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Unifying the “dual-track” pricing mechanism for coal in China: Policy description, influences, and suggestions for government and generation enterprises

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ABSTRACT

The coal supply in China has been abundant in recent years, while the coal inventory of large generation enterprises has been sufficient. Therefore, overcapacity has occurred in China's coal industry, and the coal price has been relatively low, compared to the coal price during 2008–2012. At the same time, many coal transportation railways will begin operation to improve transportation capacity, and these measures will be able to guarantee the stability of coal prices. Under such circumstances, the Central Government has published the Guidance on Deepening the Reform of the Coal Market and has unified the dual-track pricing system for coal. The development of the coal industry and power industry is a key energy factor that affects the development of the national economy; therefore, this policy has far-reaching implications for the steady supply of coal and the reliable production of electricity. However, due to the non-market-oriented power industry management mechanism, this policy could have some negative influences on the power sector and coal sector, especially for the generation enterprises that will be exposed to risks of upper stream coal price shocks. Therefore, this paper focuses on analyzing the negative influences caused by the unification, and it introduces related measures for the government and for generation enterprises. First, this paper introduces the features and development of a dual-track coal pricing mechanism, which originated in 1985, and subsequently analyses the conditions for implementing the unification for the dual-track coal pricing mechanism. Second, from the information in related government documents, we analyze the negative influences on the coal and power industry caused by the unification accordingly. Finally, recommendations and measures for the government and generation enterprises are offered.

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1. Introduction

Since 1985, the coal market has progressively opened, and the supply and demand sides of the coal sold for electricity (coal sold for electricity, or CE, indicating the coal sold to generation enterprises to generate electricity) have conducted transactions under the supervision of the government based on a different pricing mechanism, which is different from the normal market. The generation enterprises have two means to buy coal. On the one hand, the coal price is set according to the contracts signed by the coal enterprises and generation enterprises, namely the “special contracts” of CE, for which the price is controlled by the government, and the generation enterprises are allowed to purchase a certain amount of

coal at less than the market price. The coal purchased in this manner is referred to as “planned coal” (because of the feature of its pricing mechanism being similar to the planned economy). On the other hand, when CE special contracts are not able to meet the demand of generation enterprises, they must buy the additional CE at the market price (Shen et al., 2012); this type of coal is referred to as “market coal”. There are significant differences between planned coal and market coal in terms of their supply, transportation capacity and price. All of these factors have limited the effects of the market mechanism, resulting in unfair competition. However, over the history of the “dual-track pricing system”, there have always been disputes over CE contracts, and these contracts are not conducive to the stable supplying of coal. Because the dual-track pricing system has become increasingly unsuited to the requirements of the economic development of the coal market and the future electricity market, related reform is imperative under such circumstances (Du et al., 2013; He et al., 2012).

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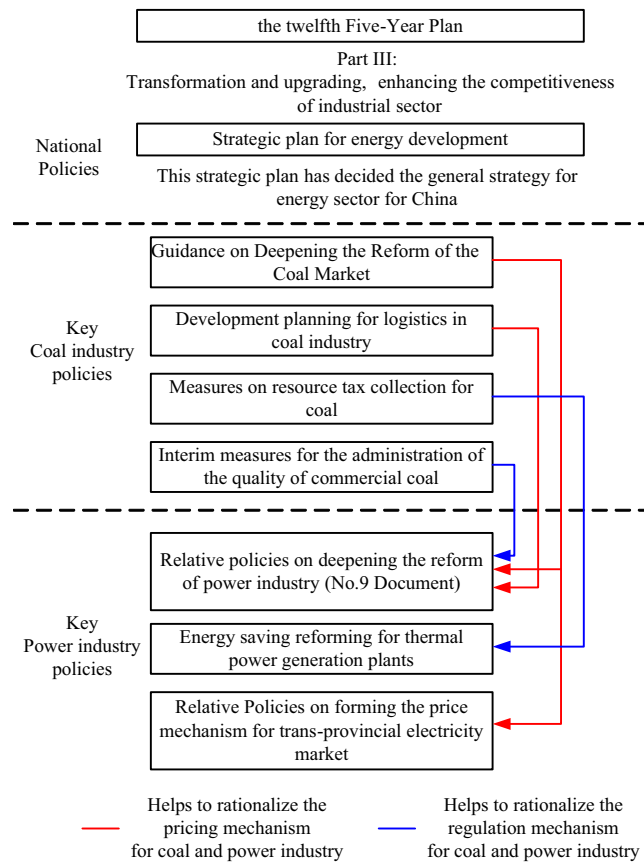


Fig. 1. The logic linkages for the reform policies of coal and power industry.

(Source: Author's own elaboration)

During “the Twelfth Five-Year Plan”, due to the continuous reduction in the growth of GDP (from 9.3% in 2011–7.2% in 2015), the Central Government decided to stimulate economic vitality in various industries. Regarding the energy sector, which continued to operate under the planned economy during the “twelfth Five-Year Plan”, marketization reform has become the key solution in allowing the price to play the decisive role in the optimized allocation of resources (Li et al., 2015; Gu et al., 2016). Regarding the coal sector, which is an upstream industry of the power industry and many other key industries, its marketization has become the basis for other industries. During 2015, which was the end of the “twelfth Five-Year Plan”, the Central Government published several documents regarding reform in the energy sector, and some of these reforms were parallel to the reform of the coal industry, while some were more detailed policies (Burke and Liao, 2015). Hence, we present a figure to show their linkages by listing important policies regarding coal industry and its downstream industries (Fig. 1).

In this situation, the National Development and Reform Commission (NDRC) formulated a proposal to unify the dual-track pricing system for coal, indicating that the special contracts for CE would be eliminated and only the normal market would remain. The Central Government published a document entitled *The Guidance on Deepening the Reform of the Coal Market* (hereafter referred to as *The Guidance*) in 2013. This government document ended the dual-track pricing system for coal that lasted for nearly three decades.

The Guidance is of great significance. As the data show, the installed capacity of coal-fired power generation accounted for nearly 80% of the total installed capacity in China, whereas coal and fuel costs accounted for 70%–80% or more of the on-grid price of generation plants. At the same time, generation enterprises in

China rely heavily on coal-fired generation. However, the market-oriented reform of the power industry has only recently begun. Therefore, unification might have some negative influence on the power sector and coal sector, especially for generation enterprises because they are completely exposed to the risks of upstream coal price shocks. Therefore, this paper first analyses the external conditions of the unification of the dual-track coal pricing mechanism and then analyzes its possible negative influences on power sector and generation enterprises. Finally, related solutions and recommendations are proposed. The logic linkages of this article are shown in Fig. 2.

2. The conditions for the unification of the dual-track coal pricing mechanism

The unification of the dual-track coal pricing mechanism was undertaken in 2012; however, the special contracts for CE were not fully cancelled. Some provincial governments still allow generation enterprises to negotiate with coal enterprises to decide the coal price at less than the market price. In this section, we first present the basic idea of dual-track coal pricing mechanism and then analyze in Section 2.2 whether it is the right decision to cancel the dual-track coal pricing mechanism.

2.1. Introduction to the dual-track coal pricing mechanism

The dual-track coal pricing mechanism originated in 1985, and it refers to the different pricing mechanisms of the supply and demand sides of coal after the gradual liberalization of coal prices. On the one hand, the CE price was set according to contracts signed by the coal enterprises and generation enterprises, in which the

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