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The National Treasury
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CALL FOR PUBLIC COMMENTS ON THE PROPOSED CARBON TAX AS PUBLISHED ON THE 14th OF DECEMBER 2017 REGARDING THE FOLLOWING DOCUMENTS:

1. **MEDIA STATEMENT**
2. **DRAFT CARBON TAX BILL (HEREINAFTER REFERRED TO AS "THE BILL")**
3. **EXPLANATORY MEMORANDUM FOR THE CARBON TAX BILL, 2017 (HEREINAFTER REFERRED TO AS "THE EXPLANATORY MEMORANDUM")**
4. **RESPONSE DOCUMENT DECEMBER 2017**
5. **SOCIO-ECONOMIC IMPACT ASSESSMENTS SYSTEM JULY 2017 (HEREINAFTER REFERRED TO AS THE "SEIAS")**

Introduction

The South African Iron and Steel Institute ("SAISI") appreciates the opportunity granted to comment on the proposed Carbon Tax Bill as it will have a significant impact on the South African iron and steel industry and the viability thereof.

SAISI has in the past repeatedly pleaded its opposition to the proposed Carbon Tax and that iron and steel producers need to enjoy additional relief measures or exemption in order to remain sustainable in the event of a price on carbon being implemented similarly to other jurisdictions where a price is/was placed on carbon due to the iron and steel industry being trade exposed and prone to carbon leakage.

The latest version of the Bill does not adequately address the concerns that have been raised in the past on previous versions of the Bill and our main concerns remain, namely:

1. The tax load will be highly disproportionate to the earnings potential of iron and

steel manufacturers, even with the allowances being considered.

2. There is no alternative technology that can be used to produce steel and reduce emissions to the extent required, so the effect of the Carbon Tax would not incentivise a change in behaviour, but rather be a penalty – which is contrary to the main purpose of the Carbon Tax.

3. The industry would be exposed to imports not subject to a similar tax making the South African industry potentially uncompetitive or not viable at all. The severe economic hardship experienced by the iron and steel sector is well known.

4. The ability to pass on the Carbon Tax to customers is limited, especially for the export market, thereby reducing potential export revenue for South Africa. The allowance for trade exposure does not sufficiently address this concern. Significant amounts of steel also enter our borders in the form of finished goods and such imports are difficult to control. The fact that steel is present in so many finished goods further adds to the argument that more relief should be granted for the iron and steel sector in terms of trade exposure (10% not adequate).

5. The complexity of the tax. The fact that an emitter needs to distinguish between process, energy or combustion and fugitive emissions adds to the complexity. These emissions often occur in a combined manner and one emission type often cannot take place without the other as part of the production of steel. The higher allowances for the process and fugitive emissions should hence be applicable to the total emissions of an emitter and not only to the portion characterised as process and/or fugitive emissions. It should also be noted that the higher tiers provided for in the IPCC guidelines do not in all cases supply sufficient guidance to distinguish between the emission types.

6. The issue of choice regarding energy sources. A consumer of electricity for instance does not have a choice other than ESKOM as a supplier and cannot exercise any influence to change its emission behaviour.

7. Timing of the tax.
    - South Africa has already achieved significant emission reductions due to the high cost of electricity and the availability thereof in the past. Weak economic growth further contributed to this phenomenon.
    - Further, a balanced approach to sound environmental management should also be considered as the proposed tax will significantly impact on profitability of producers and hence less funds may be available to address other pressing issues namely air quality and water.
    - The global playing field regarding a price being levied on carbon is far from being level yet, and closer scrutiny, where implemented, reveals that the iron and steel industry is grandfathered to prevent unintended consequences.

The central theme within The Bill and related documents is the intention of the tax to change behaviour. The iron and steel industry is severely restricted in this sense as no new technologies exist to reduce emissions by the percentages that climatologists call for as mentioned in point 2 above. The iron and steel industry depends on carbon as a reductant to convert iron ore to steel and there is currently

no alternative technology available to reduce emissions by the percentages that climatologists call for. In other words, the proposed Carbon Tax will fail to achieve its fundamental objective of changing behaviour, even when high carbon taxation rates as is the case now, are proposed. The unfortunate effect of the Carbon Tax would be that the existence of the iron and steel industry in South Africa is threatened further. In literature, including the Mitigation Potential Report (2014) compiled by DEA, Electric Arc Furnace (EAF) and natural gas based technology is referenced as being more climate friendly for the manufacturing of steel. EAF technology is already widely in use within the iron and steel sector, but it needs to be kept in mind that such technology is electricity intensive, a commodity that faces above inflation price increases over the short and medium term. Natural gas based technology is also not a feasible option due to natural gas availability only being envisaged to increase once "fracking" becomes a reality. The cost of natural gas based technology is also exorbitant at this stage. The integrated production route of iron and steel (very carbon intensive) also remains a necessity as global steel demand cannot be satisfied from the EAF route which is based to a large extent on the recycling of scrap metal.

Integrated producers of iron and steel, in order to prevent carbon emission costs, may also consider higher quality raw materials, which need to be imported and this may well be an unintended consequence of the tax. Local producers would obviously prefer local suppliers of raw materials for various reasons.

Specific Concerns

a) Revenue Neutrality on the price of electricity

The structure of South Africa's energy sector means that the future energy mix cannot be shaped by a price signal (carbon price) entirely since its emission reductions are driven by the Integrated Resource Plan (IRP). Although not explicit in the Bill itself, we understand that the current intention is to ensure revenue neutrality on the price of electricity for the economy for the first phase. This intention is stated in the Memo and the SEIAS as follows:

During the first phase of the carbon tax (until 2020), the introduction of the tax will have no impact on the price of electricity. This is achieved through the phased approach to the introduction of the tax, the modest effective tax rate during the first phase, providing a credit for the payments of the electricity generation levy and a credit for the renewable energy premium built into the electricity tariff complemented by additional budget allocations for free basic electricity...

While this intention is supported, it is not clear how this will be achieved practically and within the current structures of the Custom and Excise Act, the Multi-Year Price Determination (MYPD) methodology and the Regulatory Clearing Account (RCA) methodology. The renewable energy premium, which together with the environmental levy (electricity generation levy), plays a critical role in determining ESKOM's tax payable (formula on page 17 of Bill), unfortunately remains an unknown at this stage.

It is stated under sub-section 6(2)(c) of the Bill, that the renewable energy premium will be determined by the Minister by notice in the Gazette, however, reference to this prescription is not included in Section 19 of the Bill. We further seek clarity that this figure will be gazetted annually, and clarity of the process of the technical work on the methodology that will be used to calculate this premium. This is important to ensure that electricity price neutrality is achieved as intended.

Furthermore, it needs to be articulated how the taxpayer will calculate this. SAISI is very concerned that should ESKOM become liable for carbon tax, it would immediately be passed onto the consumer.

It is important to note that the removal of the provision for revenue neutrality of the price of electricity at the end of the first phase of the carbon tax (2022) without any corresponding decrease or removal amendment to the environmental levy on electricity, will result in double taxation on electricity. This will cause significant harm to the economy.

b) Carbon Tax pass through for Petroleum Sector (page 6&7 of Response Document)

It is mentioned that this sector will be unable to recover its carbon emission costs and that the National Treasury is considering a pass through mechanism for the sector. SAISI is surprised as the iron and steel industry will also not be able to recover its carbon emission costs as the sector is a "price taker" that operates in a competitive environment. Based on a principle of fairness, should all sectors that are unable to pass on their carbon emission costs, not receive such treatment? The objective of the carbon tax, namely to change behaviour seems to be compromised when adopting such a mechanism.

c) Addition of a Carbon Tax to liquid fuel prices (page 7 of Response Document)

Mention is made that the price of diesel and petrol may increase by 13 and 11 cents/liter due to the emissions associated with the combustion of such fuels. The National Treasury should note that the addition of a carbon tax to the price of such fuels is not possible due to the fact that the equipment in which such fuels are used will in many cases fall below the threshold as specified for Transport Equipment (IPCC code 1A2g) namely 10MW(th). Motor vehicles for instances, fall well below this threshold.

It is also apparent that a double taxation on vehicle emissions is intended as a CO_2 tax is already collected upon the purchase of new vehicles. This aspect cannot be supported.

d) Tax Payable (Section 6(1) of the Bill)

The formula provided here for industrial process emissions does not reflect the allowance for that category as reflected in schedule 2.

In addition, the basic combustion and process allowance are combined in the table provided in the annex to give 70% for process emissions. It was always understood that this was intended to include an allowance against combustion emissions as well, therefore, the formula needs to deduct 70% from the sum of combustion and process emissions, because the emission types often take place in a combined way to manufacture the end product namely steel.

It is proposed to revise the equation to reflect the application of the allowance section in schedule 2 as follows:

$X=\{(E+P+F-S) \times (1-L) \times R\} - \{D \times T\}$

Where L is the highest combination of all applicable allowances achievable for process, fugitive and energy emissions. T is the carbon tax tariff per ton of CO_2 applicable to fuel/diesel as included in the fuel price, not that this will be possible.

The above should clarify the statement about complexity raised under point 5 of the introduction. SAISI suggests that no carbon tax is added to the fuel price and that diesel related emissions should rather be taxed as combustion

emissions where emitters exceed specified thresholds. In which case the suggested formula will become even simpler.

e) Customs and Excise Act as Tax collection instrument

The Carbon Tax Bill requires payment of the carbon tax based on six-monthly environmental levy accounts, as is the case with all other environmental levies in terms of the Customs and Excise Act.

SAISI remains concerned with the use of this Act. Schedule 3 of the Bill includes completely revised text which adds to our concerns. Environmental levies are typically imposed on "goods". This is not appropriate for GHG emissions and the proposed amendment to the Customs and Excise Act does not address this, which means the standard rules for environmental levies apply to the carbon tax.

It is understood that the licensing procedure in terms of the Customs and Excise Act applies to individual premises and not only to the taxpayer. Business has engaged extensively with DEA in developing GHG reporting regulations which lend themselves to be the basis of a carbon tax. It was always understood that the GHG emission data submitted to the DEA would be the basis of the carbon tax. It appears from these amendments that this will not be readily achievable.

Without significant amendment, it is not suitable for the carbon tax for the following reasons:

- The Act requires licensing of warehouses, however, GHG emissions are reported at company level.
- The Act refers to "goods" which remains a challenge.
- There is a lack of alignment between the reporting requirements under DEA, and the taxpaying entity under SARS, which makes verification impossible.

SAISI supports the call for engagements between the National Treasury, DEA and SARS regarding the administration of this instrument.

f) Use of benchmarks as an incentive (Z-factor): The Bill and related documents do refer to benchmark related incentives in determining an adjustment to the basic tax-free threshold, the so-called Z-factor. SAISI did submit a Z-Factor study to the National Treasury as part of its preparation of the Z-Factor regulations which will be published in due course. SAISI maintains that the recommendation of the Davis Tax Committee whereby the Z-factor is only determined by considering the historical performance of a specific company that is liable for Carbon Tax, would have been a much simpler process, but reluctantly accepts Treasury's decision to follow a more complex process.

g) The implementation of offsets: The Bill and related documents provide for offsets that could increase the tax-free threshold by between 5% and 10% depending on the emission category. It is mentioned that regulations will be issued by the National Treasury in due course to explain and define the concept further. The definition of projects or interventions that may qualify as offsets for determining a company's carbon tax liability based on previously published documents was, however highly restrictive and a major shortcoming was that co-generation initiatives will not qualify as offsets. SAISI trusts that this concern will be addressed in the yet to be published regulations. SAISI also requests that a uniform off-set allowance (%) be applied to all emission types. As stated by SAISI before the tax design must be made simpler. It should also be stated

that the implementation of offsets will have costs attached to it, and that this allowance is not necessarily an allowance compared to the other allowances.

h) The link between The Bill and the reporting mechanisms being developed by DEA:

i. The definition of Fugitive emissions is not aligned with the IPCC Guidelines or the DEA Technical Guidelines for GHG Reporting and needs further attention.

ii. As stated before, the classification of GHG emissions into three types, namely process, energy and fugitive adds to the complexity of the tax design. It should be noted that the higher tiers provided for in the IPCC guidelines for the reporting of emissions do not in all cases provide sufficient guidance to distinguish between the three emission categories.

iii. It should be noted that in various instances within the documentation, reference is made to country specific emission factors that need to be used for tier 2 related GHG calculations, however not much country specific data is supplied as part of schedule 1 of the Bill.

iv. On page 12 of the Explanatory Memorandum for the Bill it is stated that a tier 3 methodology to determine GHG emissions entails continuous monitoring. It should be noted that this is one of many tier 3 methodologies that can be applied. It should also be noted that fugitive emissions cannot be monitored in many cases.

v. The IPCC guidelines stipulate that all the iron and steel industry's emissions from its various processes should be considered to be process emissions with the exception of coke making emissions. The example on page 18 & 19 of the Explanatory Memorandum (Example 5) is not aligned with the IPCC emission categorisation and it is recommended that this example is removed from the document.

vi. Throughout the documents, the term terra (eg TJ) is used. It should be noted the correct word to be used is tera (10^{12}) as the words have different meanings.

i) Difficulty in assessing the full impact of the Carbon Tax as per the Bill: There are three sets of important regulations that should be read together with the Bill and that are intended to be published at a future stage. It is thus requested that all related draft regulations pertaining to Trade Exposure, Z-Factor and Offsets be published as soon as possible, as only then will the full impact of the tax become tangible.

j) Tax rebates for energy efficiency improvements: The National Treasury states in the accompanying documents to the Bill that the revenue collected from the Carbon Tax could be applied for 12L rebates provided for in the income tax legislation, to defend the Carbon Tax as it may alleviate the financial impact of the proposed Carbon Tax. This will however not be the case as energy efficiency improvements are most often achieved by once-off projects and hence the rebates are also of a once-off nature, whereas the tax will be collected on a continuous basis. Within the iron and steel sector, the potential

tax rebates will be small compared to the potential carbon taxes that will be imposed. It should be mentioned further that within a sector where losses are experienced, the appetite for tax incentives is low as they may not be of benefit. The proposed Carbon Tax may also be a drain of money, with loss making producers having no benefit from other tax incentives like 12L for instance.

k) Uncertainty regarding Climate Change Policy: The DEA has commenced with its Carbon Budget setting process. Although not legislated as such, the DEA is working towards a climate Change Act. The impression is created that there is no policy coherency at this stage as you have two state Departments working in isolation to achieve Climate Change related outcomes. Alignment is severely limited between the Carbon Budgets and the Carbon Tax other than relief being granted in the Carbon Tax design when participating in DEA's Carbon Budget process. There is a substantial risk that punitive measures that form part of the Carbon Budget concept may be enforced over and above a carbon tax. Assurances by Treasury in the supporting documents to the Bill, that punitive measures will not be duplicated, does give some reassurance, but concerns in this regard do remain.

l) Additional relief for the iron and steel industry: To date, pleas for additional relief measures have not been taken into account. As mentioned already, local steel producers may not be in a position to pass on their Carbon Tax liability to the consumer. In Europe, for instance, the plight of the iron and steel industry was recognised as it is trade exposed and prone to carbon leakage. This decision has led to a situation where free allocations were granted to iron and steel producers within the EU emissions trading scheme (ETS) as a point of departure. SAISI requests that a similar point of departure is implemented in South Africa in order to ensure that our iron and steel industry remains competitive in the event of a carbon tax being implemented.

Conclusion

From the above concerns and facts raised, SAISI is not supportive of the proposed Carbon Tax as proposed in The Bill. The fragility in which the South African iron and steel industry finds itself in should be treated with extreme caution and the potentially unintended consequences and risks alerted to should not cause the downfall of a strategic industry. It is an important sector that is worth protecting especially in light of the fact that steel will always remain an important commodity, also when adaptation measures may need to be implemented to abate the effects of climate change.

SAISI is more than willing to engage further with the National Treasury regarding the concerns raised and trusts that the above information will assist in establishing a special dispensation for the iron and steel industry, a strategic industry sector where punitive measures should be considered with care.

Yours sincerely

Johann Nel
Acting Secretary General