
South Africa Draft Market Readiness Proposal (MRP) Expert Group Feedback

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Outline

1. Expert group and its role
2. Addressing competitiveness issues: options and implications
3. Revenue recycling options
4. Other challenges going forward

PMR Expert Group for South Africa

- Tang Jin (Sinocarbon Ltd)
 - *John Ward* (Vivid Economics)
 - Ian Parry (IMF) (desk review only)
 - Xueman Wang and Pauline Kennedy (PMR Secretariat)
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- Desk review of draft MRP: early September 2014
 - Country visit: September 22-23

Expert Group Feedback

- Expert group feedback also covered all building blocks, focused mainly on analytical work
- Key topics discussed during country visit:
 - Approaches for dealing with leakage/competitiveness concerns
 - MRV system, especially consistency with tax base
 - Offset scheme design
 - Interaction between carbon tax and other policy instruments
- South Africa's revised draft MRP responds well to issues discussed with the expert group
 - And recognizes a range of important future analytical studies

Addressing leakage concerns: why?

- Most carbon pricing schemes are concerned about competitiveness impacts
- Addressing carbon leakage is not (always) the same as addressing competitiveness
 - Some contraction of output in EITE sectors would be expected even with global carbon price
 - Especially if carbon intensity of domestic production is higher than foreign production
- And some leakage may happen even with competitiveness protection measures
 - policy measures will not address leakage through changing fossil fuel prices

Addressing leakage concerns: who?

- South Africa's current proposal provides protection to sectors based on their trade intensity
 - The aspects of EU ETS leakage protection based only on trade intensity has been criticized
- Moving forward, MRP recognizes possibility of refinement
 - Take account of cost increases as well as trade intensity
 - Take account of carbon pricing among international competitors
 - Important to identify where competition is located
 - Greater sub-sectoral disaggregation
- Targeted approaches to protection enhance policy effectiveness and save revenue

Addressing leakage concerns: how?

	Link to output – as output/emissions increase, provision of assistance increase	No-link to output – as output/emissions increase, provision of assistance is not affected
Carbon-tax options	Tax-free percentage thresholds (SA current approach)	Tax free thresholds with absolute amount (possible alternative in draft MRP)
ETS	Output-based free allowance allocation	Lump sum free allowance allocation
Advantages	More effective at reducing leakage/competitiveness concerns	Not very good at reducing leakage
Disadvantages	Reduced incentive to mitigate (see SA modelling results)	Stronger incentive to mitigate
Examples	California, Australia (except electricity)	EU ETS, Australia (electricity)

Revenue recycling options and criteria

- South Africa's MRP notes the need for more analytical work on revenue recycling and the need to protect low-income households
- Three broad approaches to doing this
 - reducing price impacts
 - reducing quantity of energy inputs (promoting energy efficiency)
 - lump-sum redistribution
- And three key criteria to assess these impacts
 - efficiency/impact on economic activity?
 - promote/maintain incentives to reduce emissions
 - targeted at those that need support

Choosing between the options involves difficult trade offs

	Cost effective	Incentives for abatement	Targeted
Reducing prices	✗ - as indicated by the SA modelling	✗✗ - removing price impacts cuts off key abatement opportunity	? – varies by energy product and country circumstances
Supporting energy efficiency	✓ - typically cost effective, but may be large upfront costs; hypothecation is inappropriate	✓✓ - so long as designed well	✗ - maybe difficult to isolate support to affected households; difficult for energy reduction to fully offset price rises
Lump-sum redistribution e.g. direct tax reductions	✓ - depends on form of redistribution, but reducing other distortionary taxes can lead to double-dividend	✗ – general rise in economic activity will lead to some increase in emissions	✗ – depends on country circumstances but often difficult

Challenges: Policy interactions

- South Africa carbon tax will be introduced in dynamic policy setting
 - Planned introduction of DEROs
 - Existing electricity tax
- In right circumstances, multiple policies can be mutually reinforcing and support overall objectives
- In wrong circumstances, multiple policies can create confusion, increase costs or render policies ineffective
- Consistency requires identification of the market failure each policy is designed to address and the separate role for each

Thank you for your attention