

# **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**

## **SUBMISSION BY CHEMICAL AND ALLIED INDUSTRIES ASSOCIATION (CAIA)**

**10 AUGUST 2006**

### **1. INTRODUCTION**

CAIA is a member of BUSA and as such fully supports the BUSA submission on the Discussion Document. However there are some specific sectoral issues that CAIA wishes to comment on in this supplementary submission.

The comments set out below are confined to the questions relating to the value chain and coherence with environmental policy, as these are two areas addressed in the Discussion Document that can impact on the chemical industry.

### **2. APPROACH TO VALUE CHAIN**

#### **2.1 South African value chains**

The value chain approach set out in the Discussion Document correctly identifies the complexity of the synthetic fuel value chain and contrasts it to the refining of crude oil.

In South Africa the synthetic fuels industry plays a major role as the main supplier of a variety of basic feedstocks to the petrochemical industry. In fact the synthetic fuels industry has served the chemical industry well, providing growth opportunities to supply the domestic markets and pursue exports opportunities as is reflected in section 4 below.

#### **2.2 Applying windfall methodology on the liquid fuel value chain to identify economic rent streams (9.6.)**

Comment is invited as follows.

*Section 7 has identified the steps in the South African liquid fuels value chain where economic rent has or is being generated and which could qualify for policy recommendations by the Task Team in terms of its TOR. On the basis of this methodology and the tentative application of it to the facts at our disposal, managing anticipated future economic rents might be addressed through -*

- *existing and new fiscal measures and*

- *through the modification of the various regulatory instruments that govern the liquid fuels industry*

In considering the potential policy recommendations that could be made in terms of the Task Team's TOR, it is important to take into account not only the liquid fuel elements of the value chain but also the impact of any further taxation of the value chain on the chemical streams.

### **3. POLICY COHERENCE**

#### **3.1 Relationship between fiscal, minerals, energy, industrial and environmental policies ( 9.2)**

CAIA agrees that the interwoven nature of fiscal, mining, energy, industrial and environmental policies that apply across the liquid fuel value chain present significant challenges to the sector.

If one considers the value chain set out in 2 above, it is clear that the synthetic fuels value chain faces a significant number of regulatory challenges. Examples include the recently released Consumer Protection Bill, which includes duplicate provisions for the management of hazardous substances, including chemicals; the Air Quality Act, under which one of the synthetic fuel sites is included in a scheduled hotspot area, which requires the development of an air quality management framework, and is being supported by the chemical industry. In addition, implementation of the Environmental Impact Assessment regulations are placing increasingly stringent conditions on applicants, which are not related to demonstrated risks. Furthermore, compliance with water resource management requirements are increasingly demanding with the resultant costs.

In this regard the recently released National Treasury Discussion Document on Environmentally related taxes, identifies potential fiscal instruments in water resource management, air quality management and waste management. In addition the recently promulgated revised Regulations on Environmental Impact Assessment make provision for financial instruments.

These policy and legislative developments reflect the reality that South Africa is adopting first world standards related to environmental policies. Chemicals and chemical facilities are globally targeted by environmental lobbyists to draw attention to global environmental concerns like ozone depletion and global warming. The challenge for South Africa is to ensure the achievement of sustainable development goals in a balanced way.

As is clear from the above the liquid fuels and chemical sector already faces significant policy measures, which impact negatively on the cost of doing business. Additional fiscal burdens therefore need to be carefully considered.

*Is there coherence between the policy approach towards proposed environmental taxes and the re-regulation process being applied to the fuels industry? Elaborate on what should be the optimum interlinkage.*

The National Treasury Discussion Document referred to above does not make a specific link between proposed environmental taxes and the re-regulation process being applied to the fuels industry. However, the costs of re-engineering the liquid fuels facilities for the first phase of re-regulation of fuel specifications were significant. It is anticipated that the costs of meeting the next phase of fuel specification will be also significant. In addition the re-regulation of the liquid fuels industry impacts directly on the chemical industry in respect of the more stringent requirements on chemical additives.

*What liquid fuel investments have been made to date to meet environmental requirements and what investments are still to be made?*

A number of government initiatives to improve environmental performance, have recently been introduced or are imminent. All will have significant financial impact on the integrated synthetic fuel/chemical industry value chain and are therefore dealt with here. Some examples are provided below.

- The liquid fuels industry has expended many billions of rand over the last five years in order to comply with the increasing demands of domestic legislation. The re-engineering of refineries alone to allow compliance with the new fuel specifications amounted to more than R 7 billion.
- The liquid fuels and chemical industry concluded an Energy Efficiency Accord with the Minister of Minerals and Energy. Implementation of this accord has commenced in the larger companies in the liquid fuels and chemical sectors and it is anticipated that significant investments will be required to meet the challenging energy efficiency target set by government.
- The anticipated extension in environmental legislation of the requirement for making financial provision for rehabilitation from the mining sector to other sectors, will require significant investment in the chemical sector.
- As increasingly stringent air emission and water quality standards are developed and implemented, still further investment will be required to achieve compliance.

#### **4. DOWNSTREAM BENEFICIATION OF CHEMICAL STREAM**

The chemical sector is one of the sectors identified in ASGISA and the Government Programme of Action as a priority sector. As reflected in the Minister of Trade and Industry's Foreword to the Chemical Sector Development Strategy (CSP), "the success of the priority sectors is critical to our economy and a better life for all."

The challenges faced by the chemical sector in South Africa are encapsulated in the summary of the industry as presented in the CSP. Total chemical production in the SADC region amounted to an estimated 40.4 million metric tons, worth \$15.2 billion in 2000. South Africa is the major producing country, accounting for an estimated 87% of the total SADC output. Chemical production in other Southern African Development Community (SADC) countries is focused upon the downstream

formulation of products such as consumer cleaning products and cosmetics, as well as plastic conversion.

The CSP identifies a number of potential value chains that could be enhanced or developed in pursuit of the overall national goals for priority sectors of employment creation and alleviation of poverty through economic growth. This submission is confined to the synthetic fuels value chain and in particular petrochemical feedstocks.

One of the objectives of the CSP is to grow the less capital intensive downstream sector of the industry.

One value chain that has been identified in the CSP is the potential beneficiation of polypropylene feedstock, currently destined primarily for exports in un-beneficiated form. Polypropylene is one of the main inputs into manufactured plastic products, which are largely composed of small firms. Plastics conversion is relatively labour-intensive (closely following after sectors such as footwear, clothing and wood products), and about 70 percent of its labour force is semi- and unskilled. Plastic products are a fast growing sub-sector as plastics continue to replace other materials such as metals.

In addition to the adoption of the CSP, Government, Industry and Labour have concluded a chemical sector agreement, which commits all stakeholders to working together towards an agreed set of goals.

CAIA notes the reference in the Discussion Document to the role that Sasol could play in promoting downstream job creation by increased domestic beneficiation of polypropylene.

Polypropylene beneficiation, which is being alluded in the Discussion Document, has been identified as a priority in the business plan for implementation of the CSP and CAIA, with the active participation of the role-players in the sector, including Sasol, has started to engage with government on ways to grow this value chain.

## **5. CONCLUDING REMARKS**

CAIA remains committed to working with government and other stakeholders in implementing the chemical sector development strategy and the chemical sector agreement and believes that one of the key success factors in growing the industry is the maintenance of an investor friendly environment, which provides certainty to prospective investors. This applies particularly to the industry that is the major feedstock supplier to chemical industry, hence CAIA's support for the BUSA submission.

The continuing fragmentation of environmental policy and legislation and the tenuous link that exists between these policies and industrial policy in general remains cause for concern.

The chemical industry shares the cyclical nature of the liquid fuels industry and as such will at times make, indeed needs to make, super-normal profits, which compensate for the low profits earned in the trough of the cycle when capital is not

adequately rewarded. From this perspective, CAIA would not support any policy interventions which, in addition to the matters raised in the BUSA submission, don't seem to recognise this characteristic and hence could put the growth of feedstocks at risk.