WWF South Africa
World Wide Fund For Nature

Reg. No: 003-226 NPO
VAT No: 4820122481
Web: www.wwf.org.za
PBO No.: 130002490

Head Office:
Boundary Terraces
Bridge House, 1st Floor
Mariendahl Lane
NEWLANDS 7700
P O Box 23273
CLAREMONT 7735
Tel: +27 21 657 6600
Fax: 086 535 9433

Gauteng Office:
23 Melle Street
Cnr De Korte Street
BRAAMFONTEIN 2001
Postnet Suite 1
Private Bag X4
BRAAMFONTEIN 2017
Tel: +27 11 339 1152
08610 WWFSA (99372)
Fax: 086 538 7391

WWF comments on 2022 draft carbon tax bills

WWF appreciates the opportunity to comment on the proposed tax amendments circulated by National Treasury, and would like to commend the Treasury for their outreach in this regard. We hope that our contribution to the process will enable Treasury to strengthen and improve the efficacy of this essential policy element in the effort to build South Africa's potential as a low carbon, resilient and developmental economy.

WWF strongly supports the proposal to strengthen the carbon tax. The previous pathway proposing to stabilise carbon prices at the 2022 level provided a highly inadequate carbon price and failed to adequately incentivise mitigation within South Africa's economy. Providing clarity of the pathway is essential both for incentivising investments into carbon emissions mitigation by the private sector, and for ensuring alignment with the international standards set by trading partners. The EU's mooted Carbon Border Adjustment Mechanism (CBAM) will effectively price high-carbon South African products out of the market, especially if this is replicated by other jurisdictions.

WWF further appreciates the commitment to continue the price neutrality commitment of electricity, since this buffers the most vulnerable energy poor from potential increases. However, it must necessarily be accompanied by a policy commitment by government to not only increase the amount of renewable energy on the grid (as has been proposed in the latest determination by Energy Minister Gwede Mantashe) but also by a reduction in the overall carbon intensity of the electricity mix in line with the decarbonisation trajectory.

Notwithstanding WWF's support for the current amendments, we would like to reiterate some of our prior submissions that we feel are critical to enhance the efficacy of the carbon tax.

Limitation of carbon offsets

WWF strongly feels that carbon offsets should be exclusively reserved for hard-to-abate sectors. For most sectors of the economy, abatement options are technically available and merely require adequate carbon pricing to incentivise their uptake. In such sectors, there is therefore a likelihood that offsetting would mediate against real mitigation action, since there is always risk associated to the achievement and long-term efficacy of offsets. For hard-to-abate sectors such as cement, however, the ability to pay for real removals elsewhere in the economy may be essential.

When considering actual sequestration potential (as opposed to avoided emissions, which are challenging to prove in some cases, and in no case actually reduce atmospheric carbon concentrations) the National GHG Inventory [1] is a solid guide as to the overall potentiall for real offsets. Forestry and other landuse sectors are the only natural sinks, and they average 24MtCO_2e removals

[1] RSA, *National GHG Inventory Report South Africa 2017*, 7th edn (Pretoria, South Africa: Government of the Republic of South Africa, 2021) <https://www.dffe.gov.za/sites/default/files/docs/nir-2017-report.pdf> [accessed 30 August 2021].

DIRECTORS: VP KHANYILE (CHAIRMAN), M READ (DEPUTY CHAIRMAN), Dr MA DU PLESSIS (CHIEF EXECUTIVE), MM DU TOIT, K GABRIELS (EXECUTIVE)
M MAPONYANE, N MTETWA, AJ PHILLIPS, Dr N SONGELWA, S SOOBRAMONEY, A WATSON, P YAKO, Dr S ZINN

per annum, with a maximum of 46.5MtCO_2e removed in 2016. This quantum is net of emissions within the sector, but even assuming that the sinks were to somehow be doubled (a massive ask given the price points, land hunger and competing uses within the country) this would only be adequate to compensate for roughly 80% of Medupi's annual emissions.

Consequently, WWF also believes that South Africa should identify priority sectors for carbon budget allocation and carbon offset allowances, potentially exclude some sectors with unavoidable process emissions that do not align with a long-term low carbon trajectory. It must be noted that whilst there is indeed considerable scope for expansion of carbon offset potential in South Africa, the complications of establishing projects and the challenge of costs mean that not only are few projects making their way to the market, but also few high-quality carbon projects are being generated at all.

Removal of allowances
WWF recognises the rationale behind provision of allowances as a means of providing time for industries to make the move towards carbon reduction before the full price effect is delivered. However, WWF believes that the basic deduction of 60% across the board undermines the effectiveness of the carbon tax, and will increase the effective price shock when it is removed. Indeed, the current allowances, which are now to be extended rather than phasedown as previously articulated, effectively reduce the tax to a token price – the mooted US$20 price in 2025 would actually translate to only $1.5- $2 for most sectors.

Targeted deductions for specific vulnerabilities (as is implemented with some of the additional allowances) is more useful but not all make sense. WWF therefore recommends once again that the basic 60% allowance be removed , or at a minimum phased out incrementally over the remainder of the first phase of the tax, such that the **real** price of the carbon tax is in place by the inception of phase 2.

Unnecessary allowances include:

- The basic allowance of 60%, since this undermines the effectiveness of the tax rate.
- Trade exposure allowance: Arguably a business is now trade exposed when <u>not</u> carrying the cost of carbon, particularly in light of the incipient implementation of the EU CBAM. There is evidence that carbon taxes do not hinder competitiveness and can sometimes improve it e.g. Sweden, with a globally high price of R1,999/tCO_2e, has seen rapid growth coupled with reductions in carbon emissions.
- Performance allowance: The nature of a Pigouvian tax is such that it incentivises movement away from social ills, effectively rewarding those that move fastest by charging them less. There is no need for this additional allowance, since high performance is already rewarded through a reduced carbon tax liability.
- Carbon budget allowance: We would like to be sure that this will fall away once mandatory carbon budgets become law. One cannot be rewarded for obeying the law, only punished for breaking it.

Enhancing price trajectory
The recommendations of the IMF are that the carbon price be situated in the range $US25 to $50 by 2030, and the High Level Commission on Carbon Prices [2] recommends the low end for such prices must be $40 in 2025, and $50 by 2030. Whilst WWF applauds the increased ambition articulated in the tax proposal from Treasury, the proposed trajectory still places South Africa in the lower section of this range in 2025, and fails to align with our articulated ambition in 2030. Given that South Africa is the most carbon intensive economy in the world, and the 13th highest emitter, more ambition is needed to align with the national footprint.
Possibly more importantly from the national perspective, the imposition of the EU Carbon Border Adjustment Mechanism (CBAM) from 2027 marks the point at which access to international markets will become more challenging for South African carbon intensive products. Essentially, any allocated product (iron & steel, fertilisers, cement, and aluminium at present) will be subject to the EU's rate from a purchaser perspective – a steel purchaser will effectively pay the difference between SA's carbon price and the EU price to the EU. In this context, pegging the price at the same level as the EU means that there is no difference, and that the SA fiscus will capture the total benefit of the tax.

From the perspective of a manufacturer, access to the EU market will be contingent on the total price of manufacture, carbon price and the difference to the EU CBAM, and therefore the manufacturer will not benefit from an export allowance. Imposition of a corresponding carbon price in the South African context therefore provides stronger local incentive for decarbonisation, increases the revenue for the fiscus that can better fund positive decarbonisation incentives, and will more rapidly drive decarbonisation and improve the competitiveness of South African products on an internationally priced market.

WWF therefore strongly recommends Treasury consider stronger pricing increases over time to ensure a more rapid decarbonisation process, aligning with a higher price in 2030.

Extension of first phase
WWF finds that the extension of the first phase is not in itself problematic, except inasmuch it has extended certain provisions as detailed above. The extension of large-scale deductions effectively has continued the failure of the carbon tax to impose an adequate price signal on the market for mitigation. Certain other provisions such as the price neutrality commitment are welcomed, with the provision that committed action from government to decarbonise the electricity sector should not also be delayed.

Specific comments on tax amendments:

7.1 Carbon tax trajectory (**Amendment of section 5 of Act 15 of 2019, as amended by section 10 of Act 22 of 2020 and section 6 of Act 19 of 2021**)

> WWF applauds the increase in ambition, and proposes setting higher targets in 2025 and 2030, with concomitant increases in the annual price steps. Moreover, since the Rand's value can vary against the US dollar on an annual basis, it may make more sense to peg annual prices against a fixed US price, rather than pricing the increments against the USD. If the Rand's strength against the USD varies significantly over the 2022 to 2030 period, the final step to the proposed set prices in 2025 and 2030 may be significantly more than the annual increments in prior years.

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[2] Carbon Pricing Leadership Commission, *Report of the High-Level Commission on Carbon Prices* (Carbon Pricing Leadership Commission, 29 May 2017), p. 61 <https://www.carbonpricingleadership.org/s/CarbonPricing_Final_May29.pdf> [accessed 31 May 2017].

7.2 First phase extension: Energy Efficiency savings tax incentive extension **[Amendment to section 12L of the Income Tax Act]**

WWF supports the extension of this revenue recycling mechanism to incentivise investment in energy efficiency and consequent national mitigation action.

7.3 First phase extension: Electricity price neutrality commitment extension **[Amendment to Section 6(2)(c) and (d) of the Carbon Tax Act]**

WWF welcomes this provision as protecting vulnerable households from potential increases associated with the imposition of the carbon tax. At the same time, it is critical that government undertake rapid penetration of low-cost renewables within this regulated sector to ensure that the benefits of this reduced cost trickledown to those same households.

7.4 Limitation of electricity price neutrality deductions to electricity generation from fossil fuels. **[Amendment Section 6(2) of the Carbon Tax Act].**

WWF supports the proposed amendment.

7.5 Carbon sequestration deduction **[Amendment to Section 6(4) of the Carbon Tax Act]**

Whilst the limitation of scope of sequestration deductions to removals within the operational control of the taxpayer is a positive step in reducing the potential for double counting, WWF has previously submitted that deductions for sequestration in plantations are highly problematic in terms of overall carbon balance for several reasons:

- Carbon balance: Since no tax is liable for AFOLU activities at present, this provision allows a tax deduction for sequestration but no corresponding liability for removals of plantations, forest fires or loss of harvested wood products. The nature of the forestry industry is such that, barring the inclusion of additional areas, the overall carbon balance of operations is largely neutral (rotational forests grow for a period and then are removed, and over the entire area of operations the area of forests of a specific age/carbon content remains roughly constant). As such, this liability reduction does not reflect a real removal of carbon.
- Periods: Even were there net positive removals in forestry, the period of removals differs significantly to the period in which fossil fuel emissions stay in the atmosphere. Typical rotational periods mean that carbon in industrial plantations is retained for about 10 years on average (assuming a 20-year harvest cycle), whilst carbon dioxide from fuel combustion emissions will increase atmospheric carbon content for centuries to millennia.
- Removals: harvested wood products (HWP) is not permanent removal, especially in the pulp and paper industry. The half-life of HWP products is highly variable, ranging from days to weeks in the case of paper to decades for industrial timber.

  WWF has provided a biogenic carbon footprint calculation tool that will allow the calculation of the total removals and balance calculations for HWP that better reflects the actual rate of removals, and we would strongly recommend that Treasury use this or a similar tool to calculate actual allowable deductions for HWP. For forestry plantations, removals should only be contemplated for the period between first planting and harvest for **new areas** – net carbon balance for other areas is typically zero.

The tool can be accessed here: https://www.worldwildlife.org/projects/biogenic-carbon-footprint-calculator-for-harvested-wood-products

For further clarification or queries, please contact:
James Reeler
Senior Climate Specialist, WWF South Africa
jreeler@wwf.org.za 021 657 6688