




# Tariff Reform and Regulation in People's Republic of China (PRC)

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# Concept and Steps of Tariff Reform in PRC (1)

The PRC Government issued the “Notice on Printing and Distribution of Tariff Reform Scheme by the General Office of the State Council” in July 2003 (Guobanfa [2003] No. 62) which identifies the direction, target and principle for tariff reform.

## 1. The direction of tariff reform

To set up a tariff mechanism in response to the socialist market and economic system, capable of encouraging power development and restricting power cost rise with a view to realizing fair share of tariff, keeping the power system safe and stable, and meeting the increasing demand for power.



## 2. The target of tariff reform

Based on promoting the reform of power system and power market, establish clear and link-by-link (grid access tariff, transmission and distribution tariff, terminal sales tariff) tariff system and corresponding tariff formation mechanism.



- Relax regulation on competitive power generation and sales links, and allow the market mechanism to work; reinforce regulation on distribution and transmission under natural monopoly; reduce regulation targets and contents to increase efficiency and lower cost.

- Shift from protective to motivational regulation, i.e. transform from ROI based on increased costs, to regulation on price upper limit or income upper limit based on performance. Meanwhile, a tariff regulation system characterized by standardization, transparency, and efficiency will be formed.



# Concept and Steps of Tariff Reform in PRC (2)

## 1. The basic direction of grid accession tariff reform is to introduce competitive and market-oriented tariff.

- Phase 1: separate plant from grid; limited competition - competitive and uncompetitive grid access tariff will be regulated (gradual consolidation and prior tariff fixing)
- Phase 2: shift from limited competition to full competition (increase percentage of power with competitive tariff and gradually open the capacity tariff)
- Phase 3: full competition; access tariff is fully formed by market competition (barter market, bilateral contract, power right trade, etc.)



## 2. The distribution and transmission tariff will be regulated by government and fixed independently.

- Transmission and distribution link's tariff will be strictly regulated by government or power regulation authority due to its natural monopoly nature.
- From foreign practice, tariff regulation on monopoly grid enterprises is achieved through ROI based on increased costs or price/income upper limit based on performance, which is suitable for different development stages.
- During the grid development stage, it is suggested that ROI based on increased costs be used to regulate transmission and distribution tariff to increase efficiency, reduce cost, and allow price mechanism to work. Government will not fix cost and profit. They will be based on last year's tariff and the government will decide a range for upper or lower limit, subject to anticipated inflation and increased efficiency.



- During the grid maturity stage, it is suggested to use price upper limit or income upper limit based on performance to regulate transmission and distribution tariff.
- The grid cost will be calculated for each voltage grade. The government regulatory authority will gradually standardize and audit grid costs. The profits of grids will be based on effective assets and determined according to WACC.





### 3. Reform of sales tariff aims gradual transformation to market pricing under government regulation

- **Principles:**

- (1) fair share of tariff;

- (2) effective adjustment of needs;

- (3) taking goals of public policy into consideration;

- (4) reflecting supply and demand changes in generation;

- establishing a mechanism jointly connected with grid access tariff;

- (5) simple and easy to operate.



## Steps:

- First: optimize existing tariff structure and establish a mechanism jointly connected with grid access tariff.
- Second: re-categorize users and implement sound tariff system.
- Third: promote full development of sales of power where sales tariff will be determined by market under government regulation.



# Recent Tariff Policy Orientation and Tariff Regulation

**A. Accelerate pace of tariff reform, promote formation of rational tariff mechanism, adjust and perfect tariff policy, and promote power growth from the perspective of tariff mechanism and policy.**




## Major policy measures:

1. Adjust properly the tariff level and ease contradiction between supply and demand. In response to rise in the price of coal and environmental cost as well as tight power supply, the government increased the grid access tariff and sales tariff three times in 2004 and 2005.
2. Accelerate tariff reform for regional power market. The power market in northeast China implements dual tariff reform. Based on simulation operation, the trial operation started on Jan. 1, 2005. The power market in east China implements partial competitive tariff and continues to simulate operation. Central and south China will simulate operation this year. Meanwhile, power markets in east, south and north east China implement pilot reform in transmission and distribution as well as sales tariffs.



3. Study tariff setting for transmission and distribution key accounts, encourage power generators to supply electricity directly to key accounts, and stop sole purchase by grid enterprises. Jilin Longhua thermal electricity Co., Ltd. has directly provided power to Jilin Carbon Co., Ltd., which is a pilot trial.

4. Strengthen management of power demand, perfect policy for peak hour tariff, and enlarge gap between peak hours and low peak hours (e.g. from 1: 2.5 enlarged to 1: 4 in Beijing) to promote less power consumption in peak hours and more in low peak hours.



5. Reform and perfect cross-district/province power provision tariff, optimize cross-regional power adjustment, promote cross-region/province power trade, and optimize deployment of power resource in wider range.


6. Explore measures and methods in linking up coal and power tariff, ease the impact of increase in electricity coal on generators, and promote the coordinated development of coal and power enterprises.

7. Study how to formulate cost audit methods for transmission and distribution tariff. From the cost of construction of transmission and distribution, audit methods and procedures, standardize and supervise the cost of transmission and distribution, and reinforce supervision on cost and tariff of monopoly transmission and distribution links

8. Implement differential tariff, control unwarranted development of enterprises that consume more power, promote technological advancement and industrial reconstruction, and increase efficiency in the use of energy.

9. According to the provision of the Recycling Energy Law on power generators using recycling energy, if part of their access tariff is higher than the average access tariff of the general power generators, such part will be shared in the sales tariff by means of supplementary tariff. In this way, development of recycling energy will be supported and promoted through tariff policy.





**B. Establish and perfect relevant regulations to make the tariff transparent and reduce or eliminate violations.**

1. Promulgate tariff administration methods for access tariff, transmission and distribution tariff, and sales tariff to clarify tariff methodology and standardize tariff management.
2. For newly built plants, set their tariff according to regional average costs and declare it in advance. Change from post price fixing to declare tariff in advance to alter the previous status characterized by one tariff for one plant based on individual cost.
3. Cancel the policy on tariff for power beyond the base (outside the plan) and encourage generators to produce more power.






4. Explore tariff regulation methodology, standardize tariff behaviors, reinforce tariff regulation pursuant to law, protect the normal functioning of power market, and protect the legal rights and interests of power generators and users.

5. Study ways to disclose information on tariff, power amount, and billings to solve the imbalance between regulators and power enterprises, generators and grid enterprises. Ensure disclosure and transparency of tariff policy and relevant information to facilitate supervision.

6. Set up a system for the regular disclosure of tariff, reinforce collection statistics and analysis of price information, and disclose them to the generators and the general public.



## **C. Enhance supervision, and review and reinforce the penalty on tariff violators.**

1. Reinforce the supervision and evaluation of implementation of tariff laws and policies. The China Development and Reform Committee of the State Electricity Regulatory Commission (SERC) has organized two large examinations on tariff. This year, SERC will launch another examination.
2. Punish the violators and disclose their violations if necessary.
3. Analyze existing problems and propose solutions or improve the tariff policy.



**Thank you**