amount of land. The Administration should weigh carefully whether the land in question should be used for other purposes where the needs were more pressing. Regarding auto-fuel market's sales model, noting that the increase in sales of non-fuel products would not have a significant impact on the revenue of PFSs, and that there were fire safety concerns, the Administration had no intention to encourage PFSs to expand their non-fuel retail business and had reservation about allowing fuel trucks to provide retail services for reasons of fire safety, traffic management, etc.

Council questions

21. At the Council meetings of 22 February, 24 May 2017, 15 January, 29 April, 6 May, 20 May and 27 May 2020, Hon Holden CHOW, Hon Starry LEE, Hon CHAN Kin-por, Hon CHAN Hak-kan, Hon Tony TSE, Hon CHAN Hoi-yan and Hon CHAN Han-pan raised questions relating to the auto-fuel market and auto-fuel prices in Hong Kong. Hyperlinks to the relevant written replies from the Administration are provided in the **Appendix**.

Latest development

22. At the meeting on 28 June 2021, the Administration will brief the Panel on auto-fuel prices in Hong Kong.

Relevant papers

23. A list of the relevant papers available on the Legislative Council 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	28 March 2017	Administration's paper
	22 May 2017 (Item V)	Competition Commission's paper Competition Commission's report on study into Hong Kong's auto-fuel market Administration's follow-up paper Joint letter from Hon James TO, Hon WU Chi-wai and Hon Andrew WAN (Chinese version only) Administration's response to the joint letter Letter from Hon Frankie YICK (Chinese version only) Letter from Hon Jeremy TAM (English version only) Administration's response to Hon Jeremy TAM's letter Background brief Minutes
	17 July 2018 (Item II)	Administration's paper Administration's follow-up paper

Issued by	Meeting Date/ Issue Date	Paper
		<u>Administration's response to the motion passed</u> <u>Background brief</u> <u>Minutes</u>
	27 April 2020 (Item IV)	<u>Administration's paper</u> <u>Administration's follow-up paper</u> <u>Letter from Hon Holden CHOW (Chinese version only)</u> <u>Letter from Hon Andrew WAN (Chinese version only)</u> <u>Administration's consolidated response to Hon Holden CHOW and Hon Andrew WAN's letters</u> <u>Letter from Hon WU Chi-wai (Chinese version only)</u> <u>Administration's response to Hon WU Chi-wai's letter</u> <u>Background brief</u> <u>Minutes</u>
Council Meeting	22 February 2017	<u>Council question on "Alleged anti-competitive conduct of oil companies" raised by Hon Holden CHOW</u>

Issued by	Meeting Date/ Issue Date	Paper
	24 May 2017	<u>Council question on "Competition Commission's report on Hong Kong's auto-fuel market" raised by Hon Starry LEE</u>
	15 January 2020	<u>Council question on "Petrol pump prices" raised by Hon CHAN Kin-por</u>
	29 April 2020	<u>Council question on "Fuel prices" raised by Hon CHAN Hak-kan</u>
	6 May 2020	<u>Council question on "Easing the financial pressure brought about by fuel expenditure" raised by Hon Tony TSE</u>
	20 May 2020	<u>Council question on "Promoting competition in the fuel market" raised by Hon CHAN Hoi-yan</u>
	27 May 2020	<u>Council question on "Retail prices of auto-fuels" raised by Hon CHAN Han-pan</u>