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

**John Ward
(representative of the Expert Group)
October 4, 2014**

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)
-
- 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