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Financing the Just Transition puts a spotlight on financial institutions

The governance and the way in which financial institutions currently operate will need to change in the face of rising pressure for the financial sector to ensure the transition away from fossil fuels is a just transition. These changes require both new and more innovative financial instruments, and approaches by the finance sector to supporting just transition projects and investments.

At the same time, ensuring a just transition will not only require investment in projects as well various financial mechanisms to finance such a transition but skilled resources who have the capabilities to assist in identifying, developing, implementing and scaling up projects to ensure those displaced by an attempt to decarbonise the South African economy and impacted by climate change will have alternative likelihood opportunities.

Ensuring upscalable projects coupled with the need for a systems change within the financial sector formed a central part of discussions on Thursday during a Trade and Industrial Policies Strategies (TIPS) dialogue on “the just transition insights into the finance roadmap”. The dialogue sought to outline the current thinking around a potential financial roadmap which will be finalized by January 2022 as well as some of the research which has been undertaken to inform the roadmap document including insights on scale and replicability of projects; financial instruments; social indicators, and corporate awareness, outreach and communication.

TIPS began a process earlier this year to develop a financial roadmap for the just transition to assist in accelerating stakeholder, industry and investor action to ensure the shift from fossil fuels to a more sustainable global economy safeguards the livelihoods of those communities and businesses affected by such a shift – so in effect the roadmap seeks to make explicit the link between actions in the financial system and the realisation of broader national goals of sustainability and socio-economic development.

In setting the scene for this conversation, Rudi Dicks from the Presidency provided some insight into the discussions which are unfolding around the political declaration of $8,5bn by the international partner group which emerged out of the recent COP26. He explained that at this stage, this remained a pledge and the details still needed to be finalized in terms of how the financial pledge will be structured. Dicks pointed out that South Africa had set an ambitious integrated resource plan and critical to that was financing the just transition which was tricky.

Picking up on his comments, TIPS director Saul Levin pointed out that the work TIPS was doing around the financial roadmap was still being finalized and “there are a lot of moving parts” and in relation to issues highlighted by Dicks in terms of the international partner group wanting to engage with Eskom, there were issues not only in relation to the financing of Eskom but how to get these funds to finance new businesses, transitioning business, and how support those displaced by closing of mines and the like.

Sandy Lowitt, a TIPS research fellow who is leading the project on the financial roadmap explained that this process was about unlocking increased flows of financing into projects. The intention, she indicated, was to develop a long term systemic plan (vision 2050) to enhance the ability of the financial eco system to mainstream environmental, social and governance factors and ensure the just transition goals are incorporated into decision making and capital allocation. She stressed that an additional aim of the roadmap would be to mobilise off shore public sector funding and private local capital for such investment. As part of this, TIPS has taken a decision to set up an Observatory which will research, monitor, track and disseminate ongoing developments around the financing of the just transition both locally and overseas. This facility would explore what financial products and instruments are available as well as seek to match institutions and programmes of work. As Levin points out, the intention of the Observatory is to “keep pushing the boundaries of what needs to change.”

In line with that theme, a number of the presenters stressed that the financial system would need to change in light of the just transition. In elaborating upon the findings of her research which focused on ‘Just Transition Project Needs and Finance Response’, Chantal Naidoo from Rabia Transitions pointed out that “projects are the primary channel where finance is exchanged in pursuit of the just transition vision.” She added that the “distinguishing features of just transition projects are their focus on regenerative and transformative outcomes to people and planet due to deliberate shifts in systemic conditions, and factors outside of the control of vulnerable stakeholders. “ In addition, she pointed out that “just transition-related projects are interdependent, where one is the pre-requisite for the next. This requires a portfolio approach to just transition-related investment, where projects are not viewed in isolation or “cherry picked” by investors.” Naidoo also touched on the fact that there are already existing financial instruments in South Africa (such as green bonds and social bonds) but the key challenge is structural challenges to inclusivity and equity. In conclusion, she cautioned that the imperatives to a just transition financial roadmap required changes in policy and regulation (for example fiscal incentives to integrate ESG and other factors into investment); new instruments (such as for SMME’s and improving the capital structure of the country’s DFI system); changes in institutions and proper monitoring of financial actors contribution to the just transition.

Nicole Martens from Martens Impact Advisory unpacked some key recommendations for systemic change that would unlock just transition finance. Her recommendations included, amongst others, the need to refine the definition of the Just Transition for the local market, coupled with public support for this definition by policymakers. In addition, she highlighted the need for the establishment of a special entity focused exclusively on financing the country’s transition. A key issue raised was the problem of the pipeline of projects – which was also taken up later by Fumani Mthembi from Knowledge Pele. Martens claims, based on her research that “there has been so much talk about these projects, but there has been nothing tangible stemming from these talks – nothing that we can engage with as investors.” The reality is that there are projects but there are challenges around capacity (skills) and upscaling of projects. She points out that what is needed is increased investment in improving capacity and competence amongst policymakers, investors and project developers. In addition, the development of specialised vehicles for project incubation and aggregation; working with existing project portfolios to effect change; reforming financial institution and financial sector incentive structures, reporting, benchmarks and project valuation frameworks and improving flexibility of public sector financing frameworks.

Mthembi, in elaborating upon the scaling up of community projects, also highlighted similar concerns to Martens and pointed out that the potential to upscale was hampered by a number of factors including regulatory challenges. She explained that “just transition projects, by their nature, introduce technologies and ways of generating value that are novel, to the extent that decarbonisation has not historically been central to the impetus of job creation. As a consequence, they often run into regulatory challenges, requiring changes to be made in order to enable project viability.” In addition, there is the question of how funding of projects typically work. Mthembi pointed out that “funding typically supports the operational aspects of project rollouts but the demand on developers to advance the more systemic changes required to enable scale is not incorporated into the funding package, placing added burden on project developers. Regulatory change is, therefore, often the product of the unpaid labour of developers who stretch and strain themselves to generate the public good that is an enabling regulatory environment."

Other issues raised by Mthembi included the need for public-private partnerships; the need to factor in the broader political context of implementing such projects especially at a community level; time is a key factor in developing community projects for scale. Finally, there is the issue of gender which it comes to small-scale projects and how so-called "women's work" often is under-remunerated.

Finally, research conducted by Ed O'Keefe from Synergy Global Consulting sought to provide an initial indication of a set of consistent and transparent social indicators which could inform ESG metrics around a just transition. This was in view of the fact that there is currently a lack of a clear, consistent, and unifying framework that allows for the practical identification of what constitutes a just transition project, particularly its social and justice dimensions and their associated impacts, which is impeding investor decision-making. It was noted that this was a first iteration to begin scoping such indicators and that a base was now in place from which to move thinking and discussions forward.

In closing the dialogue, Levin pointed out that there are numerous challenges in moving ahead with how the just transition will be financed and a lot of work still needs to be done but key to remember is that "the planet will burn if we do not decarbonize" and this requires key players, including the finance sector, to support the transition and to ensure that it is just.

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In addition, TIPS has set up a Just Transition portal which can be found on the TIPS website: www.tips.org.za