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THE AFRICAN CLIMATE FOUNDATION

THOUGHT LEADERSHIP

Mobilising financing at scale for South Africa's just transition

October 2023

In the next three decades, South Africa must mobilise significant financing for the transition to a low-carbon economy in line with its self-defined pledge under the Paris Agreement whilst managing a complex parallel socio-economic transition - all in the context of the country's underlying challenges. Our research on unlocking finance at scale finds that this is unlikely to occur unless there are wholesale reforms to the way capital allocators work (in particular regarding leaning into the concept of a transition and a more holistic view than ESG and exclusion lists) and where partnerships to blend and derisk are crucial and need to be of a scale of magnitude higher than currently the case. Better project preparation and platforms to link the demand and supply of capital are required. The way public finance works in this complex transition also needs to change to provide more targeted support. Our three reports make a range of recommendations, which we summarise in this short report.

Financial needs and scale of South Africa's just transition

6-7GW of new energy capacity required each year

R8.5tn in funding required for JET (World Bank, 2022)

230 000 jobs affected (mainly in Mpumalanga)

30-year timeline

Significant **reskilling** required

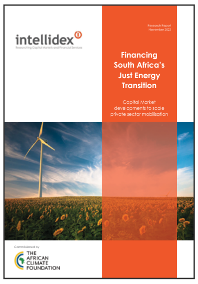
Substantial **asset repurposing** required

Requires an **inclusive** (gender, ethnicity and youth) transition

A three-part series on financing the country's just transition

In early 2022, Krutham (formerly Intellidex) identified a thought leadership gap, particularly on how South Africa would finance the just energy transition (JET). At that time, many agreed on "what" JET is, largely due to the efforts of the African Climate Foundation (ACF) and the Presidential Climate Commission. However, there was limited understanding of the "when" (aligned to Paris until 2050) and "how" South Africa would undertake this mammoth task.

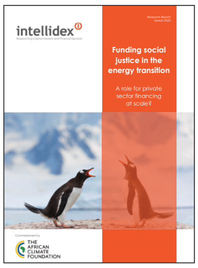
This led to the ACF commissioning Krutham to develop a three-part series on financing the JET in South Africa. The research has played a critical role in articulating the barriers to achieving a just transition and exploring potential solutions to overcoming these barriers. We provide a summary of these barriers and solutions below.



Paper 1

Financing South Africa's just energy transition: Capital market developments to scale private sector mobilisation.

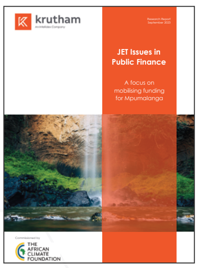
Read



Paper 2

Funding social justice in the energy transition: A role for private sector financing at scale?

Read



Paper 3

JET issues in public finance: A focus on mobilising funding for Mpumalanga.

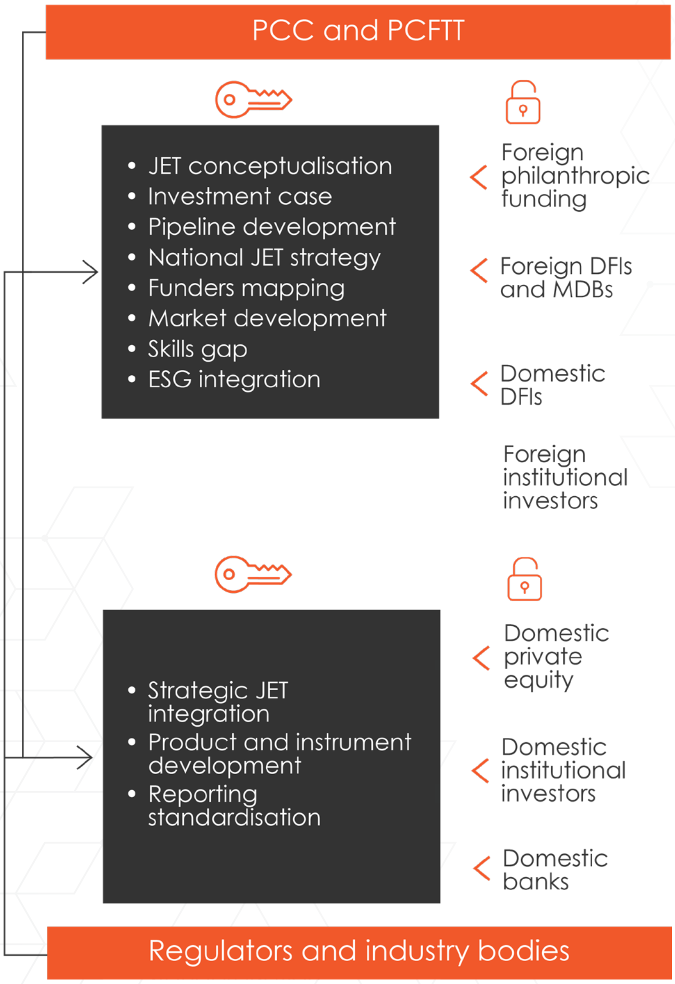
Read

Paper 1

Financing South Africa's just energy transition: Capital market developments to scale private sector mobilisation

South Africa needs to unlock an enormous amount of financing – with estimates ranging from R4tn to R8.5tn in the next three decades – from various sources of capital, both domestic and foreign, to fund its just energy transition. The highly complex process will require concerted efforts from all stakeholders in the financial ecosystem to maximise the probability for South Africa to transition to a net zero economy successfully.

The first paper identified a deluge of blockages that are currently preventing South Africa from mobilising funding at scale for the just transition. These barriers are summarised in the graphic below, as well as highlighting the stakeholders that are directly linked to these barriers.



UNBLOCKING THE BARRIERS

Our recommendations for unblocking these barriers include the following, and they are applicable in varying degrees for governments, DFIs, MDBs, regulators, institutional investors, banks, asset managers, private equity investors and philanthropies:

01
Build conceptual consensus on JET financing.

02
Develop the investment case for JET financing through targeted engagement with the various stakeholders that form part of the JET funding ecosystem.

03
Develop a pipeline of bankable projects.

04
Design a national JET strategy, including creating implementation capacity and market infrastructure to connect funders to projects.

05
Support strategic JET integration (into core business strategies, development funding mandates etc).

06
Map various funders in the ecosystem to specific activities that need funding.

07
Design investment instruments that can unlock financing at scale, ie product development.

08
Support bank financing capacity (market development).

09
Build capital market infrastructure.

10
Identify and map the skills gap to develop targeted skills development interventions.

11
Support advocacy related to rethinking existing ESG integration practices.

12
Develop reporting standardisation.

Funding social justice in the energy transition: A role for private sector financing at scale?

The transition to a new, low-carbon energy system is not just a technical exercise in establishing which technologies can best suit our needs for electrification at the lowest financial and carbon emissions cost. The changing structure of the energy system will affect patterns of employment and ownership – not only within the energy sector. This far-reaching systemic change will have distributional consequences: there are clear potential winners and many potential losers. The energy transition, therefore, requires a political process of negotiating this distribution of losses and gains in a fair way. Failure to do so will lead to an intensification of already unsustainable levels of unemployment and poverty. These broad social risks and how they can be alleviated are the foundation of the second report. The report focuses more narrowly on the broader set of issues around private sector capital mobilisation across the whole transition that our first report highlighted. This is done in the context of two types of transition activities that will require funding, including (1) ***Transitioning out*** measures to ensure workers and their communities are not left behind in the transition away from coal and (2) ***Transitioning in*** activities, which include (a) planning for and facilitating social justice in the new energy economy and (b) climate mitigation and adaptation measures. For more detail on the transitioning out and in activities, refer to this article: Framing the concept of transitioning in and transition out.

While it is difficult to pinpoint exactly how much these activities will cost, the bottom line is that an enormous amount of money is needed for the just transition. The central question of the report is: Can the private sector play a meaningful role in financing the just component of the transition?

We identify several opportunities that exist to help mobilise the scale of funding needed for the just transition, including the major barriers to overcome for each. The key opportunity areas are outlined below.

ESG investing

The easiest starting point for enabling investors and funders to plan for JET issues is to incorporate JET dimensions into existing ESG strategies. We recommend the adoption of the Impact Investing Institute's Just Transition Framework to structure new investments and report on their effects (Spengler et al., 2021). The framework addresses both environmental and social dimensions of the transition.

Community trusts

Community trusts established in the REIPPPP show promise as holders of community assets and in disbursing funds to various welfare projects. However, they should be free to engage as financial participants actively, diversifying their incomes and expanding their assets, aiming to foster local economic and social development in the typically small towns where they are located.

Place-based impact investing

These are investments aimed at yielding appropriate risk-adjusted financial returns and positive local impact while also addressing the needs of specific places to enhance local economic resilience, prosperity and sustainable development. The aim is to address structural constraints to economic growth and regional development, mainly access to finance, to reverse the long-term decline of, in particular, small towns that once hosted significant industries (Impact Investing Institute et al., 2021).

Market-based products for renewable energy

The market for financial products to finance renewable energy projects is small. Still, the rapid expected growth of solar represents an opportunity for financial institutions to develop smarter products and products for the mass market specifically. The bulk of the population currently needs to be conceived of as a target market for solar energy, and this is a large missed opportunity for banks and the mass rollout of cheaper, cleaner solar energy.

JET funds

The establishment of private debt and/or private equity funds for JET-promoting businesses can help to get funds to flow into economic activity that maximises green and social outcomes. These could be capitalised using blended structures.

Market-based products for renewable energy

There are potentially millions of adults that need to receive effective labour market programming – such as skills training for green economy opportunities and matching/intermediation services. Structuring these programs on an outcomes basis has a track record in promoting youth employability in South Africa and could be expanded to the green economy.

Transition bonds

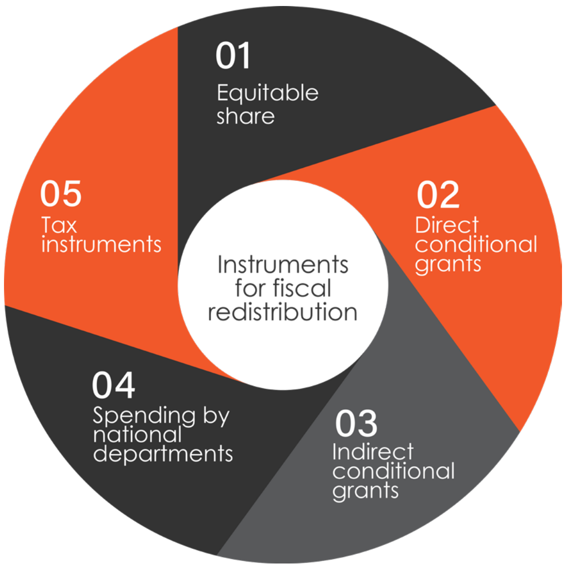
These instruments can be used to support hard-to-abate sectors to transition from carbon-intensive to net zero over the next three decades. It allows organisations to continue accessing funding despite performing poorly on climate metrics, granted that an issuer has strategically embedded a pathway to net zero.

Much of what is recommended has never been done before in the South African context or, if so, only on a very small scale. Globally it is often new or not scaled. It will require bold leadership, innovation and experimentation from asset owners and managers, investors and, ultimately, shareholders that are committed to promoting and securing social justice in a world marked by accelerating climate and social instability.

Paper 3

JET issues in public finance: A focus on mobilising funding for Mpumalanga

The third paper in our series focuses on the role of subnational government in the transition – for solving location-based problems, just and social project financing problems and generally in terms of delivery of complex programs. Subnational government's role – by which we mean provinces and municipalities in an appropriate solution set within the transition from a financing angle – has in general been seldom recognised and poorly understood, in particular when it comes to achieving scale. Indeed, we think this paper is one of the first to look at it in much detail, taking forward the issues raised in our first two papers, as well as the broader context arising from our scene setting that we lay out at the start of this paper. We focus on the policy instruments and funding mechanisms that might be available to government to facilitate local, often smaller, projects. We highlight that the appropriate choice of policy instrument will depend on the specific opportunities or adjustments that are to be supported. The accompanying diagram outlines the various instruments that are available for fiscal redistribution.



Our central recommendation is that institution-strengthening in Mpumalanga's municipalities and in key provincial departments is the key to a resilient and sustainable just economic transition and to enabling financing at scale. There are severe dysfunctionalities in sub-national government at present which militate against the kinds of blended finance and co-operative partnerships that are needed to mobilise private investment and the support of DFIs and philanthropies alongside public sector resources on a sufficient scale.

Other recommendations from the paper include:

1. Ringfence funds for the JET
The PCC should advocate for National Treasury (NT) to ringfence the revenue from environmental taxes, particularly the electricity levy, to support the just transition. To achieve an equitable distribution of this revenue, a formula-based approach is proposed that considers the differential impact of the energy transition on different parts of the country. This would be consistent with the constitutional imperative for equitable distribution of revenue.

2. Restore municipalities' creditworthiness
The PCC, with support from the NT and the AGSA, should undertake a detailed study on municipalities to establish what support is required to improve their financial position and incorporate JET into their long-term financial planning process.

3. Support leadership from affected provinces
The Mpumalanga government, with support from the Mpumalanga Green Cluster Agency, should work with municipalities to develop coherent just transition strategies.

4. Develop a coherent decommissioning schedule
Eskom, in conjunction with the PCC and NT, should develop a detailed schedule with a clear strategy outlining how the timelines will be adhered to.

5. Support blended finance solutions
The PCC can support this process by acting as a facilitator between the government, philanthropies and banks.

6. Quantify the funding requirements and map available transition funding
The PCC, with support from philanthropies, needs to do additional research on the funding demand and supply for the just transition.

7. Enhance accessibility of mechanisms used to channel JET funding
The PCC, with support from NT, should ensure that any mechanisms developed to channel funding are fit for purpose.

8. Support proactive engagement by labour
Labour, with support from the PCC and philanthropies, should take a more proactive role in crafting JET solutions.

This paper ultimately is only the start of thinking about these issues and there will be much more to write on in the future.

Achieving a just transition will likely be the largest challenge for South Africa and other emerging market economies in the coming decades. It is a highly complex process which requires a multidisciplinary approach and innovative thinking to unlock solutions that will best serve both people and the planet. The intention of these reports is not to attempt to provide a silver bullet for financing the just transition (as this simply does not exist). Instead, the reports take the theoretical concept of financing the transition from an abstract and untenable objective to something more tangible and unambiguous, allowing for proactive stakeholder engagement.

Krutham welcomes feedback and engagement on the reports to support the evolution of the just energy transition from an abstract concept to a practical investment strategy. Please engage with our team on any topics of interest to your organisation.

About Krutham (previously Intellidex)

Krutham has worked extensively on just energy transition (JET) with clients in banking, asset management, development institutions, philanthropy and policymaking. Some of our projects include work with the Impacting Investing Institute, the Africa Climate Foundation, the Presidential Climate Commission and the World Bank.

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