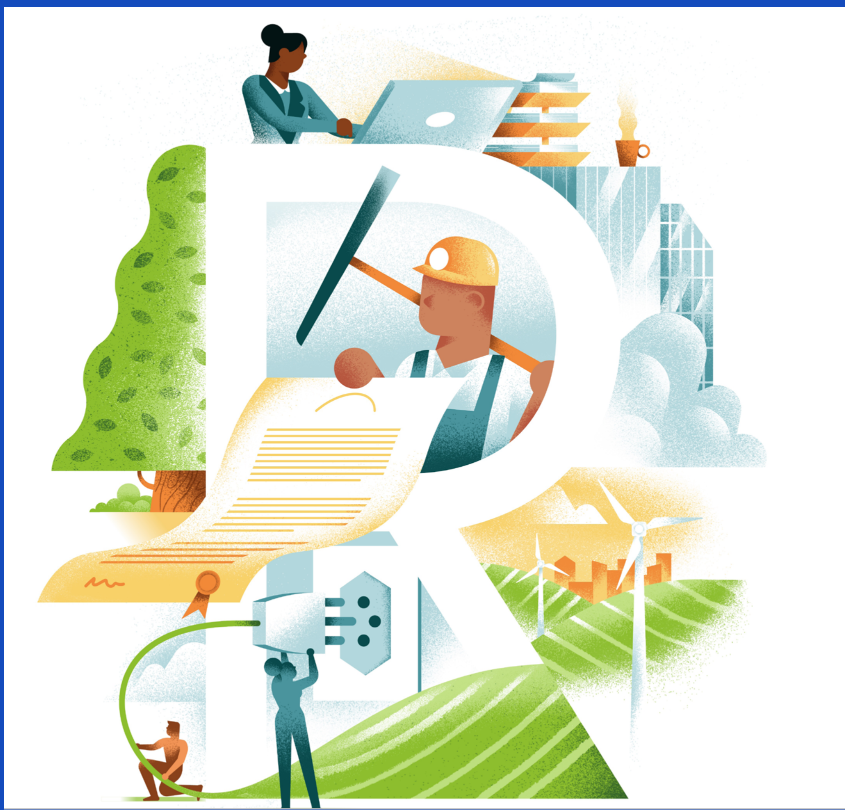
Just transition transaction in SA



An innovative way to finance accelerated phase out of coal and fund the transition for communities

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The concept in brief

A just transition shifts from historically high-emisions and exclusive development to low-emissions and inclusive development. A just transition in South Africa's electricity sector from coal to cleaner energy is critical for climate change mitigation. And to be just, the transition must leave no-one behind. A just transition transaction as a mechanism, mobilises blended finance to fund 1) the accelerated phase out of coal, thereby accelerating a transition from coal to renewable energy and 2) protection of livelihoods of those communities and workers affected.

1 What problems does a JTT seek to address?

Climate emergency meets social justice

The climate emergency means that a radical transition is required in the electricity sector globally - from fossil fuels to lower-emissions energy. In South Africa, a shift away from coal-fired electricity is a key part. To be just, the transition must protect the livelihoods of communities and workers dependent on coal.

Renewable energy is paying for itself now …

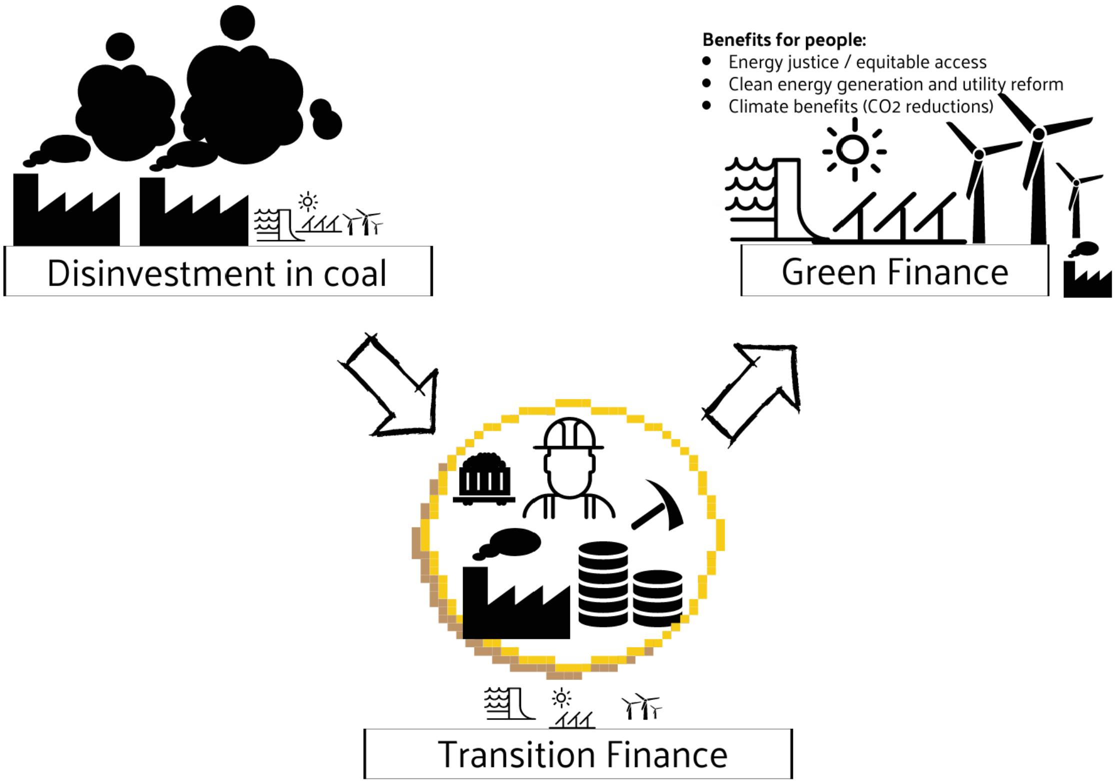
The good news is that renewable energy technologies have become cheaper than new coal. Wind and solar photovoltaics are now least-cost options in SA. So, they no longer need public climate finance, as they are commercially viable. What is not being financed is the transition away from coal.

…and the transition itself needs financing…

Disinvestment pressure reduces finance for fossil fuel infrastructure, including high-emission electricity generation, while green finance flows into green infrastructure, such as renewable energy and other cleaner energy technologies. Figure 1 shows the decline by disinvestment in coal and rise of green finance. We are in the period in between: that is when transition finance is required. Financing the transition is particularly important in a developing country like SA, with pressing developmental needs. SA requires transition finance to implement the transition and at the same time make provision for societal justice.

FIGURE 1

Transition finance

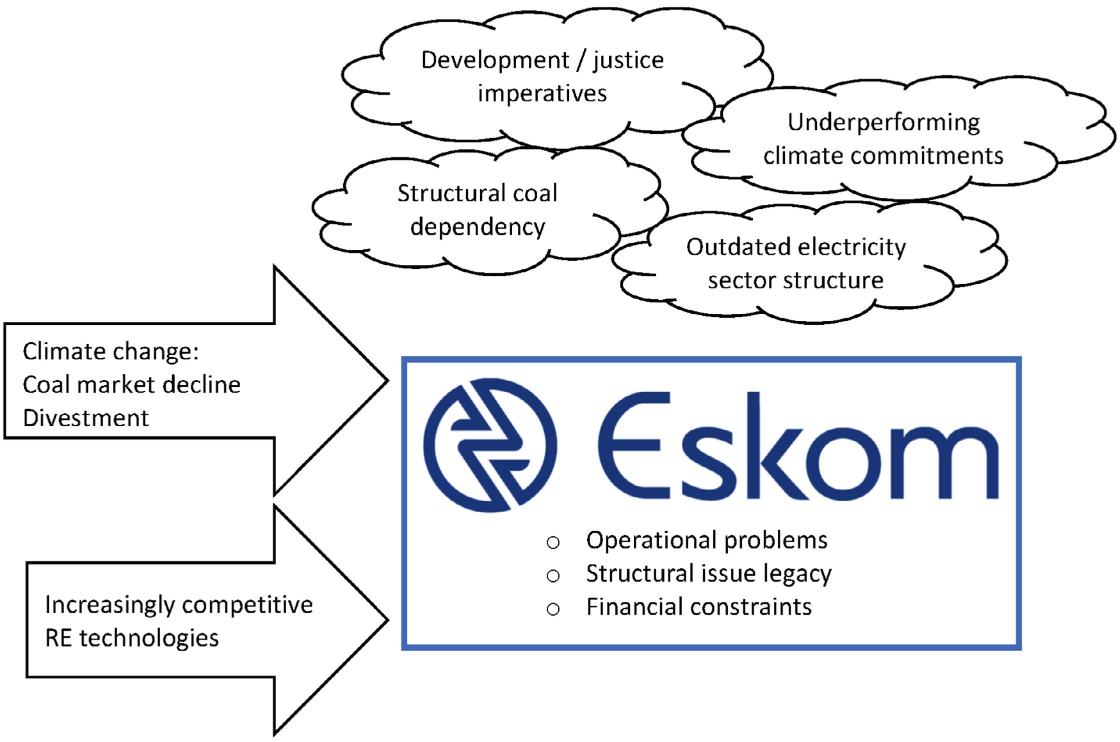


.. but SA needs overcome complex problems faced by its electricity utility, Eskom

The JTT addresses some of many structural challenges facing Eskom, SA's parastatal electricity company. Eskom has had a monopoly on electricity supply since the early 20th century, still supplies over 90%, controls transmission and more than half of distribution. It is the source of approximately 41% of the country's gross emissions in 2015. But Eskom faces operational, structural and financial problems, which have become worse in recent years and that constrain investment in the energy transition. These problems are considerable. The oldest power plants in the coal fleet have already had their lifetimes extended and these plants are inefficient and emissions intensive. Wastage of funds in Eskom through inefficiency and outright corruption during the state capture years, during which state tenders were awarded in exchange for personal gain, has made this worse. Conventional solutions are unavailable; increasing electricity tariffs further is politically challenging. And Treasury has no funds for further bail-outs. The previous monopoly supplier is now facing competition from independent power producers. Yet it also controls the grid – and fair competition requires unbundling, but the structure of the electricity sector is outdated. There is more to these complex problems, as shown in Figure 2 and explained in our case study. This means that innovative solutions are needed. And the multiple crises have focused attention on Eskom and finding a way forward.

FIGURE 2

The electricity parastatal is under pressure from, and constrained by a set of complex problems



2 The R488 billion problem of Eskom debt

The biggest and salient problem is that Eskom has debt of R488 billion and counting. The extent of this portfolio is due to many factors, including budget overruns at Medupi and Kusile, the two coal plants with 4800 MW each that Eskom built in the last decade, irregular tender activity in coal supply contracts, and non-cost-reflective tariffs. Most of the debt is in the generation division. The overall debt portfolio requires regular 'rolling over', as loans mature. Therefore, there is an ongoing need to re-finance the utility by accessing the capital markets. Eskom is unable to service all of this debt: a portion is therefore stranded, and this has been referred to as 'legacy debt'. It has been suggested that the stranded debt portion is in the region of R200 billion.

Eskom's debt poses a risk to the entire country's finances in two ways, 1) directly because sovereign guarantees on part of Eskom's legacy debt strain the fiscal framework, and have contributed to the country's rating being downgraded; and 2) indirectly, through threatening the utility's ability to provide constant electricity supply and revenue-generating activity. In a severe financial crisis, Eskom struggles to raise further debt. That is even more true in the context of global coal disinvestment.

The Just Transition Transaction and two parts of "Eskom debt"

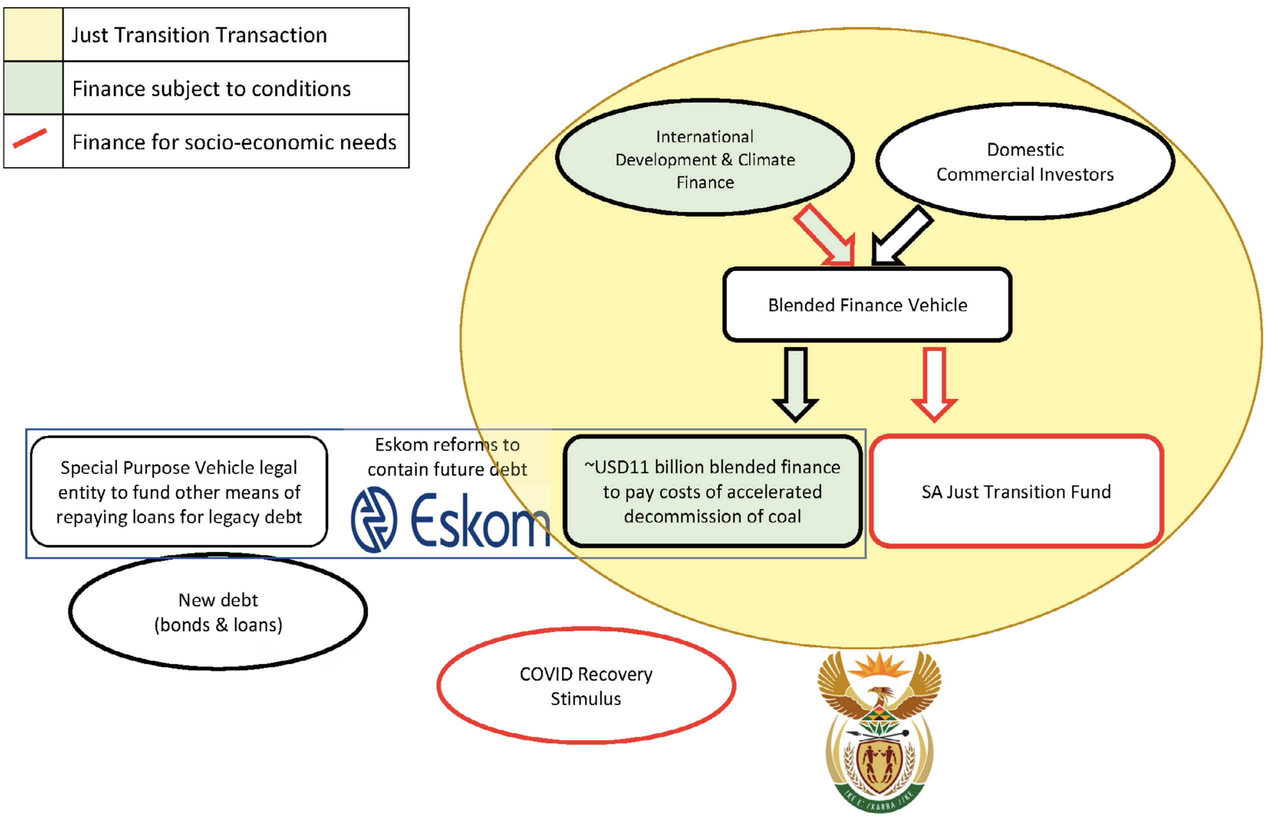
Our case study focuses on just two sets of Eskom's costs that need to be funded.

A. Additional costs of decommissioning coal
B. Fund other means of repaying loans for legacy debt

In reality, there are more, and in this case study we assume that operating costs are recovered in conventional financing arrangements, through tariffs and new (sustainable) debt, while the Transition Finance is secured within the JTT, as illustrated in Figure 3.

FIGURE 3

Transition finance: funding accelerated phase out of coal and socio-economic needs, and not directly legacy debt



What part does the JTT fund ? and what does it influence?

The JTT is to fund the additional costs of decommissioning coal and a just transition. In other words, the JTT directly supports part of Eskom debt (part A, above), but only indirectly makes a difference to the costs to 'fund other means of repaying loans for legacy debt' (part B, above).

While funds would be provided to Eskom to use, it would have to meet conditions. These conditions include measures that support innovative solutions to some problems for Eskom, including unbundling its operations and a financial turnaround for Eskom, as well as an accelerated phase-down of coal power carbon emissions. The last point means mitigation, and attracts international climate finance. In Figure 3, conditional finance is shown with green shading.

The JTT would not focus on providing funding to repay loans associated with 'legacy debt'. But by funding the accelerated decommissioning, the JTT enables Eskom to access capital markets again, albeit indirectly via a blended finance vehicle.

3 What is 'JTT'? A just transition transaction

$11 billion of blended finance – let's dig into that

The indication is that the blended finance vehicle (BFV), shown in Figure 3, would provide "a long-term (~20yr) debt facility of approximately $11 billion to refinance the national utility Eskom, conditional on additional mitigation and social action, with credible remedies" (Meridian Economics 2020).

The JT Fund: significant funding for development drawing on value created by concessional finance

The JTT would also create a source of funding for regional or community development projects through the Just Transition Fund. That is an important sense in which this is a just transition transaction – ensuring energy and social justice for the most vulnerable. By creating value using the share of the concessional finance, the Fund has significant income – to be spent on the transition of communities and workers.

The JTT creates funding for development by putting the ICF concessional loan and commercial funder loan finance into the Blended Finance Vehicle (BFV). The BFV then lends to Eskom at a rate of interest that is lower than market rates and slightly higher than the combined rate of interest that the BFV pays on the ICF and commercial funder finance. This means that the BFV will earn more interest from Eskom than it will in turn pay to the ICF and commercial funders. The difference earned by the BFV accrues within the BFV. This accrued value is then paid to the Just Transition Fund on an annual basis.

Blended finance

The JTT is premised on the principle that the international development and climate finance community will make funding available in return for demonstrating accelerated reductions in carbon emissions to 2050.

More specifically, the transaction would seek to secure both grant and concessionary (subsidised) loan facilities to SA from development finance institutions (DFIs). The finance is blended in two dimensions – combining domestic and international sources, as well as commercial and concessionary loans.

Faster phase out of coal – compared to what?

The key word is 'transition', meaning an accelerated phase-out of coal. What does 'accelerated' mean – faster than what? In our case study, accelerated phase out means faster than in the baseline for GHG emissions in the electricity sector, assumed to be commission of coal in the integrated resource plan (IRP).

Who are key actors in the JTT?

Key actors include commercial and concessionary funders, National Treasury and Eskom. Creating an enabling policy environment makes the National Energy Regulator of SA another important actor, together with two national departments in charge of Eskom, Minerals & Energy and Public Enterprises. A Presidential Climate Coordinating Committee has been agreed in principle by government, business and labour, and will oversee the just transition.

4 What the JTT does and does not achieve

Eskom financeable again … though not paying for legacy debt

The JTT can sustain Eskom through the transition, in order to 'keep the lights on'. While the future of the grid may be much more decentralised in SA and globally, no South African wants load-shedding (repeated episodes of temporary power shutdowns) for the years until we get there. While hot debates about the role of Eskom continue, it is the provider of the last resort. The JTT does contribute to Eskom's financial sustainability by committing Eskom to a more viable business model (keeping it solvent as it decarbonises) and restoring its access to funding and thereby contributing to de-risking Eskom

Not addressing all challenges of SA electricity or all of mitigation

A word of caution. While we think the JTT is the bee's knees, it does not solve all problems. The JTT cannot on its own deliver solutions to all the challenges in SA's electricity sector, or even repay all Eskom debt. Nor will a single transaction – large as it is - deliver all the mitigation effort that SA should be making to make a fair contribution to limit temperature increase to "well below 2 °C" and pursuing efforts for 1.5° C. The JTT can make a significant contribution to address the complex set of challenges, creating possibilities of change.

5 Significance of the deal for decision makers in the area of ICF

A different dimension of 'climate finance'

The traditional focus of climate finance has been on green finance or disinvestment. The JTT shifts this focus to funding the phase out of coal. We argue that the JTT plays a catalytic role, financing less coal and thereby creating space for green technologies. In summary, the just transition transaction changes the meaning of (international) climate finance to include an important and neglected category, transition finance.

This is a 'big deal' – large and innovative

The JTT creates a highly innovative use of ICF to address socio-political and economic barriers to achieving climate and development objectives. It funds a transition process.

A way of implementing Paris

The JTT proposal is particularly significant for international climate finance due to the sheer scale of the proposed deal - $11 billion as the total finance contributed by ICF and commercial funders. It is innovative in the focus of climate finance.

Just transition transactions, we propose, are a way of implementing Article 2.1 (c) of the Paris Agreement. The JTT makes financial flows for investment in electricity infrastructure consistent with a pathway towards low greenhouse gas emissions in SA's electricity sector. That contributes to mitigation. And if much more transition finance flowed in this way, there would be more global mitigation, reducing the need for adaptation.

JT Fund is a concrete example of funding socio-economic transition

The JTT is a significant source of funding for a just transition. The JT Fund in this case study of South Africa is a concrete example of funding the socio-economic transition costs. This also should make clear that finance is necessary, but needs to work with other enablers – policy, institutional, cultural drivers of change.

An idea whose time has come post-COVID: more JTTs across the world?

In the post-COVID economy, a new role for international climate finance through just transition transactions is more relevant than ever. While much about the post-COVID world is highly uncertain, what is clear that all countries are taking on more debt. Countries that have no fiscal space will require debt relief or forgiveness. Since the just transition transaction can assist with financial sustainability, we argue that such transactions will become highlv relevant in the post-COVID world.

6 What is to be done?

Decision-makers in SA should fully support the just transition transaction. President Ramaphosa endorsed the JTT at the 2019 UNSG summit. Leaders across government, labour, civil society, business and Eskom – including its new CEO – should work together to realise a JTT.

The international climate finance community should mobilise at least $ 4billion of concessional finance for the JTT. Work on the JTT in SA is advanced, and can be implemented. DFIs should include transition finance in their mandates and portfolios. Other countries should consider the JTT, and how it might be adapted to their context.

Further Reading

Winkler, H, Keen, S & Marquard, A 2020 .Climate finance to transform energy infrastructure as part of a just transition in South Africa. Case study for IKI-SNAPFI. University of Cape Town, www.diw.de/snapfi/en/ and https://doi.org/10.25375/uct.12871883.v1

Meridian Economics 2020. The role of transition finance for climate mitigation: A just climate transaction for South Africa. Cape Town. http://tiny.cc/rl0lnz

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About this policy brief

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