FREE MARKET FOUNDATION

Johannesburg
PO Box 4056 | Cramerview 2060
Tel 011 884 0270 | **Fax** 011 884 5672
Email fmf@mweb.co.za

Cape Town
PO Box 805 | Cape Town 8000
Tel 021 422 4982 | **Fax** 021 422 4983
Email fmf.ct@mweb.co.za

Durban
PO Box 17156 | Congella 4013
Tel 031 572 3308 | **Fax** 031 572 3308
Email urbach@telkomsa.net

Comment to the National Treasury on the Carbon Tax Policy Paper
Reducing greenhouse gas emissions and facilitating the transition to a green economy

1. The Free Market Foundation

The Free Market Foundation (FMF) is an independent non-profit public benefit organisation founded in 1975 to promote and foster an open society, the rule of law, personal liberty, and economic and press freedom as fundamental components of its advocacy of human rights and democracy based on classical liberal principles. It is financed by membership subscriptions, donations and sponsorships.

Most of the work of the FMF is devoted to promoting economic freedom as the empirically best policy for bringing about economic growth, wealth creation, employment, poverty reduction and human welfare (including better healthcare, increased life expectancy, literacy and educational quality). As a think tank the FMFs fundamental approach to policy questions is consumer-based. The foremost question the FMF asks in addressing any policy question, including the contents of the above mentioned Policy Paper is: will this policy be to the long term benefit of consumers and especially those who are the poorest and most vulnerable? Consumer satisfaction is generally achieved by an absence of barriers to entry into the provision of goods and services, allowing consumers a choice between the offerings of freely competing providers, and the absence of regulations that impose avoidable costly burdens on the providers of goods and services. The Policy Paper and the proposals it contains will be assessed to ascertain whether it is likely to result in the most beneficial economic results for the citizens of the country.

2. A question of economics and not of science

2.1 Climate change

According to the Press Release issued by the National Treasury, "Climate change poses a major challenge to humankind, and one of the most significant ways to mitigate this risk is by reducing greenhouse gas emissions such as carbon dioxide. There is also growing concern that climate change could slow or even reverse progress on poverty reduction."

Although the FMF does not get involved in the scientific debate on climate change, we do monitor with close interest the fact that there are significant variances in views about what is happening and what the consequences of the disparate views are likely to be. What has become clear is that the greatest certainty on the issue of climate change is the persistence of uncertainty. Some of the matters that appear to be the subject of most uncertainty are:

(a) Whether absolutely reliable predictions about future climate conditions are possible.
(b) Whether humans are capable of having any significant influence on climate – either to bring about a worsening of conditions or an improvement.
(c) Whether increased quantities of CO_2 in the atmosphere have negative or positive effects.

There are too many uncertainties to justify a specific government policy intended to bring about a positive economic outcome in respect of this issue. Attempts to have a mitigating influence on the climate face the difficulty that there is too much uncertainty to warrant the imposition of a carbon tax intended to change the behaviour of energy producers and users. Because of the lack of certainty there is a distinct possibility that the effects of the introduction of a carbon tax could "slow or possibly even reverse progress on poverty reduction" – the opposite of what is intended. This is, for instance, a certainty, if the climate science on which the policy has been based, turns out to be wrong. What we observe is a distinct decline in the apparent confidence level of the climate scientists during the past few years and the sense of urgency with which they predict calamitous events.

2.2 South Africa's undertakings at the 2009 Copenhagen conference (COP17)

South Africa's undertakings at the 2009 Copenhagen conference were conditional upon the conclusion of, "a fair, ambitious and effective agreement in the international climate change negotiations under the UNFCCC and Kyoto Protocol, as well as the provision of financial resources, technology transfer and capacity-building support by developed countries." None of these international commitments have been met and the appetite of developed countries for financial contributions towards CO_2 reductions in countries like South Africa appears to have cooled. This would appear to mean that South Africa is no longer bound by its COP17 undertaking.

There can surely then be no justification for going forward with a carbon tax if the other parties to the agreement are not abiding by its terms. This is especially so when considering that when the developed countries were at South Africa's level of development, they did not burden their industries with an expense of this nature. In fact, their industries functioned in an extremely low-tax, low-regulation, environment, which made it possible for them to grow rapidly and plough back a much greater share of their profits into building their businesses.

2.3 The economics of the carbon tax

The Treasury states that, "Economic modelling undertaken suggests that a broad based carbon tax will make a significant contribution towards emissions reduction with limited macroeconomic impacts". First, we note that the Treasury refers to "limited macroeconomic impacts". This could mean that there are prospects of considerable negative microeconomic impacts in some parts of the economy that according to the economic model would be counter-balanced by positive developments in other parts of the economy.

Economics does not function in this fashion. For instance, a steel mill that closes down because it has been hit by a carbon tax that has rendered it uneconomical cannot be said to be replaced by labour-intensive agriculture that is carbon neutral. This is recognised to some extent in the 20% relief for iron and steel production in the calculation of the carbon tax, but the only relief that would not cause some level of disruption would be 100%.

No matter how meticulously economic modelling is carried out, it cannot determine what will happen in real life. Just as in the case of income tax, it is not possible to determine where a tax will eventually fall. For instance, the income tax paid by a company could in the final analysis be borne by customers in increased prices, employees in reduced wages, shareholders in reduced dividends or share values, or a combination of all these.

It is stated by the Treasury "that the primary objective of implementing the taxes is to change future behaviour, rather than to raise revenue". This essentially means using different fuel types to those that are currently being used or changing the method of producing energy, both of which have cost implications for firms that go beyond any carbon taxes they may be forced to pay. As a relatively poor developing country, with massive unemployment and a host of other problems that need to be resolved, the government should desist from adding additional and unnecessary costs to those already borne by industries and consumers. The CO2 reduction that South Africa can achieve at great cost and with major disruption to many firms, will be minute compared to the huge increases in CO2 produced by the world's major countries.

South Africa should desist from imposing a carbon tax until:

- The major countries that undertook at COP17 to pay the costs make a firm commitment to do so.
- The scientists produce greater certainty that South Africa's efforts to reduce CO2 emissions are not an exercise in futility.
- There is incontrovertible evidence that a carbon tax is proved to bring about reductions in emissions and that it is not merely another tax that creates economic distortions.
- Major countries have imposed the costs of a carbon tax on their economies (to avoid South Africa creating a competitive disadvantage for its local industries).
- It can be shown that the imposition of the carbon tax will not cause increased unemployment.
- The economy is growing rapidly and the currently unemployed people have been absorbed into the labour force.

2.4 The Precautionary Principle (imposing costs now because costs may occur later)

According to the logic of the precautionary principle, action must be taken to prevent a potential risk even when there is inadequate evidence to prove that the risk actually exists. The consequence of applying such a principle is enormously costly and diverts resources away from current issues that are in need of attention. Climate change is such an issue and South Africa faces many proven risks that can be clearly identified and which can be mitigated by positive action; risks that pose a much greater threat to South Africa's people than the potential threats posed by climate change.

Three such risks in South Africa are mass unemployment, a failed schooling system, and the risk of failure of the electricity system. These risks are real and scheduled to have extremely negative consequences for the country if not soon resolved. Instead of applying the precautionary principle to the possibility of harm from climate change, government should apply its resources to solving the crises in the three aforementioned areas that are in dire need of positive action.

In fact, the proposed policies that regard the production of energy from coal as fundamentally undesirable will have severe repercussions for the country. The opposite view would have more positive consequences. Whatever available resources will produce the lowest cost energy for consumers should be utilised. This does not mean that energy producers should not use technology to keep pollution to a minimum, but to put a ban on using coal to overcome the electricity shortage will have costly economic consequences.

South Africa is a developing country and the highest priorities are growth, jobs, investment and economic efficiency.

2.5 In-depth research on the socio-economic consequences of the carbon tax

There has been inadequate time for researchers to do in-depth research on the potential socio-economic consequences of the imposition of the carbon tax in South Africa. There is evidence from other countries that the institution of a carbon tax does not have the intended effect of reducing the quantity of carbon emissions.

2.6 Tax Review Committee and the carbon tax

The introduction of new taxes, such as the carbon tax, should not proceed in view of the appointment of the Tax Review Committee which has the task of reviewing the entire tax system.

3. Conclusion

There is reason to be concerned at the intention to introduce a new and unavoidably destabilising carbon tax at a time when the economy is struggling to deal with the effects of a major worldwide economic slowdown. It is disturbing that the tax is being introduced to deal with an issue over which, according to reports, there is increasing uncertainty amongst experts, most notably regarding the fact that predictions of warming have not materialised. There also appears to be growing uncertainty amongst experts regarding the role played by anthropogenic carbon emissions and what was previously claimed to be a consensus amongst experts appears to no longer exist.

Prepared by:

Eustace Davie
Director
Free Market Foundation
PO Box 4056
Cramerview 2060

Email: egdavie@mweb.co.za
Tel: 011 884 0270