T20 Policy Brief

Task Force 02
SUSTAINABLE CLIMATE ACTION AND INCLUSIVE JUST ENERGY TRANSITIONS

Financing Sustainable Just Energy Transitions: Challenges and Ways Forward

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Abstract

This Policy Brief considers the Just Energy Transition Partnership (JETP) for accelerating energy transitions in developing countries. We set out how the JETP model and proposed financial instruments can generate social and economic transition risks and have broader implications for governance and policymaking on climate action and sustainable development. We make recommendations for sustainable and inclusive financing, including reducing reliance on debt instruments and private finance; undertaking adequate technical assessments of financial, legal, regulatory and policy risks of energy transition; and comprehensive assessments of social and economic transition risks.

Keywords: Climate Finance, Energy Transition, Just Energy Transition Partnerships, UNFCCC

Diagnosis of the Issue

A key priority of the G20 Brazilian Presidency is to deepen the support for and implementation of a 'just and inclusive energy transition' to accelerate financing for energy transitions while at the same time addressing the social and economic dimensions of energy transitions, including impacts on the labour force, sustainable development and energy access (G20, 2024).

Launched in 2021 with South Africa, JETPs were extended to Indonesia and Vietnam in 2022 and Senegal in 2023, with other potential countries in the pipeline. JETPs are country platforms coordinated by national governments to generate financial resources to support the decarbonisation of energy sectors through coordination with an International Partners Group (IPG). The IPG comprises of bilateral donors, including G20 members such as Germany, France, the European Union (EU), the United Kingdom (UK) and the United States (US); multilateral development banks (MDBs); development finance institutions (DFIs) and private sector institutions represented by the Glasgow Financial Alliance for Net Zero (GFANZ).

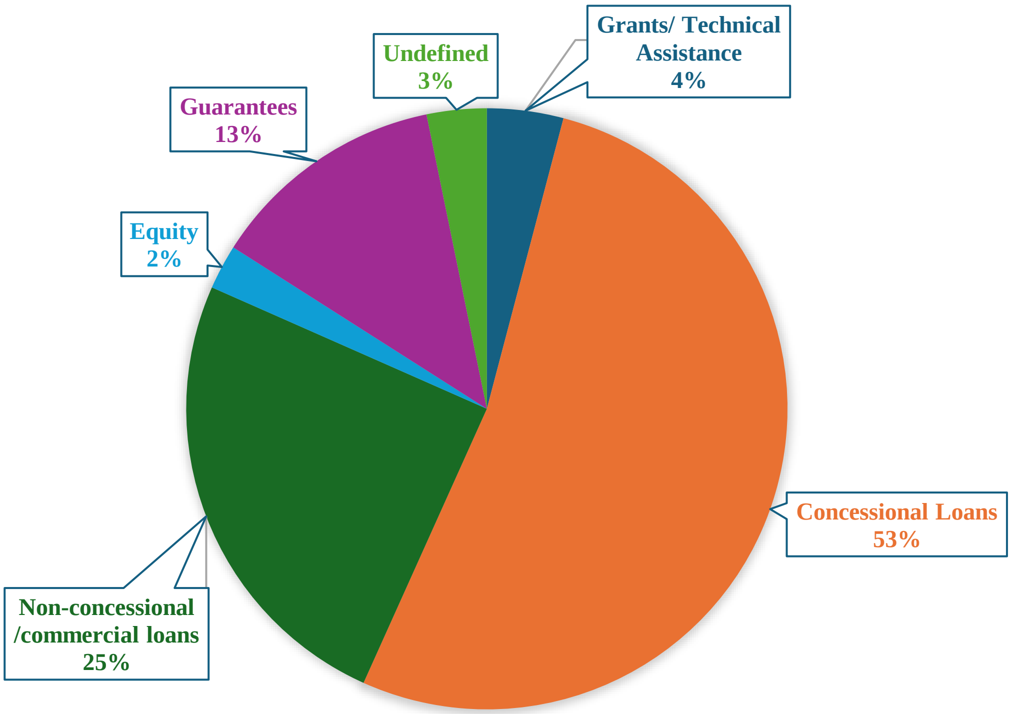
JETPs are meant to be country-driven and aligned with national development plans, shifting away from project to programmatic financing of energy infrastructure. However, questions remain on the suitability of the JETP financing model for developing countries and the implications of this climate finance framework on domestic pathways for "just transition" and on global efforts to address climate change.

We identify four main concerns with the JETP financing approach that raise legal, regulatory, policy and governance risks based on our assessments of three JETP country plans (Indonesia 2023; South Africa 2022 and Vietnam 2023).

1. Reliance on Debt Instruments and Private Finance

JETPs are heavily reliant on debt instruments and market-based mechanisms – including loans, guarantees and sovereign bonds – to finance decarbonisation and economic transition plans, with official finance geared towards catalysing commercial sources of financing (see Figure 1[1]). Reliance on loans, even official loans on concessional terms, will impact on developing countries' fiscal position and debt sustainability while reliance on commercial finance can increase contingent liabilities on the state (for state-guaranteed loans) and expose countries to volatility in international financial markets and legal risks of disorderly sovereign debt defaults in the absence of appropriate mechanism to deal with private creditors (Connelly et al 2024; Tan 2022).

Figure 1: Financial Instruments Pledged to South Africa, Indonesia and Vietnam by the IPG per Instrument Type



[1] Please see Appendix for breakdowns and charts.

2. Legal Risks from Foreign Investments

The JETP approach is premised on attracting foreign investors in the renewable energy sector through incentives, such as guarantees, public-private partnerships (PPPs) and blended finance, while phasing out domestic coal and other fossil fuel production in the host state. International legal frameworks, such as investment treaties, that protect foreign investments run in parallel to national implementation of commitments made under the JETPs. This interaction may pose significant legal and regulatory risks that hinder a just and inclusive energy transition (Tan et al 2023). Investment treaty protections are likely to render both fossil fuel phase-out and clean energy policy-making more costly for governments through protections against indirect expropriation and protection of investors' legitimate expectations (Tienhaara and Cotula 2020).

3. Social and Economic Transition and Governance Risks

JETPs place greater emphasis on financing large-scale infrastructure and regulatory and policy reform to enable energy transition than on mitigating the social and economic dislocations to communities or on developing social and environmental safeguards for clean energy projects. The focus on private financing and limited public, especially grant, financing, limits the capacity of host countries to support communities, such as workers and local businesses, impacted by clean energy transitions. Additionally, insufficient attention is paid to broader macroeconomic and fiscal risks of energy transition that impact on the national economy beyond these affected communities. For example, declining public revenues from traditional energy production sources curtail countries' expenditure on public services, such as healthcare and education, exacerbating the structural economic challenges and undermining the realisation of economic, social and cultural rights (Tan et al 2023).

4. Risk of Incompatibility with Multilateral Climate Commitments

As the JETP framework sits outside the United Nations Framework on Climate Change (UNFCCC), its operations may conflict with commitments under the multilateral climate regime. Official finance committed are mainly drawn from official development assistance (ODA) budgets. The diversion of ODA towards climate finance undermines the principle of “additionality” of climate finance and can impact on the mobilisation of resources to meet other Sustainable Development Goals (SDGs). There is also a risk that strategic priorities will be driven by the IPG and the private sector while interventions to create enabling environments for private investments can accelerate the loss of policy and regulatory autonomy in developing countries and undermine sustainable development pathways.

Recommendations

The prioritisation of “just and inclusive energy transition” by the G20 Energy Transitions Working Group (ETWG) requires that global energy transitions must ensure that the process of decarbonisation does not create or exacerbate social and economic inequalities within and among countries. The G20 should ensure that financing for energy transitions is in line with their obligations under the UNFCCC and Paris Agreement. Climate change mitigation must be designed and financed in a way that preserves opportunities for countries to meet countries’ sustainable development needs and address the transition risks for economies and local communities.

The creation of Taskforce for the Global Mobilisation Against Climate Change by the G20 Brazilian Presidency to align climate finance initiatives with state obligations under UNFCCC and the Paris Agreement is a positive step. We outline below, key recommendations that the Taskforce, the ETWG and Environment and Climate Sustainability Working Group should consider in developing a G20 roadmap on climate finance and energy transition.

Climate finance should not be fragmented across different platforms and entities, nor should it be premised on strategic interests of developed countries and commercial interests of private investors over and above global collective interests on climate action and local community social, economic, and other human rights. Climate finance should be guided by multilaterally agreed principles, including the principles of equity and common but differentiated responsibilities and respective capabilities (CBDR-RC), additionality, predictability and country ownership.

We recommend the following policy measures to ensure that energy transition financing platforms, such as the JETPs, function within the climate finance legal framework, respecting the obligations of developing countries and is developed in a holistic, inclusive and participatory manner taking into account the sustainable development needs and human rights of all stakeholders. Ultimately, financing just energy transitions must be part of a broader package of reforms to the current system of global economic governance and international economic law, including dealing with significant debt burdens of developing countries and substantially reforming the asymmetrical international investment regime.

1. To Counter the Risk of Reliance on Debt Instruments and Private Finance

As recognised by the G20 New Delhi Declaration, developing countries have differing needs, circumstances, priorities and vulnerabilities in relation to energy transition and climate resilience. Plans for financing a just transition should be prioritised and designed according to domestic and local needs and should not primarily be driven by investor or donor priorities. For new investments in the renewable energy sector, contracts and/or terms of licencing should be designed to ensure that the host country has adequate policy space to set domestically-driven national development and energy transition policies. Policymakers should consider not only the financial impact of the contracting of further debt to fund the energy transitions but also the legal risks associated with contracting debt with different classes of private creditors, the terms of the debt and the jurisdiction governing debt contracts. An increased dependence on external debt will not only impact on countries' debt sustainability but also increase their vulnerability to regulatory changes in the jurisdictions the debts are contracted in.

	1. Institute debt sustainability assessments and debt audits to accompany each energy transition investment plan.
	2. Channel more finance through sovereign finance to host states to decide what is best to finance, supporting country ownership of just transitions and aligning plans with national development priorities.
	3. Undertake assessments of bilateral and multilateral financial commitments that are contingent on legal, regulatory and policy reforms to ascertain broader social and economic impacts of conditionalities and ensure they progress rather than hinder climate action.
	4. Financial instruments and terms of financing must align with national climate action plans and SDG pathways.

2. To Counter the Legal Risks from Private Investments

Legal, regulatory, and policy reforms linked to financing instruments, such as development policy loans from MDBs or bilateral aid agencies, must be evaluated against the broader risks to the financial system and fiscal position of host governments. The additional financial risks arising from the broadening of the funding base to private actors PPPs via DFIs and philanthropic funding should be considered in determining the financial risk and liabilities incurred by host countries. There is also potential for regulatory chill where governments refrain from or postpone regulating due to potential or actual threats of investment disputes and exposure to significant financial burdens for breaches of investment treaty standards (Boue, 2023).

	5. Prioritise official financing to states and public entities instead of blended finance and guarantees for private investors, whose appetite for investment is not guaranteed.
	6. Organise financing in a framework of genuine partnerships that respects the policy space of host countries.
	7. Incorporate risk assessments in energy transition plans to identify potential liabilities arising from the host countries' investment treaty and contract commitments to foreign investors.

8. Design and implement energy transition investments with investment law risks in mind in terms of (a) financing allocated to the cost of fossil fuel phase-out, and (b) incentive offers and guarantees of regulatory stability to future renewable energy investors and other "green" investments.

3. To Counter Social and Economic Transition and Governance Risks:

Without a holistic, cross-sectoral approach to decarbonisation, finance and investment plans may undermine rather than support just energy transitions. There is a risk that a financing agenda that is oriented to private interests can subordinate countries' priorities to the interests and priorities of private investors without the necessary social, economic and environmental safeguards to facilitate a just and equitable energy transition for communities. It is important that the financial criteria for prioritisation of investment decisions for energy transitions carry equal weight with the social and economic considerations for just transition outcomes. Financing social and economic transitions and enhancing adaptative capacities of communities and countries are as crucial as financing infrastructure and policy and regulatory change.

9. Host states should require the application of a human rights and environmental due diligence (HREDD) framework to assess social and economic transition risks and prospective impacts before, throughout and after transition investments, including on vulnerable populations.

	10. Projects should ensure free, prior and informed consultations with and consent by local communities to make social and environmental safeguards and standards effective.
	11. Financiers and investors should ensure that adequate and effective environmental and social safeguards and standards are in place for all reasonably foreseeable adverse impacts from financed projects on communities and the environment.
	12. Provide adequate and long-term financing to minimize adverse social and economic impacts and ensure sustainability, including access to adequate remedies for adversely affected persons.

4. To Ensure Compatibility with Multilateral Climate Commitments

Financing for energy transitions should respect the agreed principles of the multilateral climate regime, in particular CBDR-RC and finance be new, additional and predictable as per the obligations under the UNFCCC. These initiatives should be designed mindful of considerations of debt sustainability, cost-effectiveness, harmonisation of climate action with social and economic impacts of low-carbon transition, and should guarantee the establishment of governance and safeguards to manage risks of the transition programme.

	13. Ensure that the financial arrangements conform to commitments of all parties, including the host state and the developed countries, who are signatories to the UNFCCC and the Paris Agreement. Ideally, channel finance via funds established under the UNFCCC/ Paris Agreement.
	14. Ensure that energy transition financing is “new and additional” in line with obligations under the UNFCCC Articles 4.3 and 4.4 and supports “country-owned strategies” with transparent and predictable financing compatible with Article 9.3 and 9.7.
	15. Ensure that finance for just energy transition do not divert ODA spending in other SDG areas, such as health and education.

SCENARIO OF OUTCOMES

RISKS	CURRENT SCENARIO	CHANGE FROM CURRENT SCENARIO BY IMPLEMENTING RECOMMENDATIONS	
		ACTION	EXPECTED OUTCOME
Risks of Reliance on Debt Instruments and Private Finance	● Increased sovereign debt risks and limited assessment of debt liabilities	+ Debt sustainability assessment and debt audits for each climate finance plan	= More holistic debt profile, accounts for contingent liabilities
	● Prioritises private and blended finance	+ Prioritises official finance, especially grant financing, directly to governments	= Increased debt sustainability and lessens exposure to movements in financial markets
	● Unmitigated policy and regulatory conditionalities	+ Assessment of policy and regulatory reforms	= Maintains policy and regulatory space for governments to drive forward just energy transitions
	● Fragmented financing and investment plans	+ Alignment with national climate plans and Nationally Determined	= Effective delivery of energy transition projects and finance which do

		Contributions (NDCs) and SDG pathways	not undermine social and economic development
Legal Risks from Private Investments	● Terms and conditions of private finance contracts do not always safeguard public interest and ‘catalytic’ finance does not always mobilise investment	+ Prioritise official finance and use blended finance and other catalytic capital wisely	= Better evaluation of financial, legal and policy risks of financial instruments
	● Finance conditional on policy and regulatory reforms which reduce policy and regulatory space	+ Partnerships based on mutual respect and reforms based on national priorities	= Country ownership of climate action plans
	● International investment treaties and contracts privilege rights of private financiers and foreign investors over community rights and interests	+ Risk assessment for investment law liabilities to mitigate potential investment arbitration claims arising from energy transition investments	= Avoiding costly investor state arbitration risks from foreign investors

	● Regulatory chill prevents governments from taking action due to risk of investor claims	+ JETPs and country platforms designed and implemented with investment law risks in mind	= Energy transition investments do not trigger legal claims by foreign investors and bondholders
Social and Economic Transition and Governance Risks	● Social and economic risks not adequately assessed and narrowly defined only with respect to communities directly impacted by energy transition	+ Social and economic impact assessments and HREDD before, throughout and after transition investments	= Holistic assessments of energy transition on communities to prevent and mitigate such impacts and providing for economic diversification of affected sectors
	● Lack of consultative processes with local communities and other stakeholders and access to information	+ Free, prior and informed consultations with and consent by local communities	= Ensuring long-term engagement with communities including mitigation and remedy for harms

	● Existing gaps in project finance environmental and social safeguards exacerbated	+ Institute rigorous safeguards, including environmental and social risk assessment for energy transition projects	= Human rights-based approach to just energy transitions
	● Limited financing for mitigating social and economic impacts of energy transition	+ Properly assess and provide adequate and long-term financing for mitigating social and economic dislocations from energy transition to workers and communities	= Ensuring a just energy transition that leaves no-one behind
Risks of Incompatibility with multilateral climate commitments	● Finance delivered outside the UNFCCC and Paris Agreement regime	+ Channel finance through multilateral funds controlled by parties to the UNFCCC and Paris Agreement	= Compliance with climate commitments and principles, including equity and CBDR-RC
	● Diversion of ODA towards climate finance undermining principle of	+ Climate finance should be delivered additional to ODA budgets and	= Mobilisation of new and additional financing for energy transition that does

	“additionality” and impacting ability to mobilise resources to meet other SDGs	ensure greater transparency in climate finance flows	not reduce other SDG finance
	● Strategic priorities driven by IPG and private sector	+ Move to multilateral partnerships not based on an aid framework	= Enabling genuine long-term and equitable finance

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Appendix

Please see Appendix: JETP/ IPG Commitments/Pledges for more detailed breakdowns and charts.

G20 BRASIL 2024
BUILDING A JUST WORLD AND A SUSTAINABLE PLANET

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