Partnership for Market Readiness

Template for Expression of Interest

South Africa

October 6, 2011
A. Expression of interest

Partnership for Market Readiness (PMR)
Expression of interest in participating in the PMR

Countries seeking support from the PMR are requested to prepare a cover letter, including a short statement confirming the country's interest in participating in the PMR. The cover letter should be accompanied by an Annex containing the following information:

1. Name of the government agency submitting expression of interest
   Department of Environmental Affairs, and the Department of the National Treasury, South Africa

2. Name and contact information of designated PMR Government focal point
   For PMR:
   Sharlin Hemraj
   Telephone: +27123155875
   Sharlin.hemraj@treasury.gov.za

   South Africa's Climate Change Focal Point
   Maesela Kekana
   Telephone: +27123103120
   Mobile: +27718952537
   MJKekana@environment.gov.za

3. Domestic mitigation action: outline what are the purposes and main objectives of your country's mitigation strategy.
   a. Provide an overview of domestic mitigation policies and plans and the status of the implementation - at both the national and sub-national levels.
   b. Briefly identify the key sectors targeted by the mitigation strategy.

    Taking into account equity and the common but differentiated responsibilities and respective capabilities of all nations as well as the inter-generational commitment of environmental rights contained in Section 24 of South Africa’s Constitution, our climate change response objectives are to:
    
    - make a fair contribution to the global effort to achieve the stabilisation of greenhouse gas concentrations in the atmosphere at a level that prevents dangerous anthropogenic interference with the climate system and
    - effectively adapt to and manage unavoidable and potential damaging climate change impacts through interventions that build and sustain South Africa's social, economic and environmental resilience and emergency response capacity.

    South Africa is committed to contributing its fair share to the global greenhouse gas mitigation effort and has aspired to its emissions peaking between 2020 and 2025, remaining stable for a decade and declining in absolute terms from around 2035. In December 2009 and in the context of this trajectory, South Africa announced at Copenhagen that the country would reduce its greenhouse gas emissions by 34% by 2020 and 42% by 2025 below business as usual, on condition that it receives the necessary finance, technology and support from the international community that will allow it to
achieve this. South Africa remains committed to this and to give credence to this will, *inter alia*

- By phasing in an escalating carbon tax to price carbon in an attempt to internalise the external costs of climate change. The use of such market-based policy measures will be aimed at sending appropriate price signals to motivate and drive the diversification of our energy mix, the implementation of energy efficiency measures and investments in the development of new and cleaner technologies and industries.

Government recognises the important role for market based instruments as fiscal incentives and disincentives to support climate change policy objectives. Thus, South Africa is exploring the implementation of market based instruments (such as a carbon tax) as part of a suite of policy interventions to support the transition to a low carbon economy. These instruments will be designed to incentivise behaviour change at the individual, institutional and macro-economic levels for a climate resilient South Africa contributing to a diversification of our energy mix, drive people to implement energy efficiency measures, achieve passenger modal shifts and generate investments in new and cleaner technologies and industries.

The energy sector is the largest contributor to greenhouse gas emissions, generating over 80% of South Africa’s emissions. The South African economy depends to a large extent on energy production and use, with energy-intensive sectors such as mining, minerals processing, a coal-based electricity and liquid fuel supply sector and energy-intensive beneficiation. Electricity production by the national utility company accounts for more than 90% of total electricity generated in the country. The main fuel of power generation is coal, which is abundantly available, accounting for more than 92% of fuel used in electricity generation. It is clear that successful climate change mitigation in South Africa must *inter alia* focus on the energy sector. Mitigation efforts therefore will include, *inter alia*,

- Development of a carbon tax policy to provide the necessary, credible long term price signals to stimulate behavior changes in both producers and consumers towards to energy efficient and low carbon alternatives.
- Consideration of the Integrated Resource Plan for Electricity Generation (IRP) and its future iterations are modeled so as to take account of the peak plateau and decline trajectory described above through the diversification of our energy mix, the implementation of energy efficiency measures, investments in the development of new and cleaner technologies and industries and the initiation of the transition to a low-carbon economy.
- Establish a business environment that facilitates the development of a local renewable energy technology manufacturing, implementation and export industry and that maximises its job creation potential in the energy, transport, agriculture, whilst investigating potential instruments for specific sectors and associated abatement costs.
- Design and roll out research, development and demonstration programmes that result in new, novel and innovative approaches to the diversification of our energy mix, development of alternative energy sources, energy efficiency, cleaner technologies and industries, carbon capture and storage and the transition to a low-carbon economy.
- Identify and resolve the financial, regulatory and institutional barriers that may impede the implementation of the financial support mechanism for renewable energy at a level adequate to incentivise large-scale investment

4. Market Instruments\(^1\): briefly outline experience to date with relevant market instruments as well as future plans.

\(^1\) Without prejudging future developments on market instruments, this question refers to instruments providing a price signal that create an incentive to use or invest in climate-friendly technologies and/or
a. Provide a brief description of experience to date with market-based instruments, e.g., type of instrument, dates of implementation, scope, and key outcomes.

b. To the extent that one (or more) specific market instrument is already identified for future implementation, provide a brief overview of the status of development/implementation and its relevance to the country’s overall mitigation strategy.

In 2006, Government published the Draft Environmental Fiscal Reform Policy Paper entitled A Framework for Considering Market-Based Instruments to Support Environmental Fiscal Reform in South Africa. The policy paper recognises the role for environmentally related taxes to complement existing regulatory policy interventions and address environmental problems such as climate change. Government has already introduced several excise taxes and incentives to support the transition to an environmentally friendly, low-carbon economy. In addition to the fuel taxes on petrol and diesel, the electricity levy of 2.5 c/kWh was implemented as a step towards developing a comprehensive carbon pricing regime as well as a CO2 based motor vehicle purchase tax. Tax incentives and specifically targeted government programmes for renewable energy and energy efficiency measures form part of government’s policy response to climate change. There might be a possibility for renewable energy certificates (RECS) and white certificates (energy efficiency) to play a role in South Africa.

In this context, the Government of South Africa published the carbon tax discussion paper entitled Reducing Greenhouse Gas Emissions: The Carbon Tax Option for public comments in December 2010. The paper elaborated on the role for carbon taxes as a policy measure to price carbon emissions and stimulate behaviour changes of producers and consumers towards less energy intensive, low carbon emitting alternatives.

The discussion paper is currently being revised into a policy document which will be published towards the end of 2011. The key considerations in the development of the carbon tax policy are:

- The tax rate should, over time, be equivalent to the marginal external damage costs of GHGs to affect appropriate incentives. However, in the absence of an international climate change agreement and therefore a global emissions pricing system, a partial, rather than full, internalisation of the externality should be targeted as an interim measure.
- Technical and administrative feasibility – Consideration needs to be given to whether the tax applies to measured carbon emissions or a proxy for such emissions (e.g. fuel inputs).
- Distributional implications – measures should be taken, either in tax design or through complementary expenditure programmes, to offset the burden such a tax will place on poor households.
- Competitiveness – to address potential negative impacts on industry competitiveness, the introduction of carbon taxes at initial low rates with a commitment to phase-in increased levels of taxation over a specific time period would grant taxpayers an opportunity to adjust to the new tax.
- Concerns about carbon leakage and the possibility of border adjustment taxes have been raised during the consultation process and will be explored.
- The design of the tax needs to minimise the potential regressive impacts on the poor processes. Such market instruments can include domestic instruments (e.g., emissions trading and non-GHG based schemes such as renewable energy and energy efficiency trading systems) and international market instruments such as reformed CDM, sectoral, and NAMA crediting.
and protect the competitiveness of key industries. Revenue recycling to minimise the costs of the tax could be achieved through some form of tax shifting and / or targeted expenditure on for specific environmental programmes.

Although a carbon tax does not set a fixed quantitative limit on GHG emissions, such a tax at an appropriate level and phased in over time to the “correct” level will provide a strong price signal to both producers and consumers to change their behaviour over the medium to long term. The carbon tax policy measure seeks to primarily stimulate behaviour change through the price mechanism, and as a secondary benefit, generate a revenue stream that may allow fiscal decisions over time that support climate change policy and broader sustainable development objectives.

The feasibility of an emission trading scheme will be explored as a second phase of our work on pricing carbon.

5. Support from the PMR: provide a short summary of your current assessment of the capacity needs and gaps for which support from the PMR is being sought. To the extent that one (or more) specific market instrument is identified, outline the type of support that your country may be seeking from the PMR.

The carbon tax discussion paper acknowledges that carbon taxes and emissions trading schemes are key policy instruments that could be used to price carbon and provide the necessary and credible price signals to stimulate behaviour change. Developing an adequate, transparent, credible and competitive emissions trading mechanism to protect the atmosphere could complement the proposed carbon tax. However, in the South African context, the oligopolistic structure of the energy sector is likely to reduce efficiency gains that would result from such a mechanism. The lack of many industry players and appropriate market structure with diverse abatement costs suggests limited opportunities for domestic trade, resulting in inappropriate permit prices. This could result in the lock-in of emission-intensive technologies where permits could be used as a barrier of entry for newcomers.

There are other concerns about emissions trading systems. The European Union emissions trading scheme (EUETS), for example, has experienced significant price volatility. Declining industrial activity in Europe and hence energy use, since the middle of 2008 in the face of fixed supply of carbon allowances and declining emissions also contributed to falling carbon prices. The price of carbon under the EU scheme appears to be too low due to the large number of free allowance allocations among industrial users, which results in economic distortions and the creation of unequal abatement incentives.

A carbon tax regime would have certain administrative advantages over emissions trading schemes:
- Oversight of the tax by the existing revenue authority
- Fewer players involved (and therefore lower costs)
- A simpler structure, minimising opportunity for abuse and risk
- A lower administrative burden, because no new accounting system is required
- Lobbying efforts would be minimised.

The role and appropriateness of emissions trading scheme and offset mechanisms to effectively complement the carbon tax policy needs to be further investigated. Accordingly, South Africa would therefore benefit from support to understand:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.</strong></td>
<td>the interaction between carbon taxes and emissions trading policy to effectively stimulate behaviour changes and least cost emission reductions,</td>
</tr>
<tr>
<td><strong>2.</strong></td>
<td>the key design aspects of emissions trading schemes and offset mechanisms that are implemented or are being proposed internationally,</td>
</tr>
<tr>
<td><strong>3.</strong></td>
<td>the necessary institutional requirements and governance structures to effectively implement trading schemes / offsets mechanisms, and</td>
</tr>
<tr>
<td><strong>4.</strong></td>
<td>the necessary financial regulatory regime and the appropriate tax treatment of revenues and transactions related to emissions trading.</td>
</tr>
<tr>
<td><strong>5.</strong></td>
<td>the optimal allocation and / or auction of permits.</td>
</tr>
</tbody>
</table>

**6. Institutional setting:** how would you plan to coordinate the PMR efforts at the domestic level, i.e., which Ministry would lead and which government agencies would be involved?

The Department of Environmental Affairs and National Treasury would lead the effort and coordinate South Africa’s inputs and participation through already existing structures that deal with climate change such as our Intergovernmental Committee on Climate Change (IGCCC) which has representation from all Ministries within the country.

**7. Stakeholder participation:** are there intentions/plans /processes to engage non-governmental stakeholders (e.g., private sector)? If so, provide brief description.

South Africa has an established forum called the National Committee on Climate Change (NCCC) through which such initiatives could be coordinated. The NCCC has representation from all government departments, civil society, business, academia, and labour.

**8. Initiatives by other bilateral and multilateral development partners:** outline any initiative(s) pursued with other international partners underway in your country that is (are) relevant to market readiness support (e.g., low carbon development strategies, MRV, etc).

Partnership with the German Government on the development of MRV capacity in the country is under way, with some areas which can be potentially linked with the PMR work.