For Information

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Legislative Council Panel on Economic Services
<u>Fuel Surcharge by Airlines</u>

Introduction

At the panel meeting held on 31 March 2003, Members requested additional information on Civil Aviation Department's (CAD) rationale for approving airlines to levy surcharges for the carriage of passengers and cargo. Members also requested further information on how the trigger mechanism for the setting of fuel surcharge for the carriage of cargo worked and the computation of the fuel price index. This paper provides the additional information requested.

Rationale for approving the levying of surcharges for carriage of passengers and cargo

2. Tariffs and surcharges charged by an airline require the approval of CAD under bilateral air services agreements (ASA) and arrangements. The Government has an obligation to regulate such tariffs and surcharges for the purpose of protecting the interest of the travelling public and preventing predatory pricing of air services products by airlines. When CAD receives a tariff/surcharge application from an airline, it will consider the application taking into account relevant factors specified in the ASAs and arrangements including, inter alia, airlines' cost of operating the services, interests of users, tariffs of other airlines operating on the whole or part of the same routes etc.

3. As explained at the last panel meeting, airlines recover their operating costs through the tariffs (i.e. ticket fares and cargo rates) they charge for the carriage of passengers and cargo. It is a business decision for individual airlines to take whatever cost management or marketing strategies they see fit to hedge against short-term fluctuation in operating costs (e.g. fuel costs). While the Government will not involve itself in airlines' business decisions, CAD will assess each application for surcharges on its own merits, having taken into account the relevant factors specified in the relevant air services agreements or arrangements.

Trigger mechanism for the setting of fuel surcharge for the carriage of cargo

4. The current trigger mechanism, proposed by the Board of Airline Representatives in June 2002, allows airlines to respond to changes in fuel prices, whether upward or downward, more promptly. Under this mechanism, the cargo fuel surcharge is adjusted on the basis of a fuel price index which is calculated weekly by averaging fuel prices in five major spotmarkets worldwide, namely Rotterdam, Mediterranean, Singapore, US-Gulf and US West Coast. A 100 point index equals US$0.5335 per US gallon of crude oil.

5. When the fuel price index exceeds 115, 135, 165 or 190 respectively for two consecutive weeks, the corresponding level of fuel surcharge will be triggered and collected by airlines giving at least one week's notice to cargo forwarders. The four corresponding levels of fuel surcharge under this mechanism are HK$0.20, HK$0.40, HK$0.60 and HK$0.80 per kg for short haul destinations, and HK$0.40, HK$0.80, HK$1.20 and HK$1.60 per kg for long haul destinations. No surcharge will apply when the index falls below 100, while any surcharge proposed for index levels beyond 190 will be subject to separate approval by CAD.

6. The trigger mechanism was approved by CAD in July 2002 for a one-year period following consultations with the Hong Kong Shippers' Council.

7. At the time of the last panel meeting (31 March 2003), the level of surcharge was HK$0.80 and HK$1.60 per kg respectively for carriage of cargo to/from Asia and rest of the world. Fuel index levels have since dropped. Accordingly, the current level of surcharge which took effect on 1 May 2003 is HK$0.40 and HK$0.80 per kg respectively for carriage of cargo to/from Asia and rest of the world.

Civil Aviation Department
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