WWF South Africa submission to National Treasury
on the revised Draft Carbon Tax Bill of December 2017

# Support for carbon tax

WWF South Africa continues to welcome the establishment of a carbon tax to facilitate South Africa’s transition to a low-carbon economy. The Long Term Mitigation Scenarios (Winkler, 2007) identified a carbon tax as one of the key instruments required to drive South Africa’s emissions downwards, and this was effectively reiterated in the 2014 Mitigation Potential Analysis, which highlighted a lack of options for mitigation without a stronger pricing driver. WWF South Africa is therefore glad to see that this much-delayed legislation is close to submission to Parliament, and urges that an effective carbon tax be promulgated as soon as possible. From its original conception in the 2007 LTMS, through the 2013 Policy Paper and the 2015 Draft Bill, the original start date has slipped by more than a decade. Given the urgency of the issue, we can ill afford more delay.

WWF is confident that that proposed management arrangements are sufficient for the carbon tax, and welcomes the clarity on aviation sector coverage under the carbon tax. WWF South Africa also strongly agrees with the response in the Response Document regarding the current emissions trajectory in that a slowed rate of growth does not obviate the need for a carbon tax to incentivise further reductions in overall carbon dioxide emissions.

WWF is also glad to see that certain of our prior recommendations have been integrated into this version of the bill. However, there are still significant issues that need urgent addressing if this is to be an effective tool for driving mitigation. We appreciate that Treasury sees this largely as a Pigouvian tax that is designed to generate revenue whilst correcting an ineffective market outcome. However, it is important to understand that it fills a larger role than this, and that as currently conceived it will not adequately fill this role.

# Inadequate pricing

WWF has previously asserted that the price of R120/t is insufficient to drive significant behavioural change. Given that this is based on modelling and literature from many sources, including the LTMS, the World Bank (Partnership for Market Readiness, 2016), the Energy Research Centre (Winkler & Marquard, 2011), and even National Treasury researchers (Alton et al., 2014), we believe it is well-founded, The current iteration waters this down considerably. Whilst the clarity on the rate of increase is welcome, the reduction in the final price[[1]](#footnote-1) coupled with a stabilisation in the second phase renders it largely ineffective as a driver of change. The carbon tax need not be the exclusive driver of a low-carbon transition, but it is a key element of the national strategy, and therefore adequate pricing is critical.

It should be noted that that the effectiveness of this tax by 2025 and 2035 (cited in the World Bank modelling report) assumed a 2016 start, so the current start date of 2019 (at the earliest) implies that effective rates will be considerably lower. In addition, the price increases are lower than specified in the original 2013 Policy Paper. The effective price differences are laid out in the table below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **..** | **LTMS modelled price** | **2013 Policy Paper** | **2015 Draft Bill** | **2017 Revised Bill** |
| Assumed start date | 2008 | 2014 | 2016 | 2019 |
| Price (doc year) | R100 (2003) | R120 (2013) | R120 (2015) | R120 (2017) |
| Start price (2018 R) | R216.94 | R148.72 | R134.27 | R113.16 |
| 2020 | R542.36 | R217.76 | R174.82 | R115.30 |
| 2025 | R542.36 | R217.76 | R174.82 | R121.95 |
| 2030 | R650.83 | R217.76 | R174.82 | R121.95 |
| 2035 | R1,084.72 | R217.76 | R174.82 | R121.95 |

In other words, this draft sets a price that is effectively only 56% of the tax proposed in the original policy paper, less than 20% of the LTMS’s 2020 recommendation, and only 30% of the recommended level from research conducted by Treasury itself (Alton et al., 2014). When combined with the large tax-free allowances, it is evident that the tax will not function to drive any significant change.

This draft, despite the assertion in the Explanatory Memorandum to the contrary, does not support the “polluter pays principle” as articulated in the National Environmental Management Act and the National Climate Change Response White Paper (NCCRWP). The second defines this as *“those responsible for harming the environment paying the costs of remedying pollution and environmental degradation and supporting any consequent adaptive response that may be required.”* Since the remedy and adaptation of climate change is difficult to estimate, it’s hard to land on solid numbers for this, but a carbon price in the range of US$30 (Alton et al., 2014). to US$46 (US EPA, 2015) in 2025 is typically used in relevant literature. The proposed price (under US$10) is well below this level. Moreover, since the revenue is not being ringfenced for adaptive and remedial effects, it is unclear how the remediation and adaptation will occur. If Treasury truly sees the Carbon Tax as a means to implement a polluter pays principle, then it is essential that the proposed price accurately reflects the potential damage and impacts of continued carbon emissions.

**WWF therefore calls for a revision of the pricing strategy.** The initial price should at a minimum be pegged at the same level as originally proposed (approximately R150 in 2018 rand), and should follow a more aggressive increment to enable a suitable price of near US$40 before 2030, or at a level that is likely to adequately drive significant change.

# Electricity and passthrough

Firstly, the provision for a renewable energy premium deduction for Eskom must be queried. The argument that this is effectively a “shadow carbon price” may indeed be made, although it should be borne in mind that there are a number of additional negative externalities avoided by renewable energy that can be accounted for within this price difference: water consumption, air pollution, human health impacts, etc. More importantly, the pricing of this premium is already integrated into Eskom’s pricing through the multi-year price determination, and therefore providing a tax deduction in line with the premium is effectively a double award of the price difference to Eskom.

Secondly, WWF would argue that providing for a full deduction of the environmental levy is not sound, because the environmental impacts of fossil fuel generation are far more than just carbon emissions – payment of a portion of the environmental levy as well as the carbon tax is therefore still consistent with the polluter pays principle. This was highlighted in the Davis Tax Commission’s recommendations for the carbon tax.

Thirdly, WWF has previously pointed out that the current structure of the electricity sector mitigates against any effect the carbon tax may have on shifting utilities. With a single mandated provider of electricity, which must supply energy in line with the Integrated Resource Plan, there is no potential for a carbon tax to incentivise a shift to low-carbon generation technology

Treasury has structured the tax very carefully to mitigate against pass-through of the carbon price in the first phase of the carbon tax. However, the broader issue is whether pass-through is reasonable. Passing through the price does not accurately reflect a polluter pays principle, because if the polluting entity is a state-owned enterprise, then the public (not the utility) necessarily pay the cost. This payment is direct if passed through; indirect if the tab is picked up by the state, or physical, through illness, water scarcity and climate change impacts, if the negative externality is not internalised. Nevertheless, as the carbon tax increases some pass-through of cost is inevitable, potentially initiating a “utility death spiral”. As prices rise high-use customers will install their own renewable power sources, reducing the revenue base available to the utility, and driving the price upward. In the absence of an alternative electricity source, therefore, those that can least afford it will have to pay more for dirty power.

This is clearly a regressive outcome, since the poor will bear the brunt of the price increase. On the other hand, Eskom will need to pay any additional tax, and if it cannot claw back the cost through a price increase, it will need a bailout (which at least means the income comes from taxpayers rather than the poor exclusively, but is still not optimal). The proposal to increase the free basic electricity allocation is therefore a critical, but insufficient, revenue recycling measure.

Being cognisant of the limited capacity of Treasury to unilaterally address South Africa’s electricity generation structures and policy, **WWF therefore strongly urges government as a whole to consider alternative options for electricity**, including:

* Earmarking revenue to provide finance or loans for community-based renewable energy installation in low income areas; this would reduce the regressive effects of passthrough, reduce electricity emissions and ensure cost-effective power provision to those in need;
* Enabling Eskom to install renewable energy itself to reduce the carbon footprint
* Providing a tax deduction to Eskom for **installation** of renewable technologies (but not for payments to IPPs, since this is already priced through the MYPD).

# Carbon Offsets

WWF is also concerned about some of the revisions proposed around the carbon offsets, but will reserve in-depth comment until the publication of the most recent draft of the regulations. The assertion made in the Explanatory Memorandum that “*the NGO sector is of the view that the offset allowance should not be permitted as it undermines the efficacy of the carbon tax”* is not consistent with our repeated inputs. WWF realises the value of offsets as a cost-effective means of mitigation, and importance for reductions in sectors with no alternative reduction mechanism. However, WWF has suggested that a number of offsets listed in the “positive list” are unsuitable for various reasons, and that therefore the total available pool of real offsets is smaller than the current projections. As such, **WWF reiterates the call to limit offsets to sectors for which there is no alternative means of mitigating emissions**, and not as a blanket allowance.

We note also that the provision for impermissible arrangements has been removed, which we welcome, as well as the inclusion of direct sequestration as a deduction. This latter is innovative, and WWF welcomes the potential to see real investment in carbon sequestration. Nevertheless, more clarity regarding the verification and review process, as well as permissible sequestration activities must be provided.

WWF South Africa also notes with concern the assertion regarding the potential linking of carbon prices with other jurisdictions through an ETS (Response Document, pg 17). Firstly, there is strong evidence that the linking of carbon markets can lead to price volatility and crashes, rather than stability (Green, 2017). Secondly, action frameworks and accounting under Article 6 of the Paris Agreement is still in development, and while the use of internationally transferred mitigation outcomes is mooted as a mechanism for finance, it must be noted that any such transfer must be additional to NDC action. Since South Africa has not yet fully quantified the approach to mitigating emissions under the NDC, and the carbon tax appears to be critical in achieving national targets, it is far from clear that any such additional offsets will become available.

# Timing

The current paper asserts that the first phase will run for five years, from 2017 to 2022[[2]](#footnote-2). This start date is highly unlikely given that the paper itself was only made available for public comment in December 2017. A more likely start date is effective from the beginning of 2019, allowing for approval by Cabinet and Parliament as well as promulgation in 2018. This means that the first five year phase would now only commence at close to the original date anticipated for the second phase – a dangerous delay for a time-critical action, which cannot be remedied without considerable potential economic impacts. **WWF therefore calls for implementation of the carbon tax as a matter of urgency.**

# Alignment with the broader mitigation system

WWF has previously commented on the proposed mitigation system, and some of these comments are of bearing here. Whilst Treasury has reiterated in this revised bill that there will indeed be some alignment between the carbon budgets and the carbon tax, and has provided a timeline, it does not appear to bear much reference to the discussion document for the Mitigation System circulated by the Department of Environmental Affairs in 2017. Specifically, the alignment review proposed in the Explanatory Memorandum occurs after the date in which the first phase of the carbon budgets has been completed, and the point at which clarity will be provided on the alignment (one year before the end of the first phase of the carbon tax, or 2021/2022) is well after the point at which the Department of Environmental Affairs anticipates this alignment to have been completed.

In the its submission for the Mitigation System, WWF points out that the DEA proposal of charging a carbon tax only on emissions in excess of a carbon budget is insufficient to motivate for real mitigation action, especially at the low prices of the carbon tax. **WWF South Africa therefore reiterates its call for a carbon tax to be charged against all emissions**, with a lower rate for those emissions within company carbon budgets, and a significantly higher penalty rate for emissions exceeding the budget. Clarity on this alignment must be provided as soon as possible.

# Conclusion

WWF South Africa thanks Treasury for the opportunity to provide a final input into the carbon tax development process, and strongly urges government to take cognisance of the provided inputs. The carbon tax is a critical tool in South Africa’s climate change toolbox, necessary to both meet international obligations and address local constitutional and developmental requirements. An inadequate tax runs the risk of blunting this tool, and hindering South Africa’s chance at achieving an easy transition to an inclusive low-carbon economy. The Urgenda court case in the Netherlands[[3]](#footnote-3) and similar cases around the world have demonstrated that all nations have a legal obligation to protect their citizens from climate change, and must take clear and forthright action to do so. WWF South Africa strongly feels that the government will be better able to meet this obligation through appropriate amendment and rapid promulgation of this carbon tax bill.

# References

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1. CPI+2% averages out to 7.5% over recent history, as compared with the 10% proposed in the 2013 discussion document [↑](#footnote-ref-1)
2. “*Given the delay in the implementation date the first phase should now be from 2017 to 2022.”* Response Document pg. 18. “*The rate of tax specified in subsection (1) must be increased … until 31 December 2022.”* Carbon Tax Bill Sect 5(2),pg 15. “*…during the first phase (up to 2022)…”* Explanatory Memorandum, pg 5 [↑](#footnote-ref-2)
3. http://www.urgenda.nl/en/climate-case/ [↑](#footnote-ref-3)