Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 01-May-2023| Report No: PIDC35923

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
South Africa	P179077	South Africa Sustainable and Low-Carbon Energy Transition Development Policy Loan (P179077)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EASTERN AND SOUTHERN AFRICA	Jun 29, 2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of South Africa	National Treasury		

Proposed Development Objective(s)

To support the Government of South Africa's effort to advance the sustainability of the power sector and provide select reforms for a low carbon transition.

Financing (in US$, Millions)

SUMMARY

Total Financing	1,000.00

DETAILS

Total World Bank Group Financing	1,000.00
World Bank Lending	1,000.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

1. **The proposed Development Policy Loan (DPL) will support the Government of South Africa (GoSA) to advance the sustainability of the power sector and provide select reforms for a low carbon transition**. The operation builds on strategies recently approved by GoSA, including the President's Energy Action Plan and the Just Energy Transition Investment Plan (JET-IP). It operationalizes some of the recommendations in the Country Climate and Development Report (CCDR) published in November 2022 and forms part of a longer-term assistance program provided by the WBG that includes the January 2022 DPO (P174246), the Eskom Just Energy Transition Project (EJETP – P177398), and several analytics and advisory services. The proposed DPL is prepared jointly with other development partners also

providing complementary budget support operations to ensure coordination.[1]

2. **The South African economy faces a growing and severe energy crisis that has led to modest GDP growth of only 2 percent in 2022; at the same time, it is committed to decarbonizing its economy, which requires a fundamental transformation of its energy sector.** Load shedding reached all-time highs, averaging 8.8 hours per day, hurting confidence, increasing the cost of doing business and restraining industrial output and activity in key sectors. While it remains substantially difficult to quantify the costs of load shedding with a reasonable degree of certainty, it is estimated that the impact of the energy crisis has reduced GDP by 2.5 percent in 2022, while affecting approximately 350,000 direct jobs, including in informal and small businesses that do not have the financial resources to use alternative sources of energy other than the grid. South Africa is also among the top 20 greenhouse gas (GHG) emitters globally,[2] threatening the country's global competitiveness and its aim to be net-zero by 2050. Energy emissions represent 81 percent of the country's profile, of which the electricity sector represents 45 percent. The CCDR estimates that the high-carbon intensity of South Africa's economy has and will affect the lives of millions of citizens through high water and air pollution levels, and a reduction of the country's competitiveness as about half of South Africa's current exports are at high risk of being penalized by the Carbon Border Adjustment Mechanism, which the European Union is on track to implement.

Relationship to CPF

3. **The WBG's Country Partnership Framework (CPF) 2022-2026 aligns both with the Government's short-term socio-economic response to the COVID-19 crisis and its medium-term ERRP in key sectors.** This DPO, like the overall CPF, supports the Government's short-term socio-economic relief package, while sowing the seeds of long-term economic transformation, in line with the three stages of the World Bank COVID-19 Crisis Response Approach Paper: relief, restructuring and resilience recovery. The CPF builds flexibility to respond to the Government's financing needs and emerging priorities. The three CPF strategic focus areas are: (i) promoting increased competition and improved business environment for sustainable growth; (ii) strengthening MSME performance and skills development to support job creation; and (iii) improving the infrastructure investment framework and the efficiency of infrastructure services in selected SOEs. Governance, gender, and the digital economy are cross-cutting themes. In doing so, the CPF responds to the binding constraints to poverty and inequality reduction as identified in the Systematic Country Diagnostic and Country Private Sector Diagnostic.

C. Proposed Development Objective(s)

4. The PDO is to support the Government of South Africa's effort to advance the sustainability of the power sector and provide select reforms for a low carbon transition.

Key Results

5. **The theory of change supported by this operation is illustrated below.** The short-term actions are the reforms supported by this operation, while the medium-term actions are the ones envisioned by the authorities necessary to

[1] African Development Bank, KfW, and Government of Canada are developing complementary policy loans to South Africa based on similar objectives to the Sustainable and Low-carbon Energy Transition DPO. AFD is also exploring budget support to GoSA.

[2] Climate Watch. Ranking includes emissions from land use and land use change. https://www.climatewatchdata.org/data-explorer/historical-emissions?historical-emissions-data-sources=climate-watch&historical-emissions-gases=all-ghg&historical-emissions-regions=All%20Selected&historical-emissions-sectors=total-including-lucf%2Ctotal-including-lucf&page=1

achieve the four pillars of the operation as described below.

The Theory of Change supported by this DPL

Overarching goal	Initiate the restructuring of the power sector to promote long-term energy security and achieve a low carbon transition	
Medium term outcomes/ Intermediary results (by March 2025)	**Improve energy security** •Operationalize NTCSA •Reduce Eskom debt. •Improve Eskom operational margin •Increase investments in transmission. •Reduce NERSA licensing processing time •Increase average transfer per FBE beneficiary	**Reduce GHG Emissions** •Increase new embedded renewable generation - 2000 MW. •Increased private capital mobilized in new Renewable Energy registered with NERSA – R37,000 million. •25% increase in revenue collected from the carbon tax.
Pillars/ Policy areas	**Initiate the restructuring of the power sector to promote long-term energy security**	**Support the implementation of a low carbon transition**
Short-term actions	•Establish a TSO with authority to develop an open market with transparent and non-discriminatory access to the grid. •Strengthen the licensing powers of the National Energy Regulator of South Africa. •Restricts Eskom's capital investments to transmission and distribution and redirect Eskom's expenditures to maintenance and environmental compliance. •Increases budgetary allocation to municipalities for FBE.	•Remove licensing threshold for new embedded generation projects (only registration with NERSA required). •Adopt tax incentives for solar panel installations for residential and commercial installations. •Approve gradual increase in the carbon tax rate. •Align the utilization period of Carbon Offsets with the Carbon Tax implementation timeline.
Medium-term actions	•Complete the unbundling of Eskom generation and distribution. •Set regulations for tariffs adequate to the new (unbundled) market structure. •Develop the primary and secondary legislation required to create an independent TSO and a competitive market with transparent and non-discriminatory basis. •Develop measures to support sustainability of municipal power distribution business.	•Ensure IPPs can access the network in a non-discriminatory basis with published tariffs. •Adopt a wheeling framework based on international best practice. •Streamline application process for embedded generation projects by establishing a one-stop shop. •Reduce allowances offered to those liable to carbon tax. •Adopt framework. for Domestic Carbon Standards. •Open the domestic carbon credit market to international players. •Promulgate the Climate Change Bill. •Implement the mandatory phase of the Carbon Budget policy and introduce sectoral emissions targets.

D. Concept Description

6. **The DPL will support the GoSA's reform efforts to initiate the restructuring of the power sector to promote long-term energy security and achieve a low carbon transition**. In agreement with the authorities and in dialogue with other development partners, it is a stand-alone operation that aligns with the government's medium-term strategies, in particular the Energy Action Plan and the Just Transition Framework (JTF) and is informed by the recent CCDR**.** The DPL will be anchored on two mutually reinforcing pillars:

- **Pillar One:** initiate the restructuring of the power sector to enhance long-term energy security with the objectives to (i) support the unbundling process of Eskom; and (ii) improve the financial sustainability of Eskom to increase investments in transmission, while mitigating impacts of increased electricity costs on the poor.
- **Pillar Two:** support the implementation of a low carbon transition by (i) promoting private investment in new renewable generation capacity; and (ii) strengthening the use of carbon pricing instruments.

7. **These two pillars attempt to balance the green, resilient, and inclusive approach to development with the urgency to address the energy crisis**. The reforms supported by this DPL should be interpreted as a first step to achieve this

balance as they will need to be followed by additional actions over time.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

8. **The just dimension of South Africa's transition to a low-carbon economy is a critical element of its success and is at the center of the JTF adopted by the government.** Such focus is justified in a country that is among the most unequal in the world, where more than half the people are poor, and where approximately 50 percent of the working-age population is unemployed or out of the labor force. The proposed operation is expected to positively contribute to South Africa's Just Energy Transition by (i) enhancing economic activity and job creation from new investments in renewable energy generation; (ii) improving service delivery of electricity and of sectors impacted by the energy crisis such as education, health, water and sanitation; (iii) cushioning poor households against projected increases in electricity tariffs required to align revenue with supply costs; and (iv) assisting the authorities to identify future reforms necessary to manage the social costs associated with the decommissioning and repurposing of existing coal-fired plants through a complementary technical assistance program. Further, increases in renewable energy will contribute to gradually reducing GHG emissions through a change in the energy mix. This coupled with implementation of GHG mitigation policies will, in the very long run, ultimately contribute to lower air and water pollution, with substantial co-benefits on human capital and the quality of living conditions.[3]

Environmental, Forests, and Other Natural Resource Aspects

9. **The Prior Actions proposed in this operation will, overall, have a neutral to positive impact on the environment, forests, and other natural resources.** Removing the licensing thresholds for embedded generation projects and supporting private investment in rooftop solar PV will have an overall positive impact by promoting access to cleaner energy and reducing the demand on coal electricity generation. A gradual increase in the carbon tax rate will also have a positive environmental impact by inducing behavior changes that lead to reduced energy consumption and pollutant emissions. Finally creating a Transmission System Operator and National Transmission Company, reducing Eskom's debt, and increasing the budget allocated to the Free Basic Electricity will have a neutral impact on the environment.

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Implementing Agencies

[3] See CCDR, 2022 for a quantification of these effects in the medium and long-term.

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APPROVAL

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