

Deregulation of China's Oil and Gas Sector

by Xiaojie Xu*

According to the China Academy of Social Sciences' Macroeconomic model, Chinese GDP will grow at a 9 percent rate from 1990 through 2000 and then level off at a 7.5 percent rate in the next decade. During the same period the China National Petroleum Corporation projects crude oil production to rise to about 4 million barrels a day (mbd) by 2010. Demand for oil, however, will continue to outstrip indigenous production, the gap between oil supply and demand being about 1 mbd in 2000 and about 2 mbd by 2010. This trend will greatly influence China's future policies.

China's oil and gas sector has undergone deregulation since the early 1980s. Unfortunately, this deregulation has been ineffective in revitalizing oil producers and promoting market-based competition. To comply with the country's escalating economic growth and competitive realities, a new oil/gas regulatory reform will be begun with petroleum legislation, new policy priorities, re-establishment of a Chinese independent regulatory authority and new industrial restructuring. These changes will bring new opportunities as well as new risks and threats.

Petroleum Law

China's current Law of Natural Mineral Resources seems ineffective in regulating onshore oil and gas activities where Chinese national oil companies are concerned. As a result, a study team headed by the China National Petroleum Corporation has been empowered to draft a new Chinese Petroleum Law. This first version of this will be submitted to the State Council later this year.

A Shift of Policy Priorities

To increase oil and gas supply and revitalize oil producers, a stable "supply quota contract" is proposed to replace the current increasing "production contract". This still requires oil producers to meet their supply commitment to the State, however, producers are free to otherwise rearrange their production so as to satisfy their long-term development plans. The gap between indigenous production and supply quotas can be filled from other domestic and international sources.

Gas policy has been linked with oil policy. This will continue for the short term. However, the regulation of gas transmission and distribution, including transnational distribution, will be governed by separate policies.

In the next few years, the current dual planned oil prices will be replaced by a single, changeable price. This price will fluctuate with world prices.

In the reform of oil taxation, international prices, commercial standards and tariffs will be emphasized. Consequently, fair, market-based competition will be encouraged. Once upstream marketing and competition policies have been implemented, internal markets will be opened to foreign oil players.

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Foreign Policy

Chinese foreign policy in this area is two fold. It encourages both the participation of foreign investors/operators and the involvement in the world market. To enhance domestic production, current onshore oil and gas exploration and production bidding activities will continue. Current policies emphasize new exploration in strategic areas, including the Tarim area, EOR projects, associated downstream cooperation as well as infrastructure construction. Legislation on joint ventures and cooperative relationships with foreign firms will be encouraged.

Due to a forecast shortage in oil/gas supply relative to demand by 2000, China is doing its best to increase related infrastructure. Current planning calls for about 2500 miles of transnational pipelines across China. This pipeline construction will cost more than US\$10 billion.

These policy changes will greatly encourage Chinese oil producers to enter national and international markets and will also open the door for foreign investment in China. But to facilitate this new environment will require an independent regulatory authority.

An Independent Regulatory Authority

To develop and sustain a healthy oil market, it will be necessary to establish an independent Chinese Regulatory Authority. This Authority would oversee the implementation of industrial policy and ensure market-based competition. The Authority's regulatory practices will be developed to fit China's realities. Eventually it will operate as an independent regulatory agency.

Additional initiatives involve the reorganization of the current government structure and oil/gas industrial framework. To promote national and international competition, this industrial restructuring should focus on a reorganization of the current four national oil companies. The proposed restructuring will focus on the core businesses of the NOCs and encourage strategic alliances worldwide. Establishing a governance structure for the NOCs will be a key part of this restructuring.

At the end of these initiatives, competition in China's oil market will be greatly enhanced. It should be noted, however, that the aim of the deregulation is to establish a competitive market and not a perfect market. The changes made must be compatible with the country's gradualism. Threats to this new deregulation include unbridled competition, runaway demand and inflation or political intervention.

16th North American Conference Proceedings

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