Tackling High Oil Price in Hong Kong from a New Perspective

Dr. Peter P. L. Chan, *FInstTA*

Hon. Treasurer,

Institute of Transport Administration

(China-Hong Kong Centre)

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Continuously rising oil price is proven to have further impacted upon the logistics industries in Hong Kong. The Civil Aviation Department of Hong Kong has approved recently 13 airlines to maintain or increase surcharges on fuel with effect from June 2008. Most of the airlines have now raised their surcharges by 22% - 39% and Cathay Pacific Airways, the flagship airline of Hong Kong, is one among the airlines. "The surcharges are expected to affect the tourism sector by the end of the year", said James Tien, the Chairman of Hong Kong Tourism Board. Mr. Tien's remark conveys effectively a warning that ancillary industries of logistics and transport in Hong Kong will also be affected by the high oil price.

The going into liquidation of the Oasis Hong Kong in April 2008, the only budget airline registered in Hong Kong, has further proven that the airline industry in Hong Kong is the first unable to sustain the high fuel cost. Packing more seats and reducing weight of non-essential equipment (such as removal of the on-board movies player) would mean not just reduction of legroom and quality of service, but also a possibility that safety of passengers will be compromised. High passenger-fare and cargo-freight would not just put off passengers and slow down economy of Hong Kong but also affect the local and international transport service. More transport operators going bankrupt means more the transport professionals and their families will suffer.

<u>The High Oil Price</u>

Oil price has increased from US$10 a barrel in 1999 to a recorded high of US$138 in June 2008. The increase has not just pushed up operation costs of logistics operations globally but also led to inflation that would in effect drive an additional 1.7 million people into poverty, according to a recent study undertaken by the Asian Development Bank.[1]

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[1] Philippine Daily Inquirer: High oil price put pressure ion government to ease people's pain, http://newsinfo.inquirer.net/inquirerheadlines/nation/voiew/20080610-141761/High-oil-prices-put-pressure-on-govt-to-ease-peoples-pain

Rhetoric nevertheless, skyrocketing oil price was largely due to supply-related problems rather than growing demands. Though the global demands for oil are increasing, particularly on the part of the developing countries, it is felt that oil-producing countries have excess capacity that is enough to meet the growing demands. Organization of Petroleum Exporting Countries (OPEC) chose however to maintain the production level at 86 million barrels per day, in spite of the estimated spare capacity of producing 2.6 million barrels more per day.[2] Increase in supply and reduction in demand seems to be the global solution but how it is going to work may be an extremely complicated issue. Executive measures such as government subsidies to help stabilizing the oil prices, development of alternative fuels, conservation of energy relying upon consumption of fuel, biofuel, and liquefied natural gas would seem to be more practical for a nation or for a Special Administration Region (SAR)[3] with the highest degree of autonomy, such as Hong Kong or Macau of China.

Commonsense tells while business sector could transfer high fuel cost to clients, households just could not do the same. High fuel cost would mean reduction of other household expenses that would inevitably affect quality of life. Pump prices in Hong Kong have gone up gradually from HK$12.98 to HK$14.72 for petrol and from HK$8.36 to HK$9.92 for diesel as at February 2008. Although many public service vehicles such as taxis and minibuses have switched progressively from petrol power to LPG power, they are however not very much better off at using LPG as its price has also gone up during the year of 2008 from HK$14.65 to HK$16.52. All these have brought pressure to bear for a fare increase.

Excise tax is one of the causes to which the high pump prices could be attributed. The Hong Kong Customs and Excise Services is the department of the Hong Kong SAR Government responsible for collection of excise duties. During the year of 2006, it collected a total revenue of HK$6.96 billion, almost half of which (47.7%) was from hydrocarbon oil[4]. The high excise duties in Hong Kong for petrol and ultra-low sulphur diesel at HK$6.06 and HK$1.11 per liter respectively have turned catalysts of loud protests from the transport trades in the recent months.

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[2] Ibid

[3] Since reunification with China on 1st July 1997, Hong Kong has ceased to be a British Colony and become a Special Administration Region equivalent to a Province of China. Under The People Republic of China Hong Kong Special Administration Region Basic Law, Hong Kong enjoys the highest degrees of autonomy as conferred by the National People's Congress of China.

[4] Hong Kong Government Year Book 2006

Discounting the fact that a GST is levied in Singapore, Hong Kong was considered to have levied a higher excise duties as compared to this neighborhood country, where only S$0.37 is levied for petrol and no excise duty is levied on diesel.[5]

Despite Hong Kong Government has waived fuel taxes for commercial transport of sea and air, it has been very much reluctant to waive oil tax for the road transports. Since public transport vehicles in Hong Kong including the buses, taxis and trucks are made by the Government to use the more expensive but more environmental friendly Euro-five diesel as their western counterparts, there is strong justification to require Hong Kong Government to extend the fuel taxes waiver to road transports. For the surged pump prices, many angry drivers in Hong Kong whose livelihoods are affected have begun to stage marches and slow-drive protests since June 2008. The Hong Kong Automobile Association representing some 12,000 private car-owners has also joined the move by writing to the Financial Secretary of Hong Kong urging for measures to solve the problem of high pump prices.

Responses of and Stance taken by the Hong Kong Government

On 20th May 2008 the Hong Kong SAR Government announced its approval for Kowloon Motor Bus Company (1933) Limited (KMB), the largest franchised buses company in Hong Kong, to increase bus fare by 4.5%.[6] The fare increase is seen as a symbol of inflation of traveling expense will affect all Hong Kong citizens, which has in turn triggered a series of applications to the Transport Department for a fare increase by other public transport operators providing buses, taxis and ferries service in Hong Kong.

Hong Kong Ferry & Kowloon Ferry Limited is the main ferries operator licensed to provide commuter-ferries services between the two sides of the Victoria Harbour and to the many outlying islands of Hong Kong. Despite the company was allowed a fare increase in 2004, it has also joined in to apply for another fare increase on the ground that its fuel cost had gone beyond its budget by 225% as a result of the repeated increases in oil price which used to cost only HK$1.2 a liter.[7] Whilst people in Hong Kong are complaining about the inflation brought about by the

[5] http://www.mof.gov.sg/budget_2003/budget_speech/annex1.html
[6] Transport International Holdings Limited 2008 Annual General Meeting http://www.tih.hkenglish .php?page=others&file=press/news2008052901.html
[7] Legislative Council of Hong Kong, Legislative Council Paper of Panel on Transport No. CB(1)2279/04-05(03)

surging oil price, one could easily overlooked the fact that the KMB's submission for fare increase in 2004 was indeed made under an assumption that the oil price would climb up only to US$85 a barrel in 2008, which is far below the actual oil price now that once climbed up to US$160 a barrel in May 2008.

On 27th June 2008, the Hong Kong Stock Market slumped 1.84% to a low of 21,773.67[8] vaporizing billions of investors' money just over the night for purely the reason that Dow Jones Industrial Average had dropped more than 3% as oil price hit US$141 a barrel. The substantial monetary loss seems however have not heightened the awareness of the Hong Kong Government about the destruction power of high oil price.

In his replies to questions asked by the Legislative Councilors in December 2004, the Secretary for Economic Development and Labour, Mr. Stephen IP, had maintained that the Government did not see the need to take any ad-hoc measures, such as setting up a committee to oversea the supply, distribution and consumption of oil and stated Hong Kong did not rely heavily on oil, which Mr. IP said accounted for just less than 5% of non-labour business[9]. He added the Hong Kong Government needed only to continuously monitor the situation to ensure reliable and sufficient energy supplies to the public. Mr. IP's statement could be regarded as a representation of the government stance on not to interfere with the pump prices, and would serve also to explain the reason why Hong Kong Government is not inclined to apply executive measures to regulate fuel costs even an increase of it would adversely affect the entire community. It is considered that the inaction on the part of the Hong Kong Government would amount to turning a blind eye to the problem, if not being shortsighted.

Abstract about Mitigating Implications of Peak Oil for Hong Kong

Rather than addressing the imminent issue of surging oil price, there have been lots of recommendations about mitigating implications of peak oil for Hong Kong in the abstract thrown in by academics, economists and energy experts. Whilst these ideas all have their own merits, it is felt that the recommendations are all rather remote, if not too idealistic, and are incapable of solving the surging oil price Hong Kong now faces. An example of such is the recommendation that "Hong Kong shall look to other wealthy cities and small countries for examples to follow"

[8] The blue-chip Hang Seng Index dropped from 22,042.35 by 413.32 points.
[9] Hong Kong Government News Release on 1 December 2004

and that "worth considering their (the Singapore's) current energy strategy"[10]. There are also the recommendation that Hong Kong shall look at (a) diversification of energy supplies; (b) development of long-term new energy sources; (c) improving energy efficiency throughout the economy; (d) industrial development of the general sector; and (e) international cooperation to secure long-term energy supplies. Without going into a detailed discussion of the effect of each and individual of the area recommended to be looked at, one may agree that the effects of the recommendation just would not be imminent and the implementation of it will require a long period and strong bargaining power and position that a country rather than Hong Kong as a SAR is better equipped. Hong Kong Government ought therefore to concentrate its efforts on the development of practical measures to stabilize local pump prices to mitigate the impacts of surging oil price, rather than continuously engaging in or advocating all these abstractions.

Elements Outside the Control of Hong Kong Government

It is agreed that there are elements beyond the control of the government of one particular nation, not to say the government of a SAR such as that of Hong Kong or Macau. These elements would include the follows: -

(a) Supply of oil by oil production countries

Crude oil is refined to produce refined products such as petrol and diesel of different standards. Many refineries are running at near full capacity and many just refrain from increasing production for the government control on prices of refined products.[11] Hong Kong has no oil refinery and is relying completely on imported refined oil products.

(b) Relief of demand by largest consumption countries

World demands on crude oil have an average growth of 1.76% per year between 1994 and 2006 and it is projected that the world demand will increase 37% over the 2006 level by 2030.[12] Developing countries have usually the highest

[10] Geoffrey Chen, Robert Footman, Alex Tancock; "Peak Oil and its Implications for Hong Kong", November 2007, www.peakoilhongkong.com
[11] In China, government is subsidizing the pump prices of refined products that would mean making more deficits when more production is made. Accordingly, refineries even are able would be reluctant to increase their capacity.
[12] International petroleum (oil) Consumption Data provided by U.S. Energy Information Administration http://www.eia.doe.gov/emeu/international/oilconsumption.html

demands and are the largest oil consumers for their growths in transportation, economy and population. The growing demands are irresistible and the only solution seems to be the development of alternative energies such as tar sands, solar power, waves or wind energies before all fossil oil run out. Superpowers have been unable to make a change and are seen taking the opportunity to make profits of the demands through speculations made by financial institutions of their countries in the oil markets instead.

(c) Political influences upon oil supply

Unstable political environments such as tension in the Middle East will create uncertainty and affect the production, transport and export of oil. These instabilities are intended, if not created, out of political motives and economic strategies of the superpowers that one must agree as beyond the control of a small country or an individual city such as Hong Kong.

Elements could be considered by the Hong Kong Government

It is felt however that there exist three elements could be practically considered by the Hong Kong Government to regulate local fuel prices for the elimination of its adverse effects. These elements include the follows: -

(a) Establishment of Strategic Oil Reserve (SOR)

Strategic Oil Reserve (SOR) is a means can be used not just for military purpose by a country but also for stabilizing local fuel prices in case of emergency, fluctuation of oil price, and sudden interruption or oil supply. Hong Kong SAR Government could consider keeping a strategic oil reserve within or even outside the territories of the SAR. To reduce its dependence on instant oil supply, the government may consider establishing SOR by way of partnership the nearby provinces of the Mainland or even the Macau SAR. During a surge of oil price, particularly one caused by speculation activities in the world oil markets, SOR could be used to stabilize local oil supply and its prices.

(b) Provision of subsidy to oil users.

Most countries in Asia, except Japan, Singapore and South Korea, have the policy of subsidizing pump prices to protect their people from price increase. Despite being an integral part of China that has also been subsidizing her oil users, the Hong Kong SAR Government has never adopted the same policy. Although there is the argument that subsidized pump prices will encourage oil consumption forcing government in a comparatively weaker financial position, it is well proven that subsidy is important for controlling market monopoly. Coupled with an effective mechanism to regulate prices increase at the retail ends, as well as an adequate use of SOR, Hong Kong Government should be able to control the pump prices at a reasonable level affordable by the citizens.

(c) Regulating the pump prices adjustment

Despite the small size of Hong Kong geographically, Hong Kong has about 200 gas filling stations operated by 7 oil companies. In theory and for the close proximities among the oil filling stations operated by different companies, the oil companies are supposed to be competing against each other whereby creating an invisible control on the retail prices of oil products.

As a matter of fact however, these oil companies are seen to be in close align joining hands to monopolize retail prices of oil by raising the pump prices ‘proactively’ and lowering it just ‘reactively’. The only competition they are seen doing is the various discounts they offer to their own oil cardholder or credit card consumers to attract purchase of their products.

For the protection of consumers, Hong Kong Government should get hold of all available information about price, supply and speculation situation of oil and devise measures to ensure retail prices of oil products would reflect honestly the import price of oil preventing oil companies from ripping off the consumers under the pretext of transferring import cost.