



BRIEFING NOTE:

Carbon Tax Policy

**POLICY AND REGULATORY
STANDING COMMITTEE**



Executive Summary

South Africa's carbon tax is entering **Phase Two (2026–2030)**, with reforms intended to strengthen its effectiveness while preserving industrial and trade competitiveness. However, the current effective carbon price remains low compared to international benchmarks, exposing the country to risks under the EU's Carbon Border Adjustment Mechanism (CBAM). A comprehensive review should extend beyond the tax itself to include **carbon pricing frameworks, carbon budget legislation, and carbon credit markets**.

South Africa's national policy on should be firmly rooted in advancing a pragmatic, low-carbon industrial agenda that acknowledges the country's unique development needs alongside the imperatives of a global industrial transformation. The government is committed to robust action on climate change, recognising that genuine carbon mitigation—particularly within hard-to-abate sectors—must be realised through a structured transition to cleaner production methods and the progressive introduction of new, lower-carbon products, paced to match market demand and technological capability.

This transition demands significant capital and will unfold over an extended period, making it essential that policy frameworks are stable and supportive—encouraging investment rather than penalising the existing production base that underpins future investments. South Africa does not regard energy security and the shift towards lower carbon intensity as competing aims; rather, they are mutually reinforcing. A robust and secure energy system is the cornerstone of sustained emissions reduction, industrial competitiveness and economic stability. National policy should therefore focus on striking a balance between climate ambition, energy security, affordability and industrial resilience, empowering industry to finance and deliver the transition at a pace that aligns with both market realities and societal expectations.

The EC P&R SC has an opportunity to review and consolidate these fragmented policies into a coherent approach that incentivises decarbonisation while safeguarding trade competitiveness, energy security, the scaling conditions for economic growth and socio-economic resilience more broadly. A key recommendation is to explore **recycling credits/ mechanisms**, allowing energy transition investments to be deductible from carbon tax liabilities improving policy efficiency, accelerating emissions reduction, and mitigating competitiveness risks without weakening price signals.

1 Introduction

South Africa's carbon tax, introduced in 2019, was designed to reduce emissions and support a just energy transition. Phase Two reforms envisage a gradual tightening of allowances, expand offsets, and an increase in effective tax rates over time. At the same time, CBAM implementation by the EU from 2026 places pressure and opportunity for South Africa to align its carbon tax framework with international standards while directly supporting domestic transition investment. Hard to abate sectors that are heavily dependent on fossil fuel inputs, as well as all industries dependent on electrons from a public grid which are ~85% coal-generated over a given 24-hour cycle, are impacted by South Africa's ambitious carbon pricing regime and need policy support to invest in their own transition.

2 Objectives for EC P&R SC Review of Carbon Tax Policy

- 2.1 **Carbon pricing integration:** Review coherence between carbon tax, carbon budgets, and carbon credit markets with a view to improving policy effectiveness and certainty.
- 2.2 **Industrial resilience and transition enabling:** Assess how to best provide policy support for hard to abate sectors in particular to invest in their own transition, particularly where doing so drives expanded investment into system-wide energy resilience.
- 2.3 **Export Competitiveness:** Assess exposure to CBAM and propose alignment strategies that protect South African exports while reinforcing climate ambition.
- 2.4 **Fiscal design:** Evaluate recycling credits to channel tax liabilities into transition investments.

- 2.5 **Implementation capacity:** Ensure Treasury and SARS readiness for expanded scope.
- 2.6 **Sectoral impacts:** Review implications for electricity supply, mining, fuels, and broader industrial base.
- 2.7 **Stakeholder engagement:** Balance industry concerns with climate commitments.

3 Problem statement/Opportunity

- **Problem:** Fragmentation between carbon tax, carbon budgets, and carbon credit markets creates policy uncertainty. While the IMF has argued in its much cited 2020 report that current effective carbon prices remain too low to drive meaningful decarbonisation or protect trade competitiveness, the same report emphasises that escalating carbon pricing without meaningful transition pathways (supported by integrated government policy) will not drive growth-enabling transition (and a transition which is growth destructive will not attract and sustain broad-based democratic support).
- **Opportunity:**
 - Consolidate carbon pricing instruments into a coherent framework.
 - Align domestic carbon pricing with international benchmarks to mitigate CBAM risks.
 - Introduce recycling credits to channel carbon tax liabilities into energy transition investments.
 - Strengthen the role of carbon markets to incentivise private sector participation.
 - Orient the carbon tax regime to incentivise and enable investment into South Africa's low carbon industrial transition

4 Proposed approach/Implementation considerations

- **Phase Two reforms:** review structure of allowances (including a potential specific allowance for hard to abate sectors), expand offsets in synch with carbon market development, and gradually raise effective tax rates.
- **Carbon pricing integration:** Align carbon tax with carbon budget legislation and carbon credit markets.
- **Recycling credits:** Allow investments in renewable energy, efficiency, and transition projects to offset carbon tax liabilities.
- **Sectoral focus:** Review impacts across electricity supply, mining, fuels, and broader industrial base represented in the Energy Council.
- **Implementation considerations:**
 - Predictable tax trajectory to guide investment.
 - Flexibility of recycling credit structure to allow for investment at multiple phases of technology maturity over multiple years, particularly for hard to abate sectors
 - Strengthened monitoring, reporting, and verification (MRV) systems for compliance.
 - Clear rules for offsets and credits to ensure environmental integrity.

5 Implications

- **Financial:** Potential increase in revenue, but concurrent risk of reduced competitiveness for carbon-intensive exports / exposure to carbon leakage unless recycling credits are introduced.
- **Legal/Regulatory:** Need for clarity on integration of carbon tax, carbon budgets, and carbon markets.
- **Operational:** Treasury and SARS capacity to administer expanded scope.
- **International:** Exposure to CBAM penalties if carbon pricing remains weak.

6 Risks and Mitigation

- **Risk 1:** Policy fragmentation undermines effectiveness.
 - *Mitigation:* Align carbon tax, carbon budgets, and carbon markets under a unified framework which engages pragmatically with transition investment requirements

- **Risk 2:** CBAM penalties on exports.
 - *Mitigation:* review amendments to carbon pricing regime to minimise tax impact at border (such as through recycling credits that still allow the carbon taxation to vest) and negotiate transitional arrangements with EU, particularly for hard to abate sectors (in alignment with South Africa's nationally determined contribution/ NDC approach)
- **Risk 3:** Weak offset integrity.
 - *Mitigation:* Tighten rules and ensure science-led standards are used to secure credibility of offset markets
- **Risk 4:** Political resistance from carbon-intensive industries.
 - *Mitigation:* Introduce recycling credits and position allowance structures for hard to abate sectors to balance competitiveness with climate goals.

7 Conclusion

Phase Two of South Africa's carbon tax is a pivotal moment for aligning domestic climate policy with international trade realities. The EC P&R SC should review gaps in policy clarity, fiscal design, and international competitiveness, while consolidating carbon tax, carbon budgets, and carbon markets into a coherent framework. Recycling credits, as part of a specific transitional allowance structure for hard to abate sectors can provide a practical mechanism to link carbon tax liabilities with energy transition investments.