Eskom

Honourable Yunus Carrim, MP
Chairperson
Standing Committee on Finance (National Assembly)
Parliament of RSA
Plein Street
CAPE TOWN

Dear Mr Carrim

ESKOM'S PRELIMINARY COMMENTS IN RESPECT OF THE REVISED DRAFT CARBON TAX BILL AND SUPPORTING DOCUMENTS OF 14 DECEMBER 2017

Eskom would like to thank you for the opportunity to participate in the public hearings on this second revision of the draft Carbon Tax Bill and the supporting documents.

Eskom has submitted comments on the proposed carbon tax and engaged with National Treasury since the first discussion paper was published on this proposal in 2010. Over this time period, it is acknowledged that National Treasury has made two significant concessions for the electricity sector; the first being the commitment to minimising the impact on the price of electricity in the initial phase and the second being to allow for a credit for the renewable electricity premium which is built into the current price of electricity. In the second draft revision, however, it would appear that National Treasury has reconsidered the concession on the renewable premium credit, by curtailing the credit after 31 December 2022.

We have requested an extension to 9 April 2018 on the period to comment in order to thoroughly evaluate the potential impact of the proposed carbon tax, considering the substantive changes in the second revision as well as new information provided. We would still appreciate an opportunity to undertake a quantitative analysis and provide more detailed comment. A rough calculation shows that a simultaneous curtailment of the renewable credit and the crediting against the environmental levy at the end of 2022, would necessitate a pass through of an additional (approximately) R13 billion from 1 January 2023 which is expected to have a significant impact on the electricity tariff.

In the interim, we wish to reiterate comments which National Treasury has tried to address and yet which remain of grave concern to us.

The stated intent of the Bill is to "enable South Africa to meet its nationally-determined contribution commitments in terms of the 2015 Paris Agreement"; it further "seeks to give effect to the polluter pays principle by ensuring that the real cost of GHG emissions...are explicitly incorporated into prices...".

South Africa's nationally-determined contribution commitment is for national GHG emissions to follow a peak, plateau and decline emissions trajectory. It states that in "2025 and 2030, ...emissions will be in a range between 398 and 614 $MtCO_2eq$". The latest official national GHG

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inventory (2010) estimated South Africa's GHG emissions to be 518 $MtCO_2eq$ and the subsequent draft national GHG inventory (2012) indicated that South Africa's GHG emissions had remained at 518 $MtCO_2eq$. Unfortunately, no further national inventories have been published. Eskom's own voluntary reporting of GHG emissions shows that the electricity sector emissions peaked in 2013/14 and have declined year-on-year since then and we are currently at emission levels last seen in 2007. It is therefore highly likely that South Africa as a whole is well within the committed GHG emissions' benchmark trajectory range and we look forward to receiving verification of this from the Department of Environmental Affairs.

The Integrated Resource Plan 2010 and the draft Integrated Resource Plan 2016 do both include a sector-wide GHG emissions cap, the latter further incorporates a peak, plateau and decline GHG emissions trajectory where the projection has been extended to 2050. With these regulatory instruments already in place, it is not evident that additional measures are required to limit GHG emissions from the electricity sector.

As a result of the GHG emissions cap in the Integrated Resource Plan 2010, there has been a substantial roll-out of new renewable electricity supply projects under the Renewable Energy Independent Power Producer Procurement Programme. As a result of this programme, Eskom has signed power purchase agreements with all successful bidders under bid windows 1, 2, 3 and 3.5. The last of these projects is expected to achieve commercial operation later this year. Under these contracts, Eskom is obliged to "take or pay" all the renewable energy produced by these projects for a period of 20 years (i.e. up to 2038). The current average price of this energy is over R2.00/kWh, compared to an average electricity operating cost in 2016/17 of under 70c/kWh. These costs are reflected in the current electricity tariff as approved by the National Energy Regulator of South Africa and therefore represent a "renewables premium" which does not expire on 31 December 2022 but continues to 2038. Should the proposed carbon tax continue to be implemented in the current format, it is therefore recommended that the renewables credit be retained for the full contract horizon.

With the aim of the mechanism to "enable South Africa to meet its nationally-determined contribution commitments in terms of the 2015 Paris Agreement"; one of the more difficult aspects has been to achieve alignment between the proposed carbon tax and the carbon budget instrument. In 2014, the Minister of Finance delayed implementation of the carbon tax for consultation to take place "on a package of measures". Since then, a study for the alignment and integration of the carbon tax and carbon budget policy instruments post 2020 has been completed under the World Bank Partnerships for Market-Readiness Programme. This paper states "while both the carbon tax and carbon budget approach have merits, economic theory would suggest that there could be risks associated with applying both instruments to the same emissions at the same time." The study explored four categories of integration and evaluated them against eight core principles.

They found that the preferred long-term integration depends on the weighting that policy makers place on each of the criteria but that, "for the short-term, "the 'tax enforces budget' option whereby entities pay a tax on those emissions in excess of their budget is probably the easiest and most practical way to interface the instruments and provide a price incentive at the margin to reduce emissions". It is not clear what the benefits are for introducing a separate carbon tax on 1 January 2019 if a fully-integrated instrument is expected to be implemented from 1 January 2021. This is said keeping in mind the commitment to revenue-neutrality in the initial phase as well as the currently low national GHG emission levels.

Furthermore, in the second draft, changes have been made in order for industry to benefit from one GHG reporting system for the purposes of reporting GHG emissions to the Department of Environmental Affairs and for calculating the carbon tax liability. It should be noted that the first company-level GHG reports are due for submission to the Department of Environmental Affairs on 31 March 2018. It is our experience that GHG reporting is not a simple matter – there are different tiers, different categories in terms of the Intergovernmental Panel on Climate Change, various gases with different global warming potentials to which we are adding legal accountability in different company structures and simultaneously developing the supporting information technology platform. It would be prudent to ensure that all the necessary systems are in place and functioning correctly before one adds the extra complexity of submitting returns. This is likely to take a few iterations. Any errors in the administration system could have considerable legal and financial ramifications both for government and the tax liable entities. In this respect, we would like to enquire when it is planned to publish the draft Customs and Excise Rules for comment as this is required in order to provide much-needed clarity regarding the administration of the carbon tax, given that there are only nine months remaining before the proposed implementation.

Other changes in the second draft, include "additional allowances" (over and above the basic tax free threshold of 60%) that are provided to the electricity sector up to a maximum of 90%. These include allowances for trade exposure, performance, participation in the Department of Environmental Affairs' carbon budgets and the use of carbon offsets. We welcome the fact that the electricity sector is being afforded the same opportunity to receive additional allowances as the other sectors. We are not in a position to appreciate the full benefit of these additional allowances, given that the method to calculate the trade exposure, the sector greenhouse gas emissions intensity benchmark and the value of the renewable energy premium are all still to be determined by the Minister. There is some evidence to suggest that it would not be practically possible to access all of these additional allowances. Eskom has commented previously on the stringency of the draft carbon offset regulations and the offsets themselves would have to be purchased anyway at a cost up to the value of the carbon tax.

In conclusion, while National Treasury has definitely tried to accommodate all the stakeholder concerns in the second draft Carbon Tax Bill, we are of the view that a carbon tax is currently not required in order for South Africa to meet its international commitments, nor are all the required elements in place to ensure efficient implementation. These include testing of the reporting system (including the information technology platform that supports this), as well as the methodology for calculating trade exposure, the determination of the renewables credit and the sector GHG intensity benchmark, the revised carbon offsets regulations and the administration rules. Given the work that still has to be undertaken in this regard, we propose that all efforts should rather be dedicated to delivering the recommended, fully-integrated "tax enforces budget" option (which will still require all the elements mentioned above to be operational) by 1 January 2021.

Should you have any queries, please do not hesitate to contact Gina Downes, Corporate Specialist Environmental Economics on 011 800 3099 for any further assistance.

Yours sincerely

Calib Cassim
CHIEF FINANCIAL OFFICER (ACTING)
Date: 09-3-2018