CARBON TAX BILL

Presentation to the Select Committee on Finance

12 MARCH 2018

NATIONAL OFFICE

61 Katherine Street,

Sandton, 2196

P.O. Box 652807, Benmore, 2010

PARLIAMENTARY OFFICE

9 Church Square, 1st Floor Graaffs Trust Building

Cape Town, CBD

P.O. Box 3867, Cape Town, 8000

BACKGROUND TO BUSA

Confederation of business organisations including chambers of commerce and industry, professional associations, corporate associations and unisectoral organisations.

Represents South African business on macro-economic and high-level issues at both national and international levels.

Aims to ensure that business plays a constructive role in the country's economic growth, development and transformation and to create an environment in which businesses of all sizes and in all sectors can thrive, expand and be competitive.

As a principal representative of business in South Africa, BUSA represents the views of its members in several national structures and bodies, both statutory and non-statutory.

INTRODUCTION

BUSA supports carbon pricing in the economy as part of a suite of measures to address the country’s climate change transition.

Notwithstanding, BUSA has a number of serious concerns on the Carbon Tax Bill which are unaddressed, despite assurances from Government:

- State of the economy where small changes give rise to higher costs;
- Policy uncertainty post-2022 for the regulated entities; and
- Lack of policy alignment between the carbon tax and the carbon budget proposed through the draft Climate Change Bill.

BUSA is therefore not in a position to support the Carbon Tax Bill currently being considered by the Council.

BUSA

LACK OF POLICY ALIGNMENT POST-2022

- There is still no alignment of the carbon tax with the carbon budget system being developed by the Department of Environmental Affairs through the draft Climate Change Bill.

- Assurances have been given by government to a process to ensure alignment, but to date none have materialised.

- Consultation on the post 2022 regime has been promised but still no discussions have begun which perpetuates a situation of limited business investment until certainty is provided on an aligned mitigation instrument such that the same ton of emissions is only regulated once.

- In December 2018, at the Carbon Tax hearings concluded that:

  Alignment of the carbon tax policy with the carbon budgeting system of the DEA:
  - *Phase1: Introduction of the 5% carbon budget allowance in 2014*
  - *Phase2: DEA and NT working on alignment and integration of the carbon tax and carbon budget instruments for phase2, and no double penalty."*

  \- (NT Parliament – November 2018)

BUSA requests that the Carbon Tax Bill include a requirement for alignment in this version of the Carbon Tax Bill.

CRITICAL ISSUES FOR IMPLEMENTING THE CARBON TAX

Critical issues essential for the effective implementation of the tax remain outstanding which are necessary for providing policy certainty:

- GHG reporting system has not been finalised:
  - Required for verification of GHG emissions; and
  - Misalignment between GHG reporting entity and Carbon Tax payers.
- The Renewable Energy Premium has not been published, impacting the full understanding of costs from a pass through of costs perspective.

Significant uncertainty remains for taxpayers in determining their liability, as regulations regarding allowances are still outstanding:

- Carbon Offsets Regulations are still being consulted.
- Two regulations have not been released for consultation (while business has been consulted on the approach, the actual regulations have not been):
  - Performance Benchmarks; and
  - Trade Exposure.

Taxpayers have no certainty regarding allowances and cannot determine their liability impacting investment both at a provincial and national level.

INCREASING COSTS IN A FRAGILE ECONOMY

The triple challenges of poverty, inequality and unemployment are critical priorities and need to be a considered when reviewing the consequences of a policy.

The economy is currently depressed and key Presidential processes are underway to address the barriers to investment, particularly from a regulatory perspective.

The Carbon Tax is a barrier to investment which is further exacerbated by the policy uncertainty issues - this further erodes investment opportunities.

The cost of doing business is excessively high:

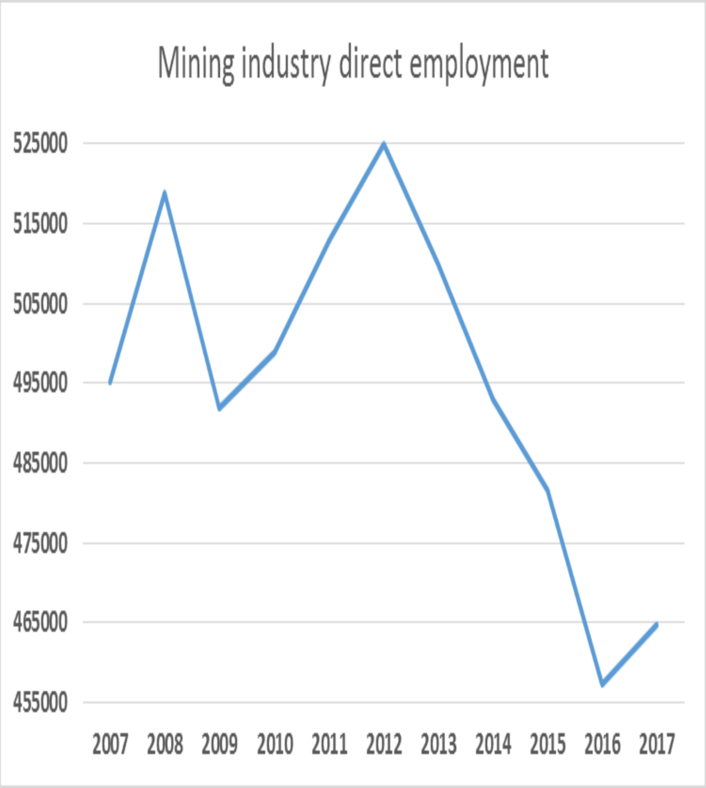
- High electricity price increases have just been announced which places pressure on business and consumers.
- The increased cost on fuel, coal and transport will be passed on to Eskom and accordingly the costs for primary energy will increase which will be passed on through the tariff.
- Having to pay carbon tax on fuel and on direct emissions on top of these already high costs renders the cost of doing business untenable.
- Likewise, The cost of the carbon tax will be passed through to the consumer, impacting basic food stuffs. There will also be an inflationary impact through the fuel tax.

The impact of the carbon tax in the economy has been underestimated and will have an impact on jobs and the poorest sectors of the country

CASE STUDY: MINING

MINING SECTOR AT A GLANCE

- Contributed R312 billion to GDP, which is 6,8% of the total GDP
- Employed 462 871 employees, which is 6,1% of private non-agricultural employment
- Contributed R93 billion to fixed investment, making up 18,2% of private sector fixed investment
- Exported R307 billion worth of output, which is 27% of the South Africa's export book
- Paid R5,8 billion in royalties
- Paid 16 billion in taxes



Economic Analysis-Impact of Carbon Tax on the Mining Industry

1. BASIC ARGUMENTS:

1. MINING IN SA IS MARGINAL BUSINESS – A SLIGHT INCREASE INPUT COST RESULTS IN THE CLOSURE OF SOME OPERATIONS

2. PRICE TAKER – UNLIKE OTHER PRODUCTIVE SECTORS (E.G. RETAIL, MANUFACTURING, FINANCE ETC.) MINERAL COMMODITY PRICES ARE DETERMINED AT THE GLOBAL MARKET. WE CANNOT TRANSFER INCREASE IN COSTS TO THE FINAL PRICE OF THE PRODUCT

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ASSUMPTIONS FOR THE TIME-SERIES ECONOMETRIC ANALYSIS

Assumptions

The following assumptions were made in order to run the time-series econometric analysis:

1. Since there is currently no time-series data for the carbon tax, we used electricity tariffs as a proxy. This is because about 80% of SA's emissions are from the energy sector, mainly power generation. While in Phase I of the CO2 tax will be electricity neutral in Phase II that will change
2. We model Phase II which kicks off in 2022, five year from now, and assume that electricity prices will soar by 5%
3. To improve the competitiveness of the primary sectors mining qualifies for a rebate under the Diesel Fuel Refund System
   - The National Treasury is in the process of reviewing the Diesel Fuel Refund System in order to clamp down on 'beneficiaries' who abuse the facility. The Minerals Council made submission that the review should focus on the abusers instead of targeting the entire sector
   - As a result of this uncertainty in the direction the Refund System will take we decided not to include it in the modelling
4. Having performed the baseline estimations we then assumed that the 5% increase in the electricity price took effect in the year 2000. From there we calculated the impact that would have had on output/production, investment, employment, and gross operating surplus.

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10 CENTS/L CO2 TAX ON LIQUID FUELS – MINING SECTOR IMPACT

Mining Sector Direct Employment
Total = 462 871 (2017)
10c/L CO2 Tax: 459 168

Indirect employment
Total = 1 305 111 (2017)
10c/L CO2 Tax: 1 294 670

Primary sector	Secondary sector	Tertiary sector
Primary sector Total: 17 705 10c/L CO2 Tax: -142	Secondary sector Total: 343 926 10c/L CO2 Tax: -2 751	Tertiary sector Total: 943 480 10c/L CO2 Tax: -7 548
Mining 17 705 10c/L CO2 Tax: -142	Manufacturing 360 954 10c/L CO2 Tax: -2 888	Wholesale & retail 148 570 10c/L CO2 Tax: -1 189
Agriculture 0	Utilities 130 222 10c/L CO2 Tax: -1 042	Transport & storage 536 977 10c/L CO2 Tax: -4 296
	Construction 6 248 10c/L CO2 Tax: -50	Finance & insurance 245 413 10c/L CO2 Tax: -1 961
		Community & personal services 12 798 10c/L CO2 Tax: -102

No. of Jobs Lost as a Result of the 10c/L CO2 Tax: 10 441
***Less* Jobs Retained Because of the Diesel Fuel Refund: 3 605**
Net Jobs Losses: 6 836

Source: Minerals Council calculations

- The mining sector has a jobs' multiplier of 2.8, one of the highest in the South African economy
- People employed as a result of the mining sector's backward linkages were more than 1.3 million in 2017
- Most indirect jobs were in the transport sector (536 977 in 2017)

Impact of the 10 cents per litre CO2 tax:

- Instead of employing 462 871 people in 2017 the sector would have employed 459 168
- Indirect jobs would have been 1 294 670 instead of 1 305 111, a 10 441 decline
- As expected, jobs would have declined by 4 296 in the transport sector
- The gross job losses would have been 10 441 in 2017
- However, net jobs would have been 6 836
- The diesel fuel tax refund offers a major cushion in terms of the number of jobs that could have been lost
- Combustion Emissions Tax through the use of diesel

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IMPACT OF THE CO2 TAX ON OUTPUT AND INVESTMENT IN THE MINING SECTOR

Transmission mechanism: 5% increase in the price of electricity in Phase II

REDUCTION IN OUTPUT RESULTING FROM CO2 TAX (R bn)				
	Gold**	Coal	Other*	Total Mining
2000	0,5	1,1	2,4	3,9
2001	0,5	1,1	2,3	3,9
2002	0,7	1,1	2,2	4,0
2003	0,6	1,1	2,4	4,1
2004	0,5	1,2	2,6	4,3
2005	0,5	1,2	2,7	4,3
2006	0,6	1,2	2,5	4,3
2007	0,7	1,2	2,4	4,3
2008	0,9	1,2	2,0	4,1
2009	0,9	1,2	1,7	3,8
2010	1,0	1,2	1,9	4,0
2011	1,2	1,2	1,6	4,0
2012	1,2	1,2	1,4	3,9
2013	1,2	1,2	1,6	4,1
2014	1,2	1,3	1,5	4,0
2015	1,2	1,2	1,7	4,2
2016	1,5	1,2	1,3	4,0

REDUCTION IN INVESTMENT DUE TO CO2 TAX (R mn)				
	Gold	Coal	Other*	Total mining
2000	706	358	2 405	3 469
2001	744	386	2 600	3 730
2002	824	439	2 960	4 223
2003	845	460	3 116	4 420
2004	667	372	2 529	3 569
2005	581	332	2 263	3 176
2006	844	493	3 376	4 713
2007	1 056	632	4 344	6 032
2008	1 297	794	5 485	7 575
2009	1 341	841	5 833	8 015
2010	1 263	811	5 648	7 722
2011	1 281	842	5 891	8 013
2012	1 241	835	5 874	7 951
2013	1 221	841	5 942	8 003
2014	1 210	853	6 063	8 126
2015	1 170	845	6 032	8 046
2016	1 099	812	5 833	7 744

IMPACT OF THE CO2 TAX ON JOBS

Transmission mechanism: 5% increase in the price of electricity in Phase II

JOB LOSSES RESULTING FROM CO2 TAX				
	Gold	Coal	Other*	Total mining
2000	2 374	238	2 165	4 777
2001	2 212	235	2 216	4 664
2002	2 143	220	2 357	4 719
2003	2 117	219	2 594	4 930
2004	2 019	233	2 947	5 199
2005	1 797	264	3 079	5 139
2006	1 787	267	3 226	5 280
2007	1 858	280	3 592	5 730
2008	1 862	303	3 838	6 002
2009	1 789	328	3 574	5 691
2010	1 756	343	3 674	5 773
2011	1 620	364	3 951	5 935
2012	1 591	385	4 098	6 073
2013	1 474	407	4 019	5 900
2014	1 331	399	3 974	5 704
2015	1 287	360	3 925	5 572
2016	1 303	359	3 630	5 292

Correlation: Gold vol. vs Selected cost variables			
	Gold prod. vol	R/$	Real price of electricity (c/kWh)
Gold prod. vol	1,00	-0,91	-0,69
R/$	-0,91	1,00	0,65
Real price of electricity (c/kWh)	-0,69	0,65	1,00

Negative correlation is a relationship between two variables in which one variable increases as the other decreases, and vice versa. In statistics, a perfect negative correlation is represented by the value -1.00, while a 0.00 indicates no correlation and a +1.00 indicates a perfect positive correlation.

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COST CURVE ANALYSIS

- Profitability, or the prospect of relatively healthy profits on a risk adjusted basis is an important variable in the decision matrix when companies are considering new or expansion investment.
- An environment conducive to healthy profits will attract capital, which will in turn result in further expansion of the mining sector and create additional jobs.
- The converse also holds, wherein, regulatory uncertainty and excessive costs erode the prospect of profitability, therefore decreasing the size of sector, jobs, export earnings and by extension contraction in those sectors which feed into the mining sector.
- While the Minerals Council embraces the notion of long term carbon pricing and various mechanisms to facilitate transition to a low carbon economy, **we are of the view that the carbon tax has the potential to erode profitability through increasing costs and hence deliver the outcome of a shrinking sector**
- The result of which would be further job losses therefore exacerbating South Africa’s structurally high unemployment rate.

COST CURVE ANALYSIS

- The central narrative of this analysis is to stress the fact that additional costs, adversely affect profitability (a key variable in the decision matrix when companies are considering new or expansion capital).

To this end, the points we would like to stress include;

- The price taking nature of the industry, and
- The need to contain costs (production costs and inflation)

PRODUCTION COSTS

- Sustainability of the mining sector is a function of producing output at an input cost that is below commodity selling prices.
- Due to generally depressed commodity prices and structurally high input costs associated with South African mining, the sustainability of pockets of the sector are in dire straits
- To illustrate this fact we have selected two industries within the mining sector, namely; the gold and PGM industries.
- These 2 sectors, collectively;
    - Employ 287 970 direct employees (62% of total mining sector)
    - 79% of total mining exports
    - 29% of total mining royalty payments

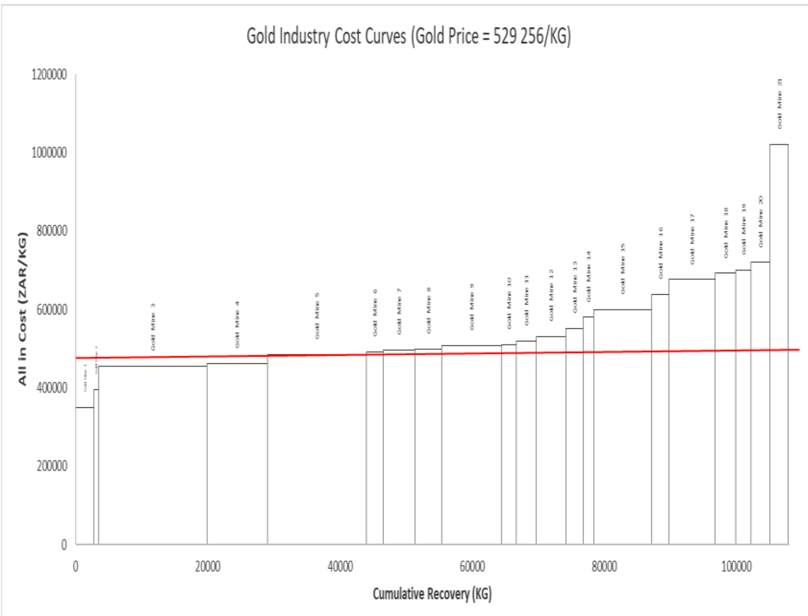
When production costs are compared to selling prices, it is regrettable to note that;

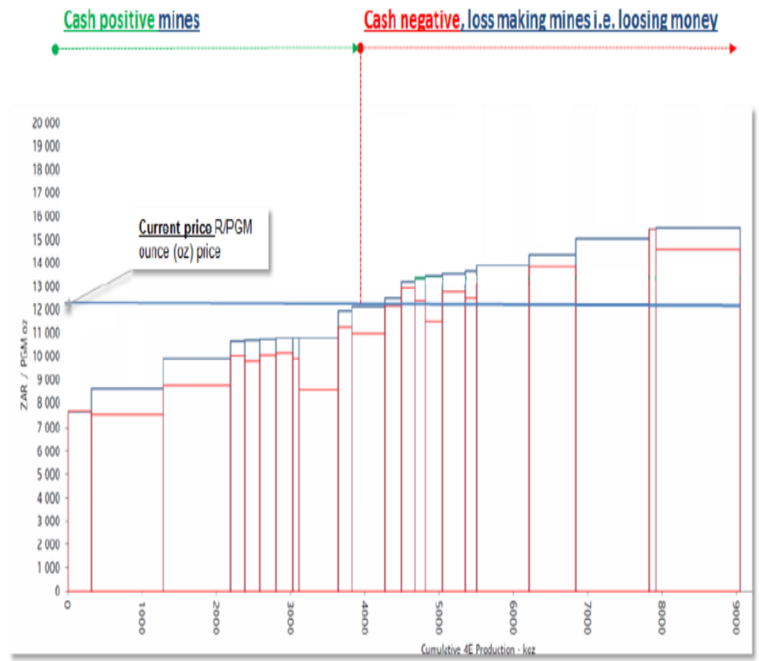
69% of gold mining operations and 52% of PGM mining operations are producing unsustainably.

Any increases to input costs through carbon tax adversely affect the sustainability of these sectors.

COST CURVES (GOLD AND PLATINUM)

69% of Gold Mining is unsustainable, while 52% of the PGM industry is unsustainable





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MINING INFLATION VS SELLING PRICE INFLATION

Total Mining		
Year	Input Cost Inflation	Selling Price Inflation
	%	%
2013	10,7	8,9
2014	10,7	-0,8
2015	6,6	-9,8
2016	9,0	21,5
2017	6,1	4,4
2018	5,8	1,7
Average	8,2	4,3

Between 2013 and 2018, input costs (measured in rand) have on average increased 8.2% for the overall mining sector, while selling prices have increased 4.3% over the same period.

The negative differential in the inflation profiles between costs and selling prices, presents a situation of profit margin erosion and places in question the sustainability of the mining sector. By extension it also adversely affects the attractiveness of the sector for new or expansion capital.

CUSTOMS AND EXCISE BILL

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INTRODUCTION

- The amended Customs and Excise Bill does not align with Schedule 3 of the Carbon Tax Bill which was voted on by the Standing Committee on Finance on 5 February 2019.
- The enabling powers to give effect to the requirements to administer the Tax must be included in the amendments of the Customs and Excise Bill.
- Policy uncertainty is an impediment to investment and the President has stated in a number of fora that Government is committed to addressing this issue.
- The Customs and Excise Amendment Bill does not pass the test of regulatory certainty in a number of areas.

Given the challenges that persist, BUSA cannot support the Customs and Excise Amendments for the Carbon Tax Bill.

PROPOSED AMENDMENTS FAIL TO MAKE OBLIGATIONS CLEAR

a) Section 54A refers to imported and manufactured goods.

Greenhouse gas emissions are dispersed to the atmosphere. Reference to GHG emissions as "goods" creates the incorrect impression that emissions can be measured and audited in the same way as any tangible good.

b) Section 54D refers to a discretionary power of the Minister to provide a rebate, refund or drawback of any environmental levy.

This is different from the allowances which must be paid to eligible taxpayers in terms of the Carbon Tax Bill.

c) Section 54E deals with licensing of premises, which implies that there will be different carbon tax accounts for each licensed premises.

This is in contrast to Carbon Tax Bill, which envisages a single taxpayer which is aligned to the reporting entity in terms of the GHG reporting regulations under DEA.

PROPOSED AMENDMENTS FAIL TO MAKE OBLIGATIONS CLEAR

d) The rules to section 54 in turn, do not adequately address the manner in which a taxpayer must submit yearly environmental levy accounts and payments as prescribed in the Carbon Tax Bill.
   The Carbon Tax Bill provides that a taxpayer must submit yearly environmental levy accounts and payments as prescribed by rule in terms of the Customs and Excise Act for every tax period.

   The tax period in terms of the Carbon Tax Bill and the accounting period in terms of the Customs and Excise Act are not aligned, which creates confusion as to when taxpayers have to submit their yearly environmental levy accounts and payments.

PENALTY PROVISIONS OF THE CUSTOMS AND EXCISE ACT

The penalty provisions in terms of the Customs and Excise Act are quite severe.
The carbon tax is based on the taxpayer's best estimate of emissions – meaning there is room for error being made by a reasonable taxpayer in such calculations.

In Treasury's response to BUSA's comments, dated June 2018, Treasury noted that:

> *"Consideration could be given to the level of accuracy of the emissions estimates that would be acceptable without incurring a penalty. For example, an 80:20 principle is applied for other provisional tax payments in terms of which estimates that are 80 per cent accurate are considered sufficiently accurate to not attract penalties."*

The Customs and Excise Amendment Act does not address this and there is still uncertainty on the applicable penalties.

BUSA

ALIGNMENT OF THE CARBON TAX ADMINISTRATION SYSTEM WITH OTHER RELEVANT INSTRUMENTS

An effective carbon tax administration system requires the following characteristics:

(a) Carbon taxpayer must be identical to GHG reporting entity to allow verification of tax liability.

(b) Basis of carbon tax must be the same as the quantum of GHG emissions reported to the Department of Environmental Affairs

(c) Management of allowances must not lead to additional administrative burdens on the taxpayer.

(d) Deduction of carbon tax as an input cost must be easily achieved.

PROPOSAL FOR AMENDMENTS

(b) (i) the allowances and limitation of allowances prescribed in the Carbon Tax Act, 2019 and calculated by the taxpayer in terms of that Act, must be offset against the environmental levy account of the taxpayer; ~~must be administered as rebates, refunds or drawbacks, as maybe applicable, in terms of this Act;~~

c) a taxpayer as defined in the Carbon Tax Act, 2019, must register with SARS, in a manner which will ensure that this registration of the taxpayer is linked to the registration of the taxpayer as a data provider in terms of the GHG reporting regulations and prescribed by rule.

THANK YOU