T20 Policy Brief

Task Force 4
Refuelling Growth: Clean Energy and Green Transitions

FROM 'CLIMATE FINANCING' TO 'JUST ENERGY TRANSITION FINANCING'

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Abstract

Policies enabling transition to a more sustainable economic system are not necessarily fair to all. Deliberate effort is needed to ensure that they do not lead to injustices that reinforce, or add on to those currently existing. Financing the transition from fossil fuels to non-polluting forms of energy use is a universal challenge. Likewise, it is extremely costly to provide sustainable, alternative livelihoods to all affected stakeholders. Unfortunately, this aspect is often overlooked. Contemporary climate finance discourse does not address, in full, the financing of economic diversification, re-skilling, and infrastructure investment, among others. This is especially true in developing countries. This Policy Brief advocates expanding the scope of *climate financing* to *just transition financing*. Financing should pay greater attention to enhancing people's capacity to adapt to the socio-technical transition. As a forum for major economies, the G20 should play a leading role in shaping and mainstreaming just energy transition financing.

The Challenge: Just Energy Transition for All

1

Transitioning to a low-carbon economy system is inevitably disputatious. It can affect many stakeholders negatively, especially workers and communities reliant on the prevailing carbon-intensive industry. Deliberate efforts need to be made to ensure it does not lead to injustices.[1,2,3] Meeting the needs of affected stakeholders is essential. As P. Newell and Dustin Mulvaney note in their 2013 paper, 'The Political Economy of the Just Transition':[4] "Issues of equity and justice will be intrinsic to whichever energy trajectory is pursued … and they need to be better understood and anticipated." It is critical to embed the justice aspect in the current climate mitigation discourse.[5]

The concept of 'just transition' first emerged in the 1970s, focused on compensating workers affected by stringent environmental standards.[6,7] Today, as the scope of sustainable development and climate change has expanded, the definition of just transition has done the same, going way beyond labour issues. Raphael J. Heffron, in his book, *Achieving a Just Transition to a Low Carbon Economy*, defines it as "a search for sustainable and equitable solutions, and equality and inclusiveness."[8] The focus has shifted from the immediate needs of displaced workers and communities to broader questions of who, how, and why some people benefit and others do not. Experts have asserted that energy transitioning policies should conform to the "three tenets of energy justice" – distributional (what), recognition (who), and procedural (how).[9,10]

The universal challenge in just energy transition is the financing. Investing in renewable energy and energy-efficient projects and retiring coal-powered plants early demands massive financial resources. They are, however, critical for climate mitigation. Equally, providing sustainable, alternative livelihoods to affected stakeholders is expensive and complex but must be done. For the transition to be truly just, it should cover not only affected workers but also local communities that bear the spillover impacts. The scale and pace of the transition will be affected otherwise.[11]

The concept of 'climate financing' must be broadened to include the needs of affected stakeholders. This Policy Brief advocates such broadening, providing examples of policies and financing mechanisms adopted in several countries that have succeeded, albeit in varying degrees.

The G20's Role: Expanding the Scope of Financing

2

Climate financing vs. Just transition financing

It is critical to differentiate between contemporary climate financing and just transition financing. In their paper, 'How Much Finance is Climate Finance?' R. Carè and O. Weber[12] maintain that there is no accepted taxonomy of climate financing; however, it is typically divided into mitigation and adaptation financing. The former pertains to financing aimed at reducing carbon emission levels, while the latter concerns building resilience and reducing climate vulnerability.[13] Examples of climate financing include fossil fuel phase-outs, renewable energy investment, building climate-resilient infrastructure, and ecosystem protection. The concept emerged predominantly during the Paris Agreement of the Conference of the Parties (COP) in 2015 to channel financial flows to costly low-emission and climate-resilient projects.

However, this concept is limited to financing climate initiatives[14] and does not provide for addressing the adverse impacts on affected stakeholders. This requires separate massive investment;[15] such initiatives should not be conflated with climate adaptation. Contemporary climate financing should be expanded to include just transition financing.

Though the 'just transition' concept may have been first thought of in the 1970s, discussion around the financing is still at the formative stage.[16] There is no accepted taxonomy for just transition financing yet. However, some steps have been taken; there are a few studies that outline the characteristics that should shape just transition finance.

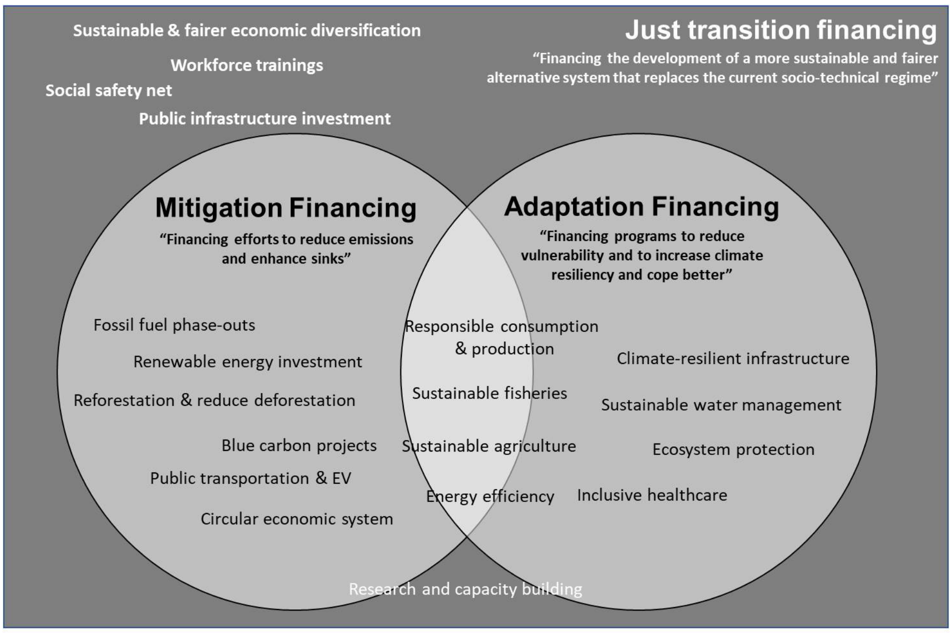
Simon Zadek, in his paper, 'Financing a Just Transition'[17] maintains that to enable "balanced, sustainable growth," there is need for productivity-enhancing and wealth-creating investments. Transition finance should go beyond providing a social safety net which is often short-term and unproductive. Support is required to create an alternative, sustainable livelihood for affected communities and workers.[18] Sanya Carley and David M. Konisky[19] have noted that just transition revolves around "efforts to enhance adaptive capacity to help burdened frontline communities cope with large economic, social and cultural changes;" adding that financing should go beyond improving climate adaptive capacity; it should also follow a bottom-up approach, with the affected communities being involved in the process.[20] Local wisdom and indigenous know-how need to be mobilised, and their direct inclusion in governance is exceptionally important.

In a nutshell, 'just transition financing' can be formally defined as "financing the development of a more sustainable and fairer alternative system that replaces the current socio-technical regime." Figure 1 illustrates the components of justice that are often left out of the contemporary climate financing concept, such as financing for economic sector diversification, workforce training, capacity building, and supporting infrastructure.

Advancing the allocation of just energy transition financing

In formulating transition policies, governments need to pay more attention to enabling conditions such as diversification plans and business development incentives, capacity building for workers, and supporting infrastructure development. The main features of such transition would be:

Figure 1. Climate Financing vs Just Transition Financing



Source: Authors' own

- ### Diversification plan with incentives

A diversification plan is essential to shift a region with carbon-intensive industries to other sustainable ones. This will provide the right signals for private entities to invest in the latter, reducing transition risk. The government should create special economic zones that provide incentives to enhance existing non-polluting businesses or develop new ones. In Australia, for example, non-coal business sectors are supported by the Australian Council of Trade Unions with energy subsidies which reduce the cost of production and improve product competitiveness.[21]

Other analysts have noted that transition programmes are more successful when they use a bottom-up approach led by local stakeholders, which takes into account their needs, vulnerabilities, and challenges.[22] The transformation of Sawahlunto in Indonesia, for example, from a coal-mining town to a mining heritage tourism city used such a bottom-up approach, where the local government and communities worked together to develop a future vision for the town.[23] This process is critical to ensure compatibility between employment and new low-carbon industries that need not necessarily revolve around renewable energy.

- ### Worker compensations and training

In the transition phase, compensation for coal workers who will lose their jobs is necessary to maintain workers' wellbeing; however, facilitating their training for re-employment is more critical. Providing re-training facilities ensures displaced workers are assisted in their re-employment preparation, and such retraining needs to match the new industrial precincts being developed in the region. Governments and carbon-intensive businesses need to invest more in workers and communities.

The education system also needs to shift emphasis to support the transition and prepare a workforce with the skills needed for a sustainable economic system. Policies to enable this are urgently needed.

- ### Infrastructure enhancement

As a region works towards transitioning, supporting infrastructure—e.g., transportation, communications, educational facilities—will help offset the lack of sufficient capacity and resources, reducing transition risk for existing and new businesses. Governments must play an important role in enabling effective infrastructure investment as public infrastructure is often not commercially attractive enough for the private sector.

Local governments are usually responsible for public goods provision. They need to invest in infrastructure that enables affected people to explore other means of income, enhancing entrepreneurship and thereby elevating the region's economic independence. The state government of Queensland, Australia, for example, has laid out 'Pathways to a clean growth economy' comprising strategies for a low-carbon growth economy, jobs, and opportunities. Sustainable infrastructure planning is integrated into the strategies, including the construction of low-carbon transport systems and renewable energy plants.

- ### Just energy transition financing policies

Just energy transition financing has to be a collective effort of governments, the private sector, and development banks. Ambitious goals have to be translated into operational steps that offer benefits and burden-sharing with the community. Governments hold the main responsibility for leveraging just transition funds from businesses, trade unions, and development banks, as well as determining their disbursement among businesses, communities, and civil society organisations.

Provision for blended finance is crucial. Public finance plays a key role in infrastructure development, especially of projects considered commercially unviable. But it can also play a catalysing role in attracting private investment, by providing grants alongside co-financing by private investors, concessional loans, domestic and internationally-backed risk-sharing instruments such as sovereign guarantees, first-loss provisions, and political risk guarantees. Risk-sharing instruments are critical because transitioning regions face transition risk. Involvement of the private sector can ensure that there are enough financial flows into the transitioning regions to support diversification.

The last few years have seen accelerated development in just transition financing instruments. A few efforts are outlined below (also see Table 1):

The European Union's (EU) Just Transition Mechanism (JTM), for example, provides grants for regions under its jurisdiction that pursue economic diversification or reconversion by prescribing national co-financing. JTF has a €17.5 billion (US$ 19 billion) fund coming mainly from the EU's budget, and aims to leverage a total investment of €30 billion (US$ 32.45 billion). The EU's InvestEU, with €26.2 billion (US$ 28.34 billion) of private investment guarantees, aims to leverage US$ 372 billion from the private sector, for sustainable investment, green growth and employment, and economic recovery from the Covid-19 pandemic. Similarly, Australia's National Reconstruction Fund (NRF) provides AUD 15 billion (US$ 10 billion) for investments aimed at diversifying and transforming its industry and economy, disbursed as loans, equity investments, and guarantees.

Scotland's JTF provides a good example of the bottom-up approach to financing. Some portions of the fund require a participatory budgeting process. So too, Australia's NRF conducts consultations and engagements with industries, unions, communities, and local governments, and is developing co-investment plans based on them.

The Just Energy Transition Partnership (JETP), first suggested at the Conference of the Parties (COP) on climate change in Glasgow in November 2021, is a mechanism to foster such transition in developing countries through multilateral financing by developed ones. France, Germany, the EU, the UK and the US jointly support JETPs with developing countries, under the aegis of the International Partners Group (IPG). So far, three countries—South Africa, Indonesia (which are members of G20) and Vietnam—have entered into JETPs with the IPG. Budgets are set for each developing country, and they have to formulate their own tailored comprehensive investment and policy plan and resource mobilisation plan for any excess amount required. But JETPs should also consider aforementioned components and mechanisms where the affected communities and workers' needs can be addressed.

Recommendations to the G20: Mainstream Just Transition Financing

3

Transitioning to a low-carbon economic system is a massive challenge. With carbon-intensive industries entrenched, transitioning will be painful—economically, socially, culturally, and politically. To address the needs of affected regions, considerable investment is needed—often overlooked in current climate financing models. There is a need to shift to just transition financing in keeping with the concept of justice. It means paying greater attention to enhancing adaptation capacity. The financing should also be a bottom-up approach focused on developing the local community's livelihoods, through transparent social dialogue and institutional representation.

A just energy transition partnership should focus not only on financing climate mitigation, but also on enhancing human resources capacity, economic diversification, and other supporting infrastructure. So far, it appears that recipient countries have been paying less attention to addressing socioeconomic impacts on workers and communities. In South Africa, for example, out of the US$ 8.5 billion pledged by the IPG, only US$ 50 million is allocated to skill development, economic diversification, and social investment. This is small compared to the total budget, as well as to other mechanisms such as the EU's JTM and Australia's NRF.

Just transition will continue to gain traction in global climate action, as governments realise the need to take measures to counter impacts that go beyond fossil fuel retirement and loss of jobs. Governments, including local governments, hold the primary responsibility to put forward both policy and financial frameworks to accelerate just transition. The G20 should play a leading role in shaping and mainstreaming just transition.

Table 1. Examples of Just Transition Financing

No	Mechanism	Source of Funds	Financing Model	Description
1(a)	EU's Just Transition Mechanism	EU's 2021-2027 budget and European Recovery Instrument, plus voluntary contributions (total €17.5 billion)	Primarily provides grants with national co-financing	Supports economic diversification and reconversion (e.g. backing up productive investment by SMEs, new firms' creation, R&D, up-skilling and re-skilling of workers, job seeker assistance programmes, early retirement schemes)
1 (b)	InvestEU	EU guarantee budget (€26.2 billion to leverage €372 billion of public and private investment)	Investment guarantees	Sustainable infrastructures; research, innovation, and digitisation; SME businesses; and social investments and skills. Primarily private investments
1(c)	Public sector loan facility	EU budget and European Investment Bank	Combined grants and loans	Supports projects by public entities that are not commercially feasible (e.g. energy infrastructure, public transport, and other social infrastructure)
2	Australia's National Reconstruction Fund	Federal budget (AUD 15 billion) with co-investment by industry	Loans, equity investments, and guarantees	Aims to create a diverse economic system for sustainable, high-value jobs. Priority areas include renewables and low-carbon technologies, value-add in agriculture, forestry, fisheries, and other enabling capacity investments.
3	Scotland's Just Transition Fund	Government's budget (£500 million 10-year commitment)	Capital funding, other mechanisms	Funding design is still being discussed with businesses, communities, workers, trade unions, and local authorities. In the first year, a participatory budgeting process was implemented.

No	Mechanism	Source of Funds	Financing Model	Description
4	Australia's Project for Hazelwood Workers	State Government: AUD 22 million	Direct state budget disbursement	Intended to support workers affected by the closure of the Hazelwood Power Station with programmes such as worker transition centres, which provide education, counselling, financial advice and subsidised training. Also being used to support affected businesses in identifying new opportunities and developing transition plans.
5	IPG's Just Energy Transition Partnership	Combination of the public (IPG and EU budget) and private (EIB loans). Each recipient country receives a different amount	Grants, concessional loans, market-rate loans, guarantees, private investment, and technical assistance	Countries receiving the JETP fund need to develop an investment and policy plan and a resource mobilisation plan to reduce greenhouse gasses emissions and support impacted communities

Attribution: Fikri Muhammad and Petra Christi, "From 'Climate Financing' to 'Just Energy Transition Financing'," *T20 Policy Brief*, May 2023.

Endnotes

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