Fifty Fifth Sovereign Debt News Update: South Africa criticizes the $8.5bn Climate Financing Package

By:

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November 15, 2022

With the UN COP27 Climate Summit underway, conversations on the need to move to replace fossil energy source dirty coal and gas with wind and solar have taken centre stage; albeit the different implications of such action in different contexts. Research has shown that for a successful, equitable and sustainable transition, it is imperative for countries to have the necessary technology, financing and land at their disposal. However, the key challenge for the African countries in the aftermath of climate change has been access to new, large-scale, predictable funding that does not exacerbate the continent's debt crises.

South Africa, on the other hand, seemed to have found better footing in the journey to a just transition as evidenced by its swift move in clinching a $8.5-billion climate finance deal with some of the world’s richest nations. The deal was hailed as a prototype for helping other coal-dependent developing countries transition to cleaner energy sources

The package, which has been provided by France, Germany, the European Investment Bank, the UK and the US, has particularly been criticized for its grant composition. Originally unveiled at the UN COP26 Climate Summit in November 2021 as South Africa’s Just Energy Transition Partnership, just 3% or $330mn is in grants. The remainder consists of about 54% in the form of concessional loan and 43% as commercial loans and investment guarantees that have the potential to increase the country's debt stock, necessitating debt servicing at the expense of future social spending.

International climate financing aimed at assisting the country's transition from coal to clean energy has been widely criticized for relying too heavily on loans. Unveiling the details of the package, South African president Cyril Ramaphosa highlighted that, “The energy transition can really only be fully and properly executed if there is more grant funding and if there is more funding made available in the form of concessional [low-interest] loans”. South Africa’s finance minister, Enoch Godongwana, also cautioned that the $8.5 billion initiative risks adding to the country's debt burden, adding that “If this [grant] composition is not changed, other countries, such as Indonesia, Vietnam and India may then say it’s not worth it.” Ramaphosa's government has been trying to reduce the country's sovereign debt, which stands at around 70% of GDP.

South Africa is one of the world's most coal-dependent countries, relying on the fossil fuel for 85 percent of its electricity. In a country with an official unemployment rate of 34%, coal directly supports at least 100,000 jobs, yet less than 1% of the total package is earmarked for social investment meant to cushion communities reliant on the upcoming closure of coal-fired power plants. Its outdated and poorly maintained coal-fired power plants are struggling to meet peak energy demand of 38GW, resulting in rolling blackouts in recent years.

Currently, the landmark $8.5 billion deal to wean South Africa off coal is in jeopardy due to contentious negotiations with the donor countries over how the funds should be spent. South Africa’s Just Energy Transition Partnership is, however, not an outlier. It is yet another example of the direct impact of climate finance on the exacerbation of the debt crisis in Africa. As found in a recent Afronomics Brief on climate finance and debt in Africa, over 55% of the climate finance received by Zambia and 43% of Ethiopia’s climate finance between 2015 and 2022 were in the form of loans. Further, Africa’s most debt and climate vulnerable countries are spending more on debt repayments than the investment needed to address their climate needs.

In all, in the South African example and the case studies considered in the Afronomics brief, climate finance has further mechanized the revolving door of debilitating debt burdens in Africa. It is therefore time that the “principle of no net debt increase from climate finance” be adopted as a fundamental norm governing climate finance globally.

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