



national treasury

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Press Release

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Possible reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry

In May 2006, the Minister of Finance appointed a Task Team to advise him on:

- possible reforms to the fiscal regime applicable to windfall profits in South Africa's liquid fuel energy sector, with particular reference to the synthetic fuel industry,
- options for securing the optimal contribution of the synthetic fuel industry to South Africa's long-term development.

The Task Team releases a discussion paper for public comment, today 20 July 2006 and which is available on the National Treasury website (<http://www.treasury.gov.za> follow left hand column down to "22 June – Windfall Tax Task Team").

This purpose of this document is to provide a basis for public discussion of the issues that the Task Team is required to address as well as to solicit informed comment. It does not represent a full discharge of the Terms of Reference at this stage. Indeed several areas require further development and sections of the document pointedly raise questions that have arisen in the Task Team's work thus far. Few conclusions have been reached and no recommendations are made at this stage. The discussion document therefore does not reflect the views of the government or of the National Treasury, who are also invited to make formal inputs into this process along with other interested parties.

If any views are expressed in this document, they have been derived from the Task Team's respective analyses of:

- the historical trajectory of the South African liquid fuels industry,
- relevant international experience of fiscal and other measures applied to liquid fuel and related industries,

- a definition of the term “windfall” and its relation to various forms of economic rent.

The South African liquid fuels value chain is technically complex and that complexity is increased by the regulatory system that has been applied historically, elements of which prevail to this day and which are in the process of being reformed. In addition to considering the history of the industry, the Task Team has also considered the economic contribution of the industry, and the continuing role of the industry to the SA economy particularly given the need to accelerate growth in South Africa. The Task Team is also mindful of the need for fiscal and policy certainty for all sectors of the South African economy, including the liquid fuel industry, and that such policies are in line with recognised best practices.

The Task Team has approached its work with care and in as even-handed a manner as is possible. We have refrained from expressing and concluding views in this document, other than those based on the facts at our disposal. It would be premature at this early stage of the investigation to have expressed specific views, as the Task Team is open to learning key lessons from past and current policies with a view to recommending that they be considered for the future. The Task Team therefore, as suggested in the TOR, is soliciting the views of industry participants and other interested and informed parties by posing a series of pointed questions, regarding the desirability and feasibility of the options that we are asked to examine. Stakeholders are also free to also provide comments on any relevant criteria that may not have been taken into account in the discussion document.

Reader’s guide to & Summary of the discussion document

The discussion document is organised as follows. In Section 3 we analyse the associated fiscal regime that has evolved for the upstream and downstream segments of the South African liquid fuel industry value chain. The methodology used is to conceptually separate upstream and downstream components of the value chain and to examine the differing fiscal approaches adopted for each. In this section we also explore the interrelationship between current fiscal policy considerations (as the Task Team understands it) relating to liquid fuel production in South Africa and considerations from other policy spheres, including energy policy, mining policy, industrial policy, technology policy and environmental policy. We also analyse selected international fiscal policy experiences and approaches in respective value chains elsewhere.

In our work thus far, we have tried to more precisely define “windfall” and to apply that definition to a rigorous analysis of the liquid fuels value chain. In Section 4 we develop a working definition, which clearly distinguishes between the two different forms of super-normal profits that are of interest to the Task Team, namely windfall profits on the one hand, and other forms of super-normal profits/economic rent. We also review various “windfall” and super-normal profit taxation and levy initiatives taken by the Governments of different countries, at different times, on the upstream and downstream segments of the energy/fuel value chain and at different stages of development of the value chain/system. Our scan of international experiences is not fully comprehensive and we would welcome any additional perspectives that may be relevant and useful.

The development of South Africa's liquid fuel industry has been unique compared to post-war growth of similar sectors in other countries. Today some 30% of South Africa's liquid fuel is produced from coal and natural gas using a domestically developed synthetic fuel technology. The same process produces the bulk of the basic organic chemicals that are utilised in the downstream chemical and allied industries, as well as a significant proportion of South Africa's chemical exports.

The liquid fuel industry's growth and development (both crude oil-based, coal-based and gas-based) has taken place under an interventionist industrial policy that gave priority to increasing fuel security/self sufficiency, using the key policy instruments of investment incentives and regulation of the entire liquid fuels value chain. Section 5 details the intricate nature and history of the regulatory system that governs the industry. Section 6 discusses the role of the liquid fuel industry in the economy, in particular the contribution of the synfuel industry.

The concepts of "windfall", developed in Section 4, are applied to the South African liquid fuel value chain in Section 7 where we test whether windfall profits have been generated in the liquid fuels industry and whether super-normal profit generation can be expected to continue into the foreseeable future. In Section 9, we conclude by pointedly raising key issues and questions that have arisen thus far in the investigation, including confirmation of the methodology that we have adopted and the analytical steps that we have taken.

Optimal Contribution of the synthetic fuel industry to South Africa's long-term development

The Terms of Reference also require the Task Team to advise on options for securing the optimal contribution of the synthetic fuel industry to South Africa's long-term development. We have interpreted this largely in terms of the desirability and feasibility for further synfuel/alternative fuel production to meet the needs of a fast-growing economy and we raise a number of questions in this regard in Section 8 of the document. It is our intention to focus more intensively on this area of our brief in the next stage of investigation.

Process

In soliciting responses to this document, the Task Team welcomes clarification and correction of any of the analyses that we have undertaken as well as any alternate views and approaches that may be more accurate and/or relevant.

The Task Team invites comment and views from interested and potentially affected parties in electronic format to be sent to the Secretariat at : kiyasha.thambi@treasury.gov.za by no later than 4th August 2006.

We further request that respondents indicate whether or not they would like to make an oral presentation in addition to the written response submitted. Oral presentations will be heard at public hearings that will be held in 2nd or 3rd week of August 2006.

Flowing from this and, in accordance with the Terms of Reference given to the Task Team, a report will be compiled and recommendations made to the Minister of Finance by mid-September 2006.

Summary Biographies of Task Team members

Dr Zavareh Rustomjee (chairperson and convenor) is an ex Director General of the Department of Trade and Industry. He is currently an independent consultant and a director of a number of companies, including the Central Energy Fund (Pty) Ltd. He is a qualified chemical engineer and holds a PhD in economics.

Dr Rod Crompton is currently with the National Energy Regulator. He was previously the Deputy Director-General for Hydrocarbons and Energy Planning with the Department of Minerals and Energy and the Managing Director of the Minerals and Energy Policy Centre.

Ms Almorie Maule is an independent businesswoman with extensive experience in the petroleum industry. She served as CEO of Engen from 1999 to March 2002.

Dr Boni Mehlomakulu is responsible for the Resource based Industries Unit at the Department of Science and Technology. She worked in the synthetic fuels industry from 1997 to August 2003.

Dr Grové Steyn is an independent consultant with expertise in the areas of regulation, technology and innovation. He is a qualified industrial engineer and holds a PhD in the economics of Science and Technology.