AIRLINES ASSOCIATION OF SOUTHERN AFRICA

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7 March 2019

Mr C.J. de Beer, MP
Chairperson
Select Committee on Finance
National Council of Provinces
Republic of South Africa

Attention : Mr Zolani Rento
Committee Secretary

Dear Mr Rento

SUBMISSION FROM THE AIRLINES ASSOCIATION OF SOUTHERN AFRICA NPC IN RESPECT OF THE CARBON TAX BILL

1. I refer to the notification in the Sunday Times on 2 March 2019 where the **Select Committee on Finance invites stakeholders and interested parties to submit written submissions on the Carbon Tax Bill. This letter is that submission.**

2. In addition, the notification states that stakeholders who are interested in making an oral presentation on this matter are requested to do so by 12h00 on Friday 8 March 2019. **I, the undersigned, Mr Chris Zweigenthal, Chief Executive Officer, Airlines Association of Southern Africa (AASA) herewith indicate that I wish to make an oral presentation on this submission** and will travel to Cape Town in order to make this presentation to the Select Committee **on Tuesday 12 March 2019**.

3. The Airlines Association of Southern Africa **(AASA) is an industry association representing** the mutual interests of its airline members, which include the **commercial scheduled airlines from South Africa and other Southern African States**. AASA also has Associate Members which are manufacturers, service providers, suppliers and industry partners which add value to the airline industry. A list of our Membership is herewith attached as Annexure A. One of the areas where AASA has been mandated to act on behalf of its member airlines is in the area of

climate change. Individual airlines have their experts in this field and we are committed to work with them in this area. Comments are herewith submitted on behalf of our airline members.

4. AASA has been very active in working with various Government Departments, notably Transport (and the SA Civil Aviation Authority), Environmental Affairs, and National Treasury on all aspects related to the climate change matters and the reduction of CO_2 emissions, as well as on providing comments on the various drafts of the Carbon Tax Bill. This includes:

    a. Letters to the Department dated 30 July 2013 including comments on the Carbon Tax Policy Paper of May 2013. Reference is also made to the submission of comments dated 2 August 2013 by the International Air Transport Association (IATA) on this same Policy Paper.
    b. Comments to the Department of National Treasury on 15 December 2015, in respect of the first draft of the Carbon Tax Bill 2015.
    c. Comments to the Department of National Treasury on 8 March 2018 in respect of the second draft of the Carbon Tax Bill 2017.
    d. Comments on draft Carbon Offset Regulations.

5. I have not received the latest draft of the Carbon Tax Bill, and therefore am unable to ascertain to what extent the comments made to National Treasury have been taken into account in a later draft which may be before the Select Committee. In this submission, I shall therefore not make specific reference to the technical issues, except insofar as they are relevant to this submission. However, there are certain points of principle which we wish to highlight to the Committee in respect of the application of Carbon Taxes through the Carbon Tax Bill to Domestic Aviation in South Africa.

6. GENERAL PRINCIPLES – SHOULD CARBON TAXES BE IMPLEMENTED FOR AVIATION?

    a. At the outset, I wish to state the **airline industry and AASA's commitment to the globally accepted need to address the reduction of Greenhouse Gas Emissions (GHGE) according to a global agreement**. The Paris Agreement signed in 2015 set out the basis for global action to address climate change and subsequent COP meetings have continued to build on the agreement reached. It is noted that deliberations at the recent COP meetings have not focused on aviation very specifically. We believe this is largely due to the initiatives and the responsibility taken by the Aviation Industry to set targets and drive the mitigation and reduction of carbon emissions for our industry. This is notwithstanding aviation's contribution to global emissions of between 2% and 3% of total emissions.

b. Throughout the climate talks, it has been recognized that **aviation would be dealt with through the International Civil Aviation Organization (ICAO)**, the UN appointed body responsible for aviation. This work in ICAO culminated in the **agreement of Member States on the Carbon Offset Reduction Scheme for International Aviation (CORSIA) at the ICAO Triennial Assembly held in Montreal in September / October 2016** where Member States agreed on a uniform scheme according to which international aviation would commit to the reduction of CO_2 emissions. South Africa was a supporter of the ICAO Resolution and endorsed CORSIA. Further detail on this scheme will be provided in a later section.

c. Whilst supporting the goal of reducing CO_2 emissions, **AASA and its airline members do not in principle support the imposition of a Carbon Tax for aviation** and for the following reasons:

   i. In the Carbon Tax Policy paper of May 2013, it is noted that "… South Africa has taken the decision to implement carbon taxes as its chosen method of driving the reduction of greenhouse gas emissions with the *"primary objective of implementing carbon taxes to change future behavior, rather than to raise revenue"*. We agree that it is important to change future behavior but believe that implementing carbon taxes is not the appropriate mechanism to achieve this and we do not believe that carbon taxes will change behavior.

   ii. From an aviation perspective, the introduction of new taxes is not encouraged nor recommended. Your attention is drawn to International Civil Aviation Organization (ICAO) Document 8632, (ICAO's Policies on Taxation in the field of international air transport), where under item 3 of the Council Resolution it is stated :

   > *"With respect to taxes on the sale and use of international air transport: each Contracting State shall reduce to the fullest practicable extent and make plans to eliminate as soon as its economic conditions permit all forms of taxation on the sale or use of international transport by air, including taxes on gross receipts of operators and taxes levied directly on passengers or shippers;"*

   Whereas this does apply to international air transport, it is our view that in maintaining the competitive capacity of the domestic aviation industry, this principle should apply to domestic aviation as well. We believe that this principle should be continued insofar as carbon taxes is concerned and an alternative to carbon taxes should be considered for aviation.

d. Tax by its own definition is revenue which goes to the general fiscus and cannot be ringfenced for specific purposes. National Treasury has advised that although efforts may be made to channel revenue to specific environmental projects, this cannot be guaranteed. This has been reaffirmed at several forums where Carbon Taxes have been discussed. Hence it appears that allocation of funds for such projects will be on the same basis as the current appropriation of funds between Government Departments during the national budget process. This would seem to contradict the statement in the media release and noted above noted in c) i) above where it is stated that *"primary objective of implementing carbon taxes to change future behavior, rather than to raise revenue"*.

e. The global airline industry has been extremely active over the past few years in taking steps to reduce carbon emissions and to mitigate the impact of airline emissions on the environment. AASA continues to be involved in the work undertaken by the Department of Transport and the SA Civil Aviation Authority in this field. AASA participated in the work to draw up the 2016 South African State Action Plan, the Action Plan to limit and reduce carbon emissions from international aviation. This plan was submitted by the Deputy Minister of Transport to ICAO during the Triennial Assembly in October 2016.

f. AASA also attended the ICAO Assembly and worked closely with the South African delegation in preparatory work and position taken by South Africa, leading up to the historic CORSIA adopted by the Assembly in October 2016. AASA supports the implementation of CORSIA.

g. National Treasury has **waived the requirement for International Aviation to be subject to Carbon Taxes in South Africa**. This we believe is entirely appropriate. There are a few issues to be noted in this regard:

   i. The global aviation industry through ICAO and supported by IATA representing the global Airline industry, developed the principles of CORSIA. It is our view that the **solution for Domestic Aviation must align with that of International Aviation.** Domestic Airlines operate their services according to international standards, recommended practices and regulations. In the interests of not requiring the airlines to be subject to two different regimes (one for international operations – ICAO's CORSIA, and another for domestic operations – Carbon Taxes), we strongly recommend that Carbon Taxes are not applied to South African domestic aviation operations. We believe that CORSIA can be adapted to the domestic airline industry in South Africa. **Different regimes will result in an administrative burden, which will incur additional costs for an already marginal airline industry and this must be avoided in the interests of the future sustainability of the industry**.

   ii. There are also examples where domestic airlines could be at a **competitive disadvantage** to their international airline competitors should Carbon Taxes be imposed on domestic airline operations. For example, if an international airline operates a flight from Cape Town with a stop-over in Johannesburg to an international destination, this would be an international flight and not subject to carbon taxes. However, if a South African airline operates Cape Town to Johannesburg, and then the passenger connects to an international flight to an international destination, the domestic flight will incur carbon taxes on the Cape Town to Johannesburg leg. This market distortion is being further exacerbated through the increasing trend of International Airlines, operating directly to the three main South African international airports but not incurring carbon taxes. All South African domestic airlines, which feed the hubs at for example OR Tambo International Airport are at a competitive disadvantage. The imposition of carbon taxes for domestic operations will be a contributing factor towards diminishing domestic connecting traffic and passengers will be incentivized to use foreign airlines through lower fare offerings. The **playing fields are not level** as the cost of the operation is more for the South African airline, making it less competitive.

h. Therefore, in answer to the question, should carbon taxes be implemented for aviation, I believe that the answer provided through the above discussion is no. It has been waived for international aviation, and I believe this waiver should be extended to Domestic aviation as well.

7. ACTIONS TAKEN BY AVIATION TO ACHIEVE THE REDUCTION OF CO_2 EMISSIONS

a. The question rightly can be asked, if carbon taxes are not applied to domestic aviation, what measures are in place to ensure aviation reduces CO_2 emissions? The airline industry believes that the primary objective of any measures to address climate change must be to ensure the reduction of CO_2 emissions. We do not believe that the introduction of carbon taxes is a measure that will encourage reduction of emissions. Carbon taxes is designed to increase revenue for the fiscus.

b. In respect of aviation, there is an incentive to reduce emissions. A reduction in emissions means a reduction in jet fuel burned which means a reduction in the jet fuel cost which means an improvement in the profit margin. Airlines will do what is necessary to reduce fuel burn and with it comes reduced emissions, and a reduced impact on the environment, the goal of climate change measures.

c. In 2009, the International Air Transport Association (IATA), introduced a plan for immediate implementation including goals to reduce CO_2 emissions. IATA and its member airlines, which include most AASA member airlines, agreed on the following targets on a global perspective:

i. 1.5% per annum fuel efficiency improvement from 2010 to 2020

ii. Achievement of global carbon neutral growth
iii. Achieving a 50% reduction on CO_2 emissions based on 2005 levels by 2050.

The above targets would be achieved by the implementation of the following initiatives:

1. Improved technology – fuel efficient aircraft, alternative sustainable fuels.
2. Operational efficiency – fuel efficient flight paths, take-off and landing procedures. (Constant improvements in flight design procedures are undertaken by ATNS in conjunction with the SA Civil Aviation Authority).
3. Improved infrastructure – airport and airspace infrastructure efficiencies. (Significant investment in infrastructure and improved airport and airspace infrastructure has been made leading to the World Cup 2010 and further investment is planned during the next five to ten years at ACSA airports together with ATNS).
4. Market based measures – includes additional measures such as Carbon offset schemes (CORSIA), Emission Trading Schemes or Carbon Taxes – the subject of this Draft Carbon Tax Bill. Our view is that Carbon offset Schemes such as CORSIA are the appropriate solution.

Whilst the above targets and initiatives are set for international aviation, to all intents and purposes, they apply to domestic aviation. Our South African based airlines operate both Domestic and International flights according to ICAO international standards and recommended practices, which are incorporated into domestic civil aviation regulations. These principles apply to both domestic and international flights.

d. Further reasons to support the airline position that Carbon offsets are the preferred method to effect carbon emission reduction are as follows:
   1. The need to avoid proliferation of incompatible international and national measures which would require the airlines to manage separate environmental monitoring systems for domestic and international aviation when the same aircraft will operate both these services.
   2. Carbon offsetting schemes guarantee a high environmental integrity
   3. Limiting carbon offsets to 10% (as we understand the current carbon offset limit in the draft Carbon Tax Bill) is not justified from a cost effective or environmental perspective.

e. We believe that this awareness, responsibility and actions taken by Aviation, should convince National Treasury, the Select Committee and ultimately Parliament of Aviation’s commitment to deal with carbon emission reduction as described above, and our overall recommendation to separate domestic aviation out of the Carbon Tax framework and extend the internationally accepted CORSIA mechanism to include domestic aviation.

f. South Africa does support a global approach to address carbon emission reduction for international aviation through CORSIA. Enforcing domestic carbon pricing measures such as through carbon taxes could be disruptive and distortionary.

8. THE CORSIA PLAN AND PROPOSAL TO DEAL WITH DOMESTIC AVIATION

a. CORSIA is designed for implementation according to the following main phases:
   i. 2021 to 2023 : Voluntary phase. States may volunteer to participate in CORSIA. 72 States have volunteered to participate in CORSIA. These include most developed States and some developing States. South Africa has not volunteered to participate as yet. This decision is up to the relevant Government Authority.
   ii. 2024 to 2026 : Phase 1. This is also on a voluntary basis.
   iii. 2027 onwards : Phase 2. This is mandatory participation in CORSIA based on a threshold of 0.5% of global aviation activity. It is anticipated that South Africa would be included in Phase 2 due to its level of activity from 2027 if it has not volunteered by that stage. States falling below that threshold including small islands, least developed countries and land locked developing countries would be excluded.

b. The SEIAS report of July 2017 made an important observation on the implementation of CORSIA based on the above time frames. It noted : *"However, since South Africa did not opt into the voluntary pilot phase or Phase 1 (2021-2026), its participation in the scheme might only be during the mandatory Phase II (as of 2027), there is a case for keeping the domestic sector in the carbon tax net so aviation emissions are accounted for."*

c. Acknowledging the above, in AASA's comment on the second draft of the Carbon Tax Bill, we made the **following proposal in dealing with domestic aviation**:

   1. As noted on several occasions, the Aviation Industry wishes to see domestic aviation excluded from the Carbon Tax implementation. From comments made by the Department of National Treasury, it would appear that the main issue concerning the Department is that in the absence of commitment from Aviation to take active measures as part of a recognized scheme to reduce carbon emissions, it is preferable to keep domestic aviation as part of carbon taxes program.

   2. To achieve its objective, Aviation needs to show the Department of National Treasury, the Select Committee and Parliament that it has

substantive means which it can implement to achieve the goals of the South African Government in respect of carbon emission reduction.

3. There are a number of measures being implemented by aviation which should provide the Committee with details of aviation's actions:

i. Notwithstanding that South Africa has not volunteered for the pilot phase or Phase 1 of CORSIA to be effective 2021, South African based airlines operating international services emitting more than 10000 tons CO_2 will be required to report their international emissions to the State with effect from 1 January 2019.

ii. This process will be enforced through approved ICAO Standards and Recommended Practices which are incorporated into Civil Aviation Regulations for implementation on 1 January 2019.

iii. South African airlines could conform to the requirement to report and monitor their carbon emissions to the SA Civil Aviation Authority in accordance with the regulations. This ensures an awareness of the responsibility for reducing emissions and introduces the accountability aspect required by Treasury.

iv. As noted above, a total of 72 States have volunteered to participate in the Pilot Phase and Phase 1 of CORSIA. These include six African States including neighbouring SADC States, Zambia and Botswana. South Africa has not at this stage volunteered. Based on current aviation activity, South Africa will be the first State for which it will be mandatory to participate in CORSIA Stage 2 from 2027. In view of this, further consultation could take place between the relevant Government Departments and the industry including AASA, IATA and the South African airlines on the merits of South Africa volunteering to participate in the Pilot Phase and Phase 1 of CORSIA.

v. There is a view that it would make sense to participate in a CORSIA system for both International and Domestic Aviation as opposed to CORSIA for International Aviation only and Carbon Taxes for Domestic Aviation. We recommend a review of South Africa's position to ensure that the best solution in the interest of the aviation industry and the South African Government in respect of achieving carbon emission reduction goals is achieved and that provision be made in the Carbon Tax Bill to take this into account.

d. I believe that the above proposal coupled with the developments also noted in item 7 above, should satisfy the Select Committee on the commitment of aviation to reduce CO_2 emissions on a sustainable and long-term basis.

9. ADDITIONAL GENERAL COMMENTS

a. The airline industry is often criticized for negatively contributing to increasing CO_2 emissions. In our view there should be incentives to reduce carbon emissions or measures introduced to encourage initiatives to reduce carbon emissions and make a positive impact on the environment.

b. Carbon Taxes will not achieve this. We support the IATA view contained in its paper submitted to National Treasury dated May 2015, commenting on the Davis Tax Committee paper on Carbon offsets, that "taxes only deliver environmental benefit to the extent that they reduce demand for air transport or that their revenues are exclusively used for environmental measures". The imposition of taxes will not achieve either of these objectives, but will serve to curtail "…investment in new technology … and newer, cleaner equipment … and will have a detrimental impact on jobs, competitiveness and the economy". This we believe is another reason why aviation should not be included in the Carbon Tax net.

c. With revenue neutrality the objective in the first phase of the Carbon Tax implementation, and with aviation shown to be committed to carbon emission reduction, it would be beneficial for aviation to participate in CORSIA for both domestic and international aviation.

d. As stated in the supporting documentation for the second draft of the Carbon Tax Bill, a review of the carbon tax impact will be undertaken after the first three years. This is supported, notwithstanding whether aviation is included in the Carbon Tax net or not.

e. In the above-mentioned supporting documentation, it is stated that the intention of Carbon Tax is to encourage companies to change their future behavior by taking steps to change their fuel inputs, production techniques and processes to lower carbon emissions. We submit that as noted above, that aviation has already taken significant measures to change its behavior through its investment in more fuel efficient aircraft, improved operational efficiencies and improved infrastructure. There is therefore no need for aviation to be further "incentivized" to reduce carbon emissions through being subjected to carbon taxes – not actually an incentive. Also as fuel is one of highest operating costs for airlines at around 30% to 35% of direct operating expenditure, airlines will continue to look at ways to reduce fuel burn, costs and therefore carbon emissions.

f. In our developing nation, even with a phased-in process, carbon taxes will continue to hinder growth and development due to additional costs from the administrative burden necessary to manage this system. We submit that with South Africa's low GDP growth forecast for the next year, this is no time to introduce Carbon Taxes and that time should be used to develop incentive schemes encouraging the reduction of carbon emissions rather than a system that penalizes the emission of carbon emissions through taxes. The principle of increasing taxes and trying to nudge the economy to a more sustainable growth path seem to be at odds, especially with our low GDP growth of around 1%. In our view it is inappropriate to burden the public and business with an additional tax burden, even in the phased in manner proposed.

10. SPECIFIC COMMENTS ON PROVISIONS OF THE CARBON TAX BILL

a. In the Explanatory Memorandum for Draft 2 of the Carbon Tax Bill, carbon pricing options are discussed. Two approaches are given to price carbon directly, namely a carbon tax or an emission trading scheme. In the last paragraph, reference is made to including a carbon offset mechanism providing flexibility for companies to reduce carbon tax liabilities whilst investing in carbon emission reduction projects. We submit that the CORSIA scheme for aviation, achieves that goal and its implementation will be very effective in achieving investment in emission reduction projects with 100% focus being on environmental objectives as opposed to carbon tax revenue which is not guaranteed to be directed to environmental projects.

b. In trying to make the Carbon Tax solution more palatable, the Carbon Tax design section provides for tax-free thresholds and allowances. From Schedule 2 of the Draft Bill, it appears that a 90% tax free allowance would be applicable. It is necessary to clarify if this understanding is correct. One could make a case that all thresholds apply to aviation given the complex nature of its business. For a 5% or even 10% carbon tax rate effectively therefore, we believe the reduction in carbon emissions would be better achieved through the globally accepted CORSIA solution. The proposed headline carbon tax rate is R120 per ton of CO_2 as noted in the Explanatory Memorandum and article 5 of the draft Carbon Tax Bill. We believe that the public should be provided with the information to show how a R120 / ton CO_2 with rebates payable as a tax will in fact reduce carbon emissions and on what basis this was determined.

c. Under Carbon Tax Administration in the Explanatory memorandum, the MRV process has not been set out in detail. We do not see how this Carbon Tax Bill can be enacted until the Regulations have been promulgated. This must be done through consultation and cannot be effectively finalized until all industries have an opportunity to assess how they will individually be impacted. International Aviation has made significant progress on the development of its MRV system, and this could be applied to domestic aviation. We submit that it would be more appropriate for domestic aviation to follow the internationally accepted MRV system than try to manage two systems.

d. **Draft Carbon Tax Bill : Section 4 : Tax Base** – The managing of the Carbon Tax system will be extremely complex. We believe that until every business knows how they would be measured (and this could be in more than one scope depending on their business), there is uncertainty as to what the Carbon Tax mechanism could cost each business. In addition, there could be anti-competitive issues between business sectors competing for similar business e.g. aviation vs road vs rail for goods and services. The analytical Carbon Tax Base Calculations provided are understood but what is unclear is which emissions each business would be liable for i.e. (1) fossil fuel combustion emissions, (2) fugitive emissions, (3) industrial processes and product use emissions, or a combination thereof. It is important that "double dipping" of carbon tax collection does not occur and industry would need to be assured of this. Further discussions are necessary with the aviation industry to get a clear understanding of the applicability of these parameters to the industry.

e. **Draft Carbon Tax Bill : Part II – Allowances. Section 10 – Trade exposure allowance.** On page 26 of the Explanatory Memorandum, a tax-free allowance of an additional maximum of 10% is applied to entities that are exposed to trade and international competitiveness. This is the case for aviation, including domestic aviation, and notwithstanding that it is noted that this has been included in the tax-free allowances for aviation in Schedule 2 of the draft Bill, this would be an added motivation to deal with domestic aviation as for international aviation.

f. **Draft Carbon Tax Bill : Part II – Allowances. Section 11 – Performance Allowance (Z factor).** There is provision for a tax free allowance to entities that have proactively implemented carbon emission reduction measures. The Aviation Industry, both globally and locally, has taken huge initiatives in this area and made great strides which we believe show this industry to be the worldwide leader in reducing emissions. The four pillar approach mentioned above, provides examples of the airline industry's achievements led by IATA. Additional allowance must be applicable to the Airline Industry if carbon taxes are applied to recognize the above achievements. We note in Schedule 2 under Civil Aviation that should carbon taxes be applicable to domestic aviation, a maximum total allowance of 90% is provided for in the first phase. This we assume is what has been proposed by the drafters of the Bill and would be applied to Civil Aviation. Hence the tax rate would be R12 per ton CO_2. It would be appreciated if this could be confirmed as a correct understanding.

g. **Draft Carbon Tax Bill : Part II – Allowances. Section 12 – Carbon budget system allowance**. Aviation would wish to understand how this could be applied to Aviation. As international operators, some airlines are, we believe, already involved in carbon budgeting processes and we would wish to know how aviation can be involved in South Africa.

h. **Section 13 – Offset Allowances**. The implementation of carbon offsets will form the basis of the CORSIA system being developed for international aviation and should be applied primarily for domestic aviation as well. Notwithstanding that we have had numerous discussions on this matter, we would welcome further engagement.

11. RECOMMENDATION AND CONCLUSION

a. In principle, aviation does not support Carbon Taxes. We believe that in a world, where aviation is such an active facilitator of travel, communication and bringing people together, the introduction of Carbon Taxes is intended to discourage and effectively shrink air transport. In addition, carbon taxes will add another cost burden on the airlines, which in the current low economic growth environment in South Africa as well as considering the marginal nature of this business, will burden the airlines even further.

b. International Aviation is excluded from the Carbon Tax regime. We believe we have shown further good reason why domestic aviation should be excluded from the Carbon Tax regime as well.

c. As shown above, the Aviation industry has shown leadership worldwide in playing an active role in reducing carbon emissions. The achievement of reaching agreement on CORSIA at the 2016 ICAO Assembly has also demonstrated the unity within aviation to tackle the climate change challenge in an integrated fashion. We believe that this is an example to all business sectors of the benefits of being united in a common objective. We therefore believe that a globally accepted scheme would be more appropriate to encourage Aviation to reduce carbon emissions.

d. We therefore recommend that the Carbon Tax Bill be amended accordingly to exclude Domestic Aviation.

e. Whatever the outcome of the Carbon Tax Bill and the consideration of our recommendations, we would welcome further opportunities to engage with all

Departments involved in the project, namely, National Treasury, DEA, DOT, and Tourism, to discuss specifics around the airline industry role and the proposals made above, and explore some of the noted alternatives to Carbon Taxes.

f. We thank the Select Committee for the opportunity to comment on this important Carbon Tax Bill and look forward to further engagement between our industry and the relevant departments in Government in trying to reach the best and most appropriate solution for aviation whilst trying to enable Government to meet its goals.

Yours sincerely

Chris Zweigenthal
Chief Executive Officer