

Reform of the Coal Sector in an Open Economy: The Case of China

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Cheap, abundant and easy to transport and store, coal has been produced and consumed to meet the energy needs of many large economies. The world has witnessed a surge in coal consumption over the last decade, driven primarily by developing economies such as China and India. China's phenomenal economic growth over the last thirty years has been powered by coal and coal-fired electricity and promoted by the export of manufactured goods whose production consumes large amounts of polluting energy.

To a large extent, policies and reforms adopted in the coal sector will impact not only on how coal will be produced and used domestically but also on the competitiveness of downstream, exporting manufacturing firms. It is therefore important for policy makers to take a broader view when designing and implementing policies affecting the coal sector, going beyond the boundary of the sector and taking into consideration possible impact on other sectors of the economy.

One of the most recent debates on China's coal industry is on the reform of coal taxation. A particular issue is whether to subject coal firms only to coal specific taxes (apart from general taxes) and scrap the lump-sum fees which has long been imposed on coal mines for the purpose of ensuring government revenues and equalising the profits of the coal and other industries. If a broad view is taken, policy makers need to consider what impact the reform will have on coal firms some of which have been in the process of corporatisation and/or

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privatisation, as well as downstream manufacturing firms which have been the main driving force behind China's rapid economic growth.

The analysis in the present paper incorporates the interests of three types of stakeholders – the government, coal firms and energy-intensive manufacturing firms. Comparison is made between the scenarios of different taxation regimes. The results indicate that scrapping the lump-sum fees and subjecting the coal firms only to special taxes are likely to increase social welfare. However, such a tax reform may induce coal firms to engage in strategic behaviour such as asset stripping, under-valued and under-priced state assets, insider control and managerial entrenchment, and de-capitalisation. Moreover, the reform may also encounter resistance from consumers, local governments and coal firms as they are likely to become worse off, thus calling for policy makers to adopt schemes to mitigate their losses.