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Smog Clears on China Energy Reform

By TOM ORLIK

China is stepping on the gas on energy reform.

Growing evidence of high environmental costs, and moderation in international energy prices, mean new leaders have motive and opportunity to clean up China's energy act. The National Development and Reform Commission, the government's powerful economic planner, is promising substantial increases in clean-energy capacity and pricing reform to drive changes in the use of conventional fuels.

Taken together, the NDRC is promising a 52-gigawatt increase in installed capacity for clean energy in 2013, up from a 36-gigawatt increase in 2012. That includes a 10-gigawatt increase in solar—a significant bump that should prop up China's ailing domestic industry. Clean energy will make up 57% of additions to China's capacity in 2013, compared with a 35% share of the increase in 2010, according to Tian Miao, an energy analyst at NSBO.

Pricing reform is also on the agenda. The NDRC says it will improve the pricing mechanism for refined oil products. That should reduce the pain of crude-oil price spikes for Sinopec, China's biggest refiner, which faces market costs for crude but government-set prices for gasoline and diesel. With Sinopec under pressure to upgrade fuel quality to prevent a repeat of January's smog, that should offset some of the cost.

Natural-gas-price reforms—currently being tested in a few provinces—are set to expand as China encourages cleaner alternatives to coal. That's good news for Petrochina, the country's biggest natural-gas importer, which is also caught between high market prices when it buys overseas and low retail prices when it sells at home.

It should also be good news for upstream gas producers. China's oil majors have been on an acquisition spree, with Petrochina's February purchase of an interest in Australian liquefied-natural-gas assets from Conoco Phillips COP -0.18% the latest example. Gas-price reform should maintain the momentum.

The loser is heavy industry, which faces an upward march in prices as China ratchets down the energy intensity of growth. With their razor-thin margins, steel smelters—accounting for 11% of China's electricity consumption—look especially vulnerable. Natural-gas distributors with relatively high exposures to residential customers, such as China Resources Gas, will also suffer, as concern about inflation prevents their passing on cost increases to customers.

As ever in China, change will be gradual, and plans can be derailed. But with political, economic and environmental interests increasingly aligned around cleaner energy, this round of reforms looks less likely to be lost in the Beijing smog.

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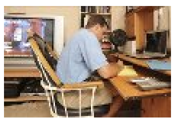

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