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Transcript

CHINA IN THE WORLD PODCAST

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Guest: **Dong Xiucheng**

Episode 46: The Impact of China's Price Cut on
Natural Gas

May 4, 2015

Wang: You are listening to the China in the World podcast series from the Carnegie–Tsinghua Center for Global Policy. In this series, we will invite Chinese and international experts to discuss China’s foreign policy, China’s international role, and China’s relations with the world. The Carnegie–Tsinghua Center for Global Policy was jointly established by the Carnegie Endowment for International Peace and Tsinghua University. It brings together leading policy experts and practitioners from China, the United States and around the world to engage in collaborative dialogue and research, aiming to identify constructive solutions to common global challenges. I am Wang Tao, a nonresident scholar in the Energy and Climate Program based at the Carnegie–Tsinghua Center for Global Policy. I will host the podcast today. It is also our first Chinese podcast. It is a great pleasure for me to invite Professor Dong Xiucheng as our guest. Professor Dong is the director of China Oil & Gas Center—SINOGCEN, China University of Petroleum. Nice to meet you, Professor Dong.

Dong: Nice to meet you, too.

Wang: At the beginning of this interview, we’d like to introduce the background of this discussion to you. The talk will be focused on the price adjustment of natural gas in China. Early this year, China’s National Development and Reform Commission announced that the existing gas and incremental gas prices will be unified from April 1. The highest city-gate price of incremental gas in each province will be decreased by 0.44 yuan per cubic meter and the highest city-gate price of existing gas will be increased by 0.04 yuan per cubic meter. Meanwhile, a multi-tier pricing mechanism on residential natural gas will be fully established this year. Professor Dong, my first question is, as it is the first substantial price cut on natural gas for the price adjustment in China, what are the reasons behind this adjustment and what’s the background and context of the price cut on natural gas?

Dong: It is mainly related to the overall plan about the price adjustment of natural gas in China. This big plan was mapped out several years ago that the price of natural gas should be linked with other alternative energy sources, namely fuel oil and liquefied petroleum gas. The last time when the incremental gas price was set, it was based on the product of the weighted average of fuel oil and liquefied petroleum gas prices at a coefficient. In order to maintain the transition, at the time the existing gas price was not raised greatly. Therefore, a “dual-track price system” was formed. Actually, the amount of existing gas is large. This time, the adjustment is to calculate both the existing gas price and the incremental gas price based on the above-mentioned method. They will both be linked with fuel oil and liquefied petroleum gas. The prices will reflect what it actually costs. This is the background.

Wang: So what industries do you think will be affected by the price adjustment? What industries may benefit from the price adjustment? What kind of impact will the price cut on natural gas have on the oil and gas industry? Will it cause difficulties in promoting further adjustment of the natural gas price?

Dong: It will directly influence the suppliers, manufacturers and importers of natural gas, as well as consumers. Natural gas is used for chemicals, fertilizers, chemical raw materials, and a small amount for power generation. Additionally, it is for household use. The related industries are very sensitive to the price. Manufacturers and traders, such as importers and manufacturers of natural

gas, will be greatly affected by the price adjustment. The price cut on natural gas will have a significant negative impact on them. Relatively speaking, downstream user-related industries, such as the chemical fertilizer industry and the chemical and power generation industries that use natural gas as raw material are beneficiaries.

Wang: What kind of impact will it have on the oil and gas industry? Recently, China National Petroleum Corporation has concluded a number of major agreements on natural gas import with Russia and Central Asian countries. China National Offshore Oil Corporation has also imported lots of liquefied natural gas (LNG). What kind of influence will the price adjustment on natural gas have on these petroleum companies?

Dong: Actually, no matter whether it is adjusted or not, this is a long-standing issue. That is to say, the conclusion of natural gas import agreements between China National Petroleum Corporation and Russia and Central Asian countries is actually a pricing formula, including offshore LNG. However, the formula varies with different gas sources based on the agreements reached. The main body of the formula is still linked with crude oil price. So, as the crude oil price drops, the prices of both [the oil from] Central Asia and offshore LNG will be adjusted accordingly. But the adjustment extent may be less than that of LPG and fuel oil. Thus a contradiction will be caused. A negative impact will be exerted on the enthusiasm for imports, either by means of pipeline transportation or marine transportation. But, overall, once the crude oil price decreases, the natural gas and LNG prices will drop, and vice versa. The relationship is just there.

Wang: Do you mean that the drop in the oil price will result in the price cut on natural gas and LNG?

Dong: Yes, they are linked in the contract. But the price is adjusted by 0.4 yuan in China. It is relatively high. In the agreements with Qatar or Australia, the price drops slightly, but the original price is not low. Since the LNG price was already high, even if it drops a little, it is not competitive compared to domestic prices.

Wang: So, you think we may face the situation of purchasing prices higher than selling prices for imported natural gas and LNG in the short term. It will frustrate importers. How should we solve the problem in the long run?

Dong: Not just importers—it will also frustrate other parties related to unconventional gas, inflammable gas, coalbed gas, coal gas, and so on, in China. Regarding coalbed gas, the state will provide some subsidies. Without the subsidies, there will be bigger troubles. Low gas price will place a restriction on them.

Wang: That is to say, after the drop in oil and gas price, these industries may face great cost pressure.

Dong: Yes.

Wang: Does the state need to provide them with cost [subsidies], or encourage them to continue to exploit gas in such a situation of low gas price?

Dong: In terms of national policy, they will be encouraged to do so, certainly. Importing is inevitable. It is a must to encourage the exploitation of inflammable gas and coalbed gas. In the final analysis, it's a matter of policy orientation. Can the subsidies in the past be adjusted? It depends on the policy. In addition, I believe it is a short-term effect. The cut of natural gas price was due to the price drop of LPG and fuel oil. However, if the crude oil price increases later, the prices of LPG and fuel oil will increase, too. So the price of natural gas is not set in stone, [even after it is] adjusted.

Wang: You have just mentioned the development of coalbed gas and domestic natural gas. Can you briefly introduce the development of the two industries in China and the impact they may be subject to? How much support will the national subsidy policy provide under the impact?

Dong: Generally, there is little business development for inflammable gas now. Only the Sinopec Group is working on it. The state offers the subsidy of 0.4 yuan per cubic meter now. It is profitable, basically. Coalbed gas is relatively scattered currently, on a small scale. The state offers the subsidy of 0.2 yuan per cubic meter now. It is inadequate overall. For coal enterprises, coal mining is more cost effective than gas exploitation. The cost of gas exploitation is higher than that of coal mining. So enterprises lack the motivation [for gas exploitation]. The subsidy is [only] 0.2 yuan per cubic meter now.

Wang: Insufficient subsidies for coalbed gas will definitely restrict the industrial development.

Dong: In the final analysis, it's a matter of substantial adjustment in energy structure. For continued development, on the one hand, it should be profitable, and on the other hand, the total consumption of coal resources should be controlled. It is interest-driven. Coal is cheap, so people are willing to use coal. If the total consumption of coal is controlled, gas must be used to replace coal. In this case, motivation is created. It is not a simple matter of price. It is closely related to the energy policy of the whole state.

Wang: In terms of the current development situation, do you think [unconventional gas] may be a beneficial supplement to the consumption of natural gas, especially the imported natural gas?

Dong: I think it is impossible in the short term. Coalbed gas has been developed for a long period of time, but little progress has been made. For inflammable gas, some breakthroughs have been made in Fuling, but there is no major breakthrough in other regions. Therefore, in my opinions, it is difficult to make unconventional gas play a greater role in the short run. Presently, domestic conventional gas and imported natural gas, pipeline gas and LNG are commonly used.

Wang: Initially, the National Development and Reform Commission developed the three-step strategy for price adjustment of natural gas. As this year's price adjustment ended, the original three steps of natural gas price mechanism was also completed. Do you think it means the price reform of natural gas has been completed?

Dong: No, not yet.

Wang: What will be done in the future?

Dong: In fact, the so-called three steps of natural gas price reform have not been fully completed. A mechanism linked with other alternative resources should be formed. It is the goal set several years ago. Similar to the original refined oil products, a set of methods should be formulated, with deep consideration, to determine the price. Previously, the price was basically determined through the method of cost-plus pricing. [The reform] is basically completed if you can figure out what the natural gas price is determined based on. However, there is an important part among the three steps. Namely, the pricing of domestic gas and industrial gas should be merged. But there is no such system now, because the domestic gas concerns the people's well-being, and additionally, the tier pricing mechanism of gas has not yet been established in various places. After the establishment of the tier pricing mechanism, the pricing of domestic gas and industrial gas should be merged. However, this will not be the end of the price reform. Now we use LPG and fuel oil, and we may expand their use in the future, so then the adjustment frequency may be increased from once a year or once a half year to once a month.

Wang: It is similar to the price mechanism of refined oil products.

Dong: Yes, it is the last part to be achieved. In fact, the medium-term goal is to relax price control, but it may take a fairly long period of time. It mainly depends on the natural gas trading center in Shanghai. Actually, a dual-track price system is formed: one is to set the price based on LPG and fuel oil prices, and the other is to set the price based on market conditions.

Wang: That is to say, there is a price in the market and also a netback price. The two prices will be coordinated with each other in the end.

Dong: Such a situation will appear in the future: the price of some gas will be set by the Shanghai trading center and the price of some other will be set by the state according to the price of other alternative resources. But the ultimate goal is to let it depend on the market.

Wang: The long-term goal is to leave it to the natural gas trading center in Shanghai and let the market [determine] the price.

Dong: Yes.

Wang: It is the long-term goal of reform. You have just mentioned that the price reform, the tier pricing mechanism will be carried out for household natural gas, and we all know that the National Development and Reform Commission intends to fully establish a tier pricing mechanism for residential gas this year. Does it mean that such a mechanism will be established by the end of this year?

Dong: It should have been completed in 2014 as originally planned. This issue is sensitive, so it has progressed slowly in places. It has been rolled out in some places, but in many provinces and cities, it was not completed according to the original steps as scheduled. The National

Development and Reform Commission specified that the price reform must be completed by the end of this year, but I believe there will still be some provinces slowing it down.

Wang: So what is the main obstacle? Is it the opposition from the residents?

Dong: The mechanism must be approved at the public price hearing. Certain formalities have to be gone through. If the formalities have not been well handled and the public price hearing does not approve the mechanism, the government will be placed in an awkward situation. So it is important to be cautious.

Wang: Perhaps, a great number of residents will hold opposite opinions, so it should be done cautiously.

Dong: Yes, there is widespread opposition from the residents.

Wang: From a macroscopic perspective, you have also mentioned that we may mainly use domestic and imported natural gas for some time in the future. Now, we have had natural gas imported from Central Asia, and possibly from Russia in the future.

Dong: We have imported from Russia now. Also, some gas from Central Asia is supplied by Russia, too.

Wang: So we also have some gas from Russia via pipelines of Central Asia. We have actually had diversified sources of imports. In terms of the security of natural gas supply in China, do you think it has been perfect? Or are there any risks that require attention or any measures to take in the future?

Dong: I think security and insecurity are relative. Technically, the more sources there are, the more secure it will be. What matters is not diversified sources, but concentrated sources. Now, China has many pipelines [for energy resources], which access Russia in the north and Central Asia in the west. Additionally, there are pipelines around for LNG. In this respect, it is relatively safe. But I don't think it is enough. The sources had better be decentralized. If sources are centralized in the hand of a large trader, there will be risks. Unfavorable influence will be exerted in the wake of any emergency or political crisis. Therefore, sources must be diversified. It is impractical to solely rely on Russia or Central Asia, or on LNG excessively. If LNG is concentrated in one or two countries, it is absolutely not viable. The more decentralized, the better.

Wang: However, Central Asia is a fairly large import channel now. More than half [of natural gas] is imported from Central Asia. Maybe, Russia will break the balance gradually.

Dong: Russia plans to supply 38 billion cube meters [to China] per year.

Wang: That is for the east line. There may be more for the west line. In this case, there will be more natural gas. But, are there any risks in these fields?

Dong: Of course yes. When [the supply] rises to a certain degree, there will be big risks.

Wang: Can you talk about the risks specifically?

Dong: For example, how should we deal with geopolitical risks? What should we do when the pipelines have to be cut off in case of geopolitical crisis? There must be risks.

Wang: As we imported natural gas from Central Asia, the pipelines between China and Russia may also face risks.

Dong: Yes, both have problems. [In case of] blockage for offshore pipelines, something will go wrong with LNG. So there must be risks.

Wang: So the proposed “Belt and Road” initiative is actually for better diplomatic relations with them.

Dong: [In addition to] geopolitical factors, [it involves] the interests of both parties. If there is no benefit, neither party will do it.

Wang: Thank you very much, Professor Dong. This is the China in the World podcast series. If you are interested in our topic today, more information can be accessed from the official website of Carnegie–Tsinghua Center for Global Policy at carnegietsinghua.org. Thank you for listening. See you next time!