

MICROECONOMICS AT WORK EXERCISE

THE DETERMINATION OF THE PRICE OF COAL

REFERENCE: ‘Oil recovery gives thermal coal a boost’ (by Stephen Wyatt), *Australian Financial Review*, 2 October 2002, p. 20.

CHAPTERS RELEVANT TO THIS EXERCISE: Chapters 3, 4, 6.

OVERVIEW

The article is about the price of (*thermal*) coal, and particularly the influence on the price of coal of the price of *crude oil*. The determination of the price of the two commodities has to be understood in terms of the *world* demand and supply situation in each case, and also the fact that they are to some extent substitutes for each other. The price of *oil* has risen significantly since November 2001 (by 80 per cent according to the article) and had a significant effect on the price of *coal* (though more in the way of stopping its fall over time (‘underpinning’ it) than leading to an increase). However, additional factors also contributed to underpinning the price of coal — for example an increase in *demand* (from Europe) and a decrease in *supply* from *other* producers (South Africa and Columbia). The ‘price’ of coal also needs to be analysed in terms of the way price is determined in practice, whether on a day-to-day basis in a free market (thus giving the ‘spot’ price) or by longer term contracts (and hence the ‘contract’ price).

QUESTIONS

1. How can the rise in the price of oil, which is the subject of the article, be explained?
2. In what way and to what extent might one expect the price of coal to be influenced by the price of oil? Why is it important to distinguish between *thermal* coal and *coking* coal?
3. What other factors may be expected to influence the price of coal?
4. From observations made in the article, what can you say about the structure of the world thermal coal market?
5. Explain the difference between the ‘spot’ price and the ‘contract’ price of a commodity such as coal.
6. What is the significance of the observation made in the article that ‘about 80 per cent of Australia’s exports of thermal coal are sold on an annual contract basis’?

7. Explain the notion of the differing 'sensitivity' of the major coal producers to (i) fluctuations in coal prices, and (ii) the proportion of their production sold on the spot market as distinct from under contract.