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South Africa Sustainable and Low-Carbon Energy Transition Development Policy Loan (P179077)

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF US\$1 BILLION TO

THE REPUBLIC OF SOUTH AFRICA

FOR THE

SUSTAINABLE AND LOW-CARBON ENERGY TRANSITION DEVELOPMENT POLICY LOAN

SEPTEMBER 28, 2023

Macroeconomics, Trade and Investment Global Practice
Eastern And Southern Africa Region

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Republic of South Africa
GOVERNMENT FISCAL YEAR
April 1 – March 31

CURRENCY EQUIVALENTS
 (Exchange Rate Effective as of September 28, 2023)
 Currency Unit = South African Rand
 US\$1.00 = ZAR19.13

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank	NECOM	National Energy Crisis Committee
AFOLU	Agriculture, Forestry, and Other Land Use	NEMA	National Environmental Management Act
CCDR	Country Climate and Development Report	NERSA	National Energy Regulator of South Africa
CPF	Country Partnership Framework	NRF	National Revenue Fund
DFFE	Department of Forestry, Fisheries, and the Environment	NT	National Treasury
DFID	Department of International Development	NTCSA	National Transmission Company of South Africa
DMRE	Department of Mineral Resources and Energy	OECD	Organization for Economic Cooperation and Development
DPL	Development Policy Loan	PCC	Presidential Climate Commission
EBITDA	Earnings before interest, taxes, depreciation, and amortization	PEFA	Public Expenditure and Financial Assessment
ERA	Electricity Regulation Act	PFM	Public Financial Management
GDP	Gross Domestic Product	RDP	Reconstruction and Development Program
GHG	Greenhouse gas	RE	Renewable Energy
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit, German Agency for International Cooperation	REIPPPP	Renewable Energy Independent Power Producer Procurement Program
GoSA	Government of South Africa	SARB	South African Reserve Bank
GRS	Grievance Redress System	SDR	Special Drawing Right
GW	Giga Watt	SOE	State-Owned Enterprise
IFI	International Financial Institution	SRD	Social Relief of Distress
IRP	Integrated Resource Plan	TA	Technical Assistance
JET	Just Energy Transition	tCO ₂ e	Tons of carbon dioxide equivalent
JET-IP	Just Energy Transition Investment Plan	TE	Transmission Entity

JTF	Just Transition Framework	TSO	Transmission System Operator
MTEF	Medium-Term Expenditure Framework	USAID	United States Agency for International Aid
LGES	Local Government Equitable Share	USD	United States Dollar
MVA	Mega Volt Ampere	ZAR	South African Rand
NDC	Nationally Determined Contribution		

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**REPUBLIC OF SOUTH AFRICA
SUSTAINABLE AND LOW-CARBON ENERGY TRANSITION DEVELOPMENT POLICY LOAN**

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P179077	No

Proposed Development Objective(s)

To advance the restructuring of the power sector to promote long-term energy security and support a low carbon transition.

Organizations

Borrower: REPUBLIC OF SOUTH AFRICA
Implementing Agency: National Treasury

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Financing	1,000.00
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DETAILS

International Bank for Reconstruction and Development (IBRD)	1,000.00
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INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

High

**Results**

Indicator Name	Baseline - July 2023	Target – March 2025
Indicator 1: Percentage of independent non-executive members appointed to the NTCSA Board	0	25%
Indicator 2: Processing time for NERSA to consider applications for the registration of electricity generation facilities	60 days	45 days
Indicator 3: Eskom debt/asset ratio	52.8%	41%
Indicator 4: Eskom operating profit margin (EBITDA/Revenues)	14.7%	19%
Indicator 5: Amount of new transformer capacity installed and commissioned in NTCSA network (MVA)	0	2,600
Indicator 6: Percentage of households receiving Free Basic Electricity as a percentage of LGES funded poor households	23%	35%
Indicator 7: Amount of MW of new renewable energy registered with NERSA and connected to the grid	259	3,000
Indicator 8: Amount of private capital mobilized in new renewable energy registered with NERSA and connected to the grid	R1,455 million	R55,000 million
Indicator 9: Number of businesses benefiting from renewable energy tax incentives	0	7,500
Indicator 10: Amount of MW of new decentralized renewable energy solutions financed with support of the bounce back scheme	0	500
Indicator 11: Percentage of women led households and businesses able to access financing for new decentralized renewable energy solutions with support of the bounce back scheme	0	30%
Indicator 12: Revenue collected from the carbon tax	R1,397 million* *baseline - 2021/22	R2,117 million



IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF SOUTH AFRICA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Development Policy Loan (DPL) supports the Government of South Africa’s (GoSA) effort to advance the restructuring of the power sector to promote long-term energy security and a low carbon transition.** The operation, for US\$1 billion, builds on recently approved government strategies to respond to the current energy crisis, including the President’s Energy Action Plan. Consequently, the operation aims to address the biggest existing constraint to economic growth. The operation is aligned with the 2022-26 Country Partnership Framework (CPF) for South Africa (FY22-26) and operationalizes several recommendations of the South Africa Country Climate and Development Report (CCDR, 2022). It is in line with the World Bank’s new vision and supports regional priorities on climate change, private sector financing, and gender. The operation has been jointly prepared with other development partners who plan to provide complementary budget support to the GoSA.¹

2. **Reliable electricity service provision is a necessary condition for economic growth and job creation; yet after years of deterioration in energy supply, South Africa faces a severe crisis.** Rolling blackouts (or load shedding) reached all-time highs, averaging 8.8 hours per day in 2022 and over 10 hours per day in the first six months of 2023. The economy is estimated to have lost between 0.7 and 3.2 percentage points of gross domestic product (GDP) in 2022 because of load shedding.² The root causes of the crisis are found in the outdated, vertically integrated market structure that is no longer adapted to respond to the needs of the energy sector and to weak governance with poor oversight of the national state-owned power utility, Eskom. Delayed and inefficient investments in generation and transmission aggravate the problem. Low collection of revenue due to inadequate tariff levels and structure, high levels of arrears accumulated by municipalities, and chronic operational issues further weaken Eskom. There are alleged actions of state capture in the sector,³ alleged plant sabotage, and regulatory obstacles, which have not been adequately addressed despite previous efforts.

3. **The unprecedented energy crisis comes when South Africa has been working to implement a just transition to a low carbon economy.** Globally, South Africa is among the top 20 greenhouse gas (GHG) emitters. Energy represents 81 percent of the country’s emissions profile, of which electricity represents 45 percent. The CCDR indicates that its high-carbon intensity has affected millions of citizens through high air and water pollution, with disproportionate negative impacts on the poorest households. Moreover, it will lead to a reduction in the country’s competitiveness since some of its current exports will likely be subject to the European Union’s Carbon Border Adjustment Mechanism scheduled for a transitional implementation phase in October 2023. In line with the World Bank’s Evolution, the DPL thus supports an approach that links country-level benefits with regional and global public goods. South Africa’s long-term energy security and a low carbon transition should benefit the country and contribute to Africa’s energy transition.

4. **To address the extraordinary economic and social cost of the energy crisis, GoSA has adopted important measures and programs in the last 12 months.** In July 2022, the President announced the Energy Action Plan and created the National Energy Crisis Committee (NECOM) to oversee its implementation. This Plan

¹ The African Development Bank (AfDB), KfW Development Bank (KfW), and Government of Canada are preparing complementary budget support loans to South Africa based on similar objectives to the Sustainable and Low-C Energy Transition DPL. Agence Française de Développement (French Development Agency, AFD) is also exploring budget support to GoSA.

² South African Reserve Bank, June 2023. Occasional Bulletin of Economic Notes. OBEN/23/01

³ Report of the Judicial Commission of Inquiry into State Capture, 2022.



is built on a two-pronged approach with both short and long-term priority actions: improving the existing supply of electricity by reforming Eskom; and accelerating private investment in renewable energy (RE). The Plan aims at transforming the electricity sector to achieve long-term energy security. In early 2023, the President also created a new Ministry of Electricity and appointed a minister to support the implementation of the Energy Action Plan. These initiatives will help initiate the institutional and policy reforms to address the sector's challenges and constitute steps toward the development of a long-term vision for the sector as the energy strategy has not been updated since 1998.⁴

5. **Concurrently, GoSA confirmed its commitment to a low-carbon energy transition in its updated nationally determined contribution (NDC) in 2021 and approved the Just Transition Framework (JTF) and the Just Energy Transition Investment Plan (JET-IP) in 2022.** These strategies emphasize that deploying least-cost RE is the most important action to foster economic growth, reduce energy intensity and the carbon footprint of the energy sector and, ultimately, help the country to achieve its climate mitigation and energy objectives. The low carbon transition is also expected to help address current inequalities by increasing electricity access and creating jobs in the longer -term.

6. **The DPL is a stand-alone operation, anchored on recent strategies for the energy sector and climate change, which supports government efforts to promote long-term energy security and a low carbon transition.**⁵ Given the political context and the nascent relationships with development partners, the government has requested a standalone operation, but further collaboration is expected over time along the roadmap for the medium-term that is described in Section 4. The focus of the operation is on advancing critical actions in two mutually reinforcing pillars that will pave the way for other medium- to long-term measures, as described in the Letter of Development Policy (Annex 2).

- **Pillar One:** Advance the restructuring of the power sector to promote long-term energy security by supporting the unbundling of Eskom, redirecting its resources toward new investments in transmission, while ensuring continued support for low-income households in a context of increasing electricity tariffs.
- **Pillar Two:** Support the implementation of a low carbon transition by encouraging private investments in renewable energy generation and strengthening the use of carbon pricing instruments.

7. **The reforms supported under these two pillars are expected to lead to concrete progress in the next 18 months.** Among them: (i) private capital mobilized in new renewable embedded generation is expected to increase from R1,455 million at the end of 2022 to at least R55,000 million by March 2025, reaching about 0.5 percent of GDP, translating the government's drive to open the electricity market to private operators; (ii) the operationalization of the National Transmission Company of South Africa (NTCSA)—as a subsidiary of Eskom (legal unbundling)—that will act as the Transmission System Operator (TSO) during the transition process that should end up in the creation of a separate TSO (as proposed in the amendments to the Electricity Regulation Act); (iii) Eskom—through NTCSA—is projected to increase investment in transmission (350 km of new transmission lines and 2,600 MVA of new transformer capacity by March 2025), which is key to connect new generation capacity—mostly from RE sources—to the national grid; finally, (iv) the use of carbon pricing instruments is expected to gradually incentivize businesses to shift toward low carbon sources of energy, including through an increase in the carbon tax rate from R144 to R236 per tCO₂e between January 2022 and March 2025.

⁴ Department of Minerals and Energy, White paper on the Energy Policy of the Republic of South Africa, December 1998.

⁵ While GoSA intends to seek additional budget support operations over the next 3 to 5 years, it was agreed to start with a stand-alone operation in part because of upcoming national elections in 2024.



8. **The operation will also contribute to South Africa’s Just Energy Transition, which is a central element of the government’s development strategy given the existing high level of inequality and unemployment in the country.** The DPL supports measures to ensure continued assistance to poor households in a context of increased electricity tariffs. It will also support a gradual increase in job creation through higher private investment in RE. Over time, the gradual decline in load shedding will boost economic activity, create jobs, and improve health, education, and security outcomes, with a proportionally higher positive impact on the poor. The progressive change in the energy mix will reduce carbon emissions and contribute to lower air and water pollution, with substantial co-benefits on human capital and living conditions.⁶ Finally, the World Bank will implement a technical assistance program financed by the Government of Canada to support future reforms in social protection and labor markets that protect communities affected by the low carbon transition, especially women (Box 2).

9. **The overall risk to PDO achievement is assessed as high.** The operation responds to the energy crisis which has created a new opportunity for reforms as policymakers have become under additional pressure by frustrated citizen and businesses, but the sector remains beset by vested interests, financial distress, weak governance, a reform program that has not yet been unified in a single vision across government, and diluted responsibilities between several ministries, which affect policy implementation. State capture in the energy sector has received increasing public attention, including through parliamentary hearings, contributing to tensions in the policy dialogue and eroding trust in the government. The limited implementation capacity across key departments, Eskom, and the national energy regulator (NERSA), as well as in many municipalities, is also a source of concern. While the operation supports short-term reform priorities, the above risks are exacerbated by the fact that the agenda requires sustained measures over the medium term (5 to 7 years). Government reforms, including those supported by this operation, will help mitigate some of the above risks by supporting the first steps toward the restructuring of the power sector. The legal unbundling of Eskom (with a focus on transmission), the opening of an electricity market with transparent and non-discriminatory access to the grid, and the promotion of private investment in RE are all structural reforms that will help establish an initial platform for the much-needed transformation of the energy sector. These measures are expected to improve the economic outlook and reduce fiscal risks but, as recognized by the authorities, they will need to be deepened, and sustained by additional measures to make tangible progress in overcoming the ongoing energy crisis in the medium to long-term.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT DEVELOPMENTS

10. **Following a short-lived rebound of 4.7 percent in 2021, South Africa's economy has returned to its decade-long trajectory of weak growth, hampered by structural constraints in the domestic market** (Table 1). Real GDP growth slowed to 1.9 percent in 2022, because of the multiple global crises amplified by the energy shortage affecting activity—especially manufacturing and mining—and business confidence. This trend continued in early 2023 with a GDP growth of 0.9 percent during the first half of the year.⁷ On the demand side, modest growth has been driven by household consumption and inventory accumulation after two years of destocking (2020-2021) during the pandemic. Investment rebounded in Q22023, driven by the energy sector. On the supply side, the economy remained constrained by transport and logistics bottlenecks, weak

⁶ See CCDR for a quantification of these effects by 2050.

⁷ Figures show year on year change.



contestability in product markets, skills scarcity, and deteriorating state capacity.

Table 1: Key macroeconomic indicators and outlook, 2020-2026

	2020	2021	2022	2023f	2024f	2025f	2026f	2027f	2028f
	Actual			Projections					
National accounts and prices (annual percentage change)									
Real GDP	-6.0	4.7	1.9	0.5	1.5	1.6	1.6	1.7	1.7
Consumer price inflation	3.3	4.5	6.9	6.0	4.9	4.5	4.5	4.5	4.5
Fiscal accounts (percent of GDP)									
Revenues and Grants	25.1	27.8	28.5	27.7	27.5	27.5	27.5	27.6	27.6
Tax revenues	22.6	25.5	26.3	25.7	25.5	25.6	25.6	25.6	25.7
Non-tax revenues	2.5	2.2	2.2	2.0	1.9	1.9	1.9	1.9	1.9
Expenditures (incl. Eskom deal above the line)	35.0	32.4	32.7	33.6	33.0	33.5	32.0	32.0	31.8
Interest payments	4.1	4.3	4.6	5.0	4.9	5.2	5.6	5.7	5.9
Non-interest expenditure	30.8	28.2	28.0	28.6	28.0	28.2	26.4	26.3	25.9
General Government Balance (incl. Eskom)	-9.9	-4.6	-4.2	-5.9	-5.5	-6.0	-4.5	-4.4	-4.2
Total Public debt	70.1	67.9	71.7	72.3	73.8	76.3	77.2	77.6	77.5
Balance of payments (percent of GDP)									
Current Account Balance	1.9	3.7	-0.5	-2.0	-2.1	-2.2	-2.2	-2.2	-2.2
Exports (f.o.b.)	27.5	31.1	33.5	31.0	30.1	29.2	28.3	27.5	26.8
Imports (f.o.b.)	23.2	25.0	31.5	31.0	30.5	29.8	29.0	28.3	27.5
Gross Reserves (US\$ million)	55,013	57,589	60,570	60,192	60,614	61,291	62,009	62,772	63,583
Other memo items									
GDP nominal (US\$ millions)	337,980	420,118	405,271	377,915	422,389	450,872	478,571	508,796	540,762
Investment (percent of GDP)	12.5	13.0	15.4	16.4	16.8	17.0	17.3	17.4	17.5
Gross Savings (percent of GDP)	14.5	16.7	14.9	14.4	14.6	14.9	15.1	15.2	15.4

Sources: National authorities and World Bank estimates.

Note: Numbers are presented in calendar years, except for the fiscal accounts which are presented in fiscal years. 2020 corresponds to fiscal year 2020/21 (April 2020 to March 2021).

11. **The energy crisis has been a major factor in the deceleration of economic growth.** While it remains difficult to precisely quantify the costs of load shedding on economic activity, it is estimated it had a negative impact of between 0.7 and 3.2 percentage points of GDP in 2022.^{8,9} Severe load shedding puts at risk approximately 350,000 direct jobs, especially for informal and small businesses that do not have the financial resources to use alternative sources of energy other than the grid. A recent survey in a major urban center

⁸ These estimates only account for the potential impact of load shedding on the supply-side of the economy by using the input/output matrix developed by Statistics South Africa that includes the use of energy in each sector. The resulting decrease in production is then translated into jobs using the labor intensity of each sector. The most impacted sectors are mining and utilities, followed by support services and manufacturing. This analysis only provides a rough estimate as businesses can adjust their energy consumption through different manners, which can also vary depending on the severity of the load shedding and the financial resources available.

⁹ South African Reserve Bank, June 2023. Occasional Bulletin of Economic Notes. OBEN/23/01.



indicated that about 20 percent of businesses have or plan to cut their labor force because of load shedding.¹⁰ Higher load shedding also discourages new investments, especially in energy intensive activities such as mining, utilities, and construction.

12. **Poverty, income inequality, and unemployment remain extremely high for an upper middle-income economy.** The poverty rate, based on the upper middle-income poverty line (US\$6.85 per day in 2017 Purchasing Power Parity), was estimated at 62.6 percent in 2022, with an additional 1.5 million people living in poverty relative to 2019, of which 37.9 percent were women. The unemployment rate stood at 32.6 percent at end-June 2023, down from its peak of 35.3 percent at end-2021 but well above the already high pre-pandemic level of 29 percent. In addition, about 40 percent of working-age South Africans are not in the labor force.¹¹

13. **Monetary policy has tightened to anchor expectations and to address inflationary pressures.** Following higher global energy and food prices, domestic inflation increased sharply in the first 8 months of 2022 before slowing down in the last quarter, to average 6.9 percent for the year. To reign-in inflationary pressures and lower expectations, the South African Reserve Bank (SARB) increased its policy rate by a cumulative 475 basis points between November 2021 and May 2023. By July 2023, headline inflation had moderated to a two-year low of 4.7 percent supported by easing fuel prices. However, pressures on inflation remain elevated on the back of electricity tariff increases, currency depreciation, and persistently high global commodity prices. Elevated domestic prices, especially for fuel and food items, have eroded consumers' disposable income and confidence.

14. **South Africa's banking sector has demonstrated resilience to global circumstances and the slowdown in the domestic economy.** Overall, commercial banks continue to report strong capital and liquidity buffers even though some remain exposed to government securities. Non-performing loans stood at 4.9 percent of the banks' portfolios in March 2023. The law on deposit insurance scheme will become effective from April 2024, strengthening customer protection. The "greylisting" of South Africa by the global intergovernmental body Financial Action Task Force (FATF) for deficiencies in efforts to combat money laundering and terrorist financing could weaken the confidence of investors in the domestic financial market if corrective measures are not implemented in the short-term.

15. **The current account has returned to a deficit in 2022, financed by financial inflows.** The current account registered a temporary surplus of 1.9 and 3.7 percent of GDP in 2020 and 2021, but it returned into a deficit of 0.5 percent of GDP in 2022. The trade balance remained positive (two percent of GDP), but it was not sufficient to compensate for the higher dividend and interest payments paid to nonresidents and higher transfers to the Southern African Customs Union. The current account balance registered a deficit of 1.6 percent of GDP in H1 2023 as the trade balance continued to weaken. The exchange rate depreciated by about 10 percent in 2022, partly because of broad-based US dollar strength, supporting the external sector adjustment. The rand has further weakened to an all-time low in May 2023 given higher global interest rates and the country risk deterioration fueled by external and domestic political factors but regained some ground since then. The current account deficit was financed by financial inflows that led to an increase in international reserves from US\$57 billion in 2021 to US\$60 billion in 2022 and further to US\$62 billion in July 2023. The weakening current account balance reflected the declining gross savings following their pandemic peak and the recovery in domestic investment. The gross savings rate has decreased to 14.9 percent of GDP in 2022 from 16.7 percent in 2021 and investment increased from 13 to 15.4 percent of GDP over the same period.

16. **The government outperformed its fiscal targets in 2021 and 2022, owing to a favorable external**

¹⁰ <https://www.dailymaverick.co.za/article/2023-03-14-load-shedding-leads-to-job-cuts-at-one-in-five-nelson-mandela-bay-businesses/>

¹¹ For greater detail on the structural challenges in the South Africa's labor market, see World Bank, South Africa's labor market can benefit from young entrepreneurs and self-employment, July 2021.



environment, overperforming revenue collection, and prudent spending. The overall fiscal deficit declined from 9.9 percent of GDP in 2020 to 4.6 percent of GDP in 2021 and 4.2 percent of GDP in 2022 (Table 2). Revenue outperformed budget estimates, by 3.7 percent of actual GDP in 2021 and 1.8 percent in 2022. The increase in revenue was the combination of favorable commodity prices, the recovery of the domestic economy, and improved tax administration. Furthermore, the government also showed commitment to preserving macroeconomic stability by maintaining expenditure growth below nominal GDP growth. As a result, public expenditure declined by 2.3 percent of GDP between 2020 and 2022. This reduction was concentrated on the public wage bill (down by 0.7 percent of GDP) and transfers (down by 1.4 percent of GDP), while capital spending remained stable at 2.3 percent of GDP during this period. In 2022, the government was able to resist political and social pressures for higher social spending despite the severe flooding in April 2022, which led to emergency spending for 0.1 percent of GDP, and the continuation of the Social Relief of Distress (SRD) grant. However, debt-service payments continued to rise, accounting for almost 16 percent of total public expenditures by 2022. To finance the fiscal deficit, the government borrowed mainly in local currency even though it issued US\$3 billion in Eurobonds in April 2022 and received financial support from the World Bank and other development partners. The total public debt increased from 57.2 percent of GDP in 2019 to an estimated 71.7 percent of GDP by end-2022.

17. **The 2023 Budget is anchored on a prudent fiscal policy based on restraining expenditure growth, though the short-term trajectory will be impacted by the debt-relief arrangement with Eskom.** The 2023 Budget (presented in February and approved in June) reinforced the fiscal objectives laid out in the 2022 Medium-Term Budget Policy Statement presented in October 2022 to: (i) reduce the budget deficit and stabilize debt-to-GDP; (ii) support economic growth by maintaining a prudent fiscal stance and directing resources towards infrastructure and fighting crime and corruption; and (iii) reduce fiscal and economic risks, including through the Eskom debt-relief arrangement. These objectives are expected to be achieved over the Medium-Term Expenditure Framework (2023-2025) through:

- Robust revenue collection despite less favorable commodity prices. This will be driven by reforms to rebuild the South African Revenue Service with improved systems (including progress on digitalization) and professional leadership, following a period of state capture. This will increase tax compliance and strengthen revenue collection. In addition, there are efforts planned to reduce tax incentives (following the advice of the Davis Tax Committee and World Bank technical assistance).
- Limited expenditure growth, with the withdrawal of the legacy pandemic-related measures (COVID-19 Social Relief Distress (SDR) grant¹² planned to end in March 2024), limited adjustments in the value of other grants, and constrained growth in the compensation bill envelope. Fiscal buffers are also maintained through contingency and unallocated reserves.
- Addressing Eskom’s financial issues in a comprehensive and accountable manner in contrast to previous ad-hoc transfers that have adversely affected budget outcomes, as supported by this DPL. National Treasury (NT) will inject US\$15 billion (R254 billion or 3.4 percent of GDP) into Eskom over the next three fiscal years (the conditions are described in Section 4.2), representing 1.1 percent of GDP in 2023 and another 2.2 percent of GDP over 2024-2025. This arrangement, accompanied by several cost-saving

¹² The COVID-19 SRD grant protected unemployed informal sector workers during the pandemic and provided R350 per month for beneficiaries between the ages of 18-59. At its peak about 11 million people received the grant at a cost of about R46 billion (US\$3 billion). In 2023 about 8 million people still receive the grant monthly.



measures by Eskom and electricity tariff increases¹³, is expected to improve Eskom’s balance sheet, reducing the probability of further financial support from NT after FY2025.

- Improvement in public procurement practices (following the recommendations from the OECD/World Bank Methodologies for Assessment of Procurement System (MAPS)) to combat leakages and corruption.

Table 2: Operations of the consolidated government budget¹

	2020/21	2021/22	2022/23 e	2023/24 f	2024/25 f	2025/26 f	2026/27 f	2027/28 f	2028/29 f
In percent of GDP, unless otherwise indicated	Actual			Projections					
Overall Balance	-9.9	-4.6	-4.2	-5.9	-5.5	-6.0	-4.5	-4.4	-4.2
Primary Balance	-5.7	-0.4	0.5	-0.9	-0.5	-0.8	1.1	1.3	1.7
Total Revenue and Grants	25.1	27.8	28.5	27.7	27.5	27.5	27.5	27.6	27.6
Tax revenues	22.6	25.5	26.3	25.7	25.5	25.6	25.6	25.6	25.7
Non-tax revenues	2.5	2.2	2.2	2.0	1.9	1.9	1.9	1.9	1.9
Expenditures (incl. Eskom deal above the line)	35.0	32.4	32.7	33.6	33.0	33.5	32.0	32.0	31.8
Current expenditure	31.1	28.9	29.3	29.9	29.4	29.4	29.3	29.3	29.1
Wages and compensation	11.3	10.6	10.6	10.6	10.5	10.5	10.4	10.2	10.1
Goods and services	4.3	4.2	4.2	4.4	4.2	4.2	4.1	4.1	4.1
Current transfers (incl. social grants)	11.2	9.7	9.8	9.8	9.5	9.3	9.2	9.1	8.9
Interest	4.1	4.3	4.6	5.0	4.9	5.2	5.6	5.7	5.9
Other current expenditure	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditures	2.3	2.3	2.3	2.1	2.1	2.1	2.1	2.1	2.1
Other expenditures	1.6	1.2	1.0	1.6	1.4	2.0	0.6	0.6	0.6
Transfers to SOEs	1.6	1.2	1.0	1.2	0.9	1.4	0.0	0.0	0.0
Of which: transfers to Eskom	1.0	0.5	0.3	1.1	0.9	1.4	0.0	0.0	0.0
Contingency and unallocated reserve	0.0	0.0	0.0	0.4	0.6	0.6	0.6	0.6	0.6
Total Public debt	70.1	67.9	71.7	72.3	73.8	76.3	77.2	77.6	77.5

Sources: National authorities and World Bank estimates.

Note:¹ The fiscal year runs from April 1st to March 31st such that 2020/21 represents the year April 2020 to March 2021.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

18. **The medium-term outlook for South Africa’s economy is in line with the modest performance achieved over the past decade, after a projected difficult year in 2023** (Table 1). GDP growth is projected to decline significantly in 2023 to around 0.5 percent, in line with the SARB and the IMF forecasts, due to intensive load shedding, growing transport infrastructure bottlenecks, and uncertainty in the global and domestic environments. The reduction in load shedding that should accelerate from early 2024, as new RE generation is gradually being deployed, should contribute to a modest rebound in economic activity over the subsequent years. In the medium-term, the GoSA’s commitment to implement structural reforms in its industrial, trade, and labor policies should ease constraints faced by businesses, unleashing some growth potential. The promotion of trade and regional integration, as well as the acceleration of the low-carbon energy transition should also

¹³ In the case of South Africa, electricity tariffs follow a multi-year price determination process (on a 3-year cycle) which incorporates rate of return and incentive price regulation principles. This methodology has been in operation since 2006, with an adequate level of implementation.



encourage (foreign and domestic) private investment and economic diversification, including toward green and mineral value chains and modern services (such as finance and logistics) where South Africa possesses significant assets and regional comparative advantages. However, the projected GDP growth rate remains conservative in the medium-term, with GDP growth projected to average 1.6 percent over 2024-2028, to account for the likely slow implementation of structural reforms (beyond the energy sector) required to unlock the country's growth potential, especially the private sector. The upcoming elections are also expected to slow down the pace of reform implementation in the domestic labor and products markets, while the external environment is expected to remain unfavorable with depressed global demand and volatile commodity prices in the medium-term.

19. **Inflation is projected to decline to 6 percent in 2023 and then converge toward 4.5 percent, which should allow a gradual easing of monetary policy over time.** This projection assumes that additional shocks on imported prices or the local currency remain limited, including the pass-through of higher global food and energy prices on domestic inflation. Domestically, potential second-round effects of the hike in municipal electricity tariffs which took effect in July 2023, other increases in administered prices, and load shedding (which increases businesses' operating costs) constitute the main inflationary risks. The SARB is expected to continue to adjust monetary policy consistent with its inflation target of 3-6 percent.

20. **The current account deficit is forecasted to deteriorate over the projection period because of less favorable terms of trade and the persistent negative impacts of transport and logistics bottlenecks on minerals and food exports.** The moderate rebalancing in the saving and investment balances is expected to continue and the current account deficit is projected to increase to 2.0 percent of GDP in 2023 and to deteriorate further to 2.2 percent of GDP over 2024-2028. This projection is nonetheless sensitive to variations in price for food and mineral commodities, which account for about half of the country's merchandise exports. Financial inflows, including foreign direct investment and portfolio investments into the domestic bonds and equity markets, are expected to finance the current account deficit, and reserves are expected to remain broadly stable this year and to increase slightly over the medium-term.

21. **The projected fiscal trajectory follows government's plans, but it assumes a slower consolidation path reflecting expected spending pressures and a less favorable global environment.** The primary balance, excluding the Eskom Debt Relief, is projected to increase from 0.2 percent of GDP in 2023/24 to 1.1 percent of GDP in 2026/27 and further to 1.7 percent in 2028/29. Revenue is forecasted to decline by 0.8 percentage points of GDP between 2022/23 and 2023/24 in the context of lower global commodity prices and weak domestic demand and to stabilize at about 27.6 percent of GDP over the medium term. On the expenditure side, the fiscal path assumes a continuation of the SRD grant beyond 2023/24, at its current nominal level, which will translate into a decline as a share of GDP. The number of beneficiaries is expected to decrease in line with the expected small rebound in GDP growth and job creation over the medium-term. The forecasted public sector wage bill for 2023/24 reflects the agreement between the government and trade unions, which is expected to increase the wage bill by about 6 percent compared to the initial budget estimate. The wage bill is projected to increase in line with inflation between 2024 and 2026, and slightly below inflation subsequently, reflecting the increasing bargaining power from NT over trade unions as a result of the landmark court judgement in favor of NT in 2022.¹⁴ Overall, spending pressures are projected to be funded through the use of the budgeted contingency and unallocated reserves over 2023/24-2025/26, and reallocations within the budget envelope. In addition, the government will have to cap the capital expenditures to 2.1 percent of GDP to achieve the projected fiscal

¹⁴ Trade Unions took government to Court in 2020 because it did not honor a 3-year wage agreement settled in 2018. The agreement was found unlawful by the Labour Appeal Court and the judgement was confirmed by the Constitutional Court. The decision was justified by the fact that the wage increase had not been budgeted for and that NT had indicated this to the state's representatives during the bargaining process.



targets. As a result, non-interest public expenditures (excluding Eskom) are projected to decrease by 0.6 percentage points of GDP in 2023/24 and another cumulative 2.7 percentage point of GDP over the 2024/25-2028/29 period. The interest payments bill on public debt will continue to increase from 4.6 percent of GDP in 2022/23 to 5 percent of GDP in 2023/24 and 5.9 percent of GDP by 2028/29. In this context, the overall fiscal deficit is projected to increase from 4.2 percent of GDP in 2022/23 to 5.9 percent of GDP in 2023/24 (4.8 percent of GDP, excluding the Eskom deal), followed by a gradual consolidation toward 4.2 percent of GDP by 2028/29.¹⁵

22. **Public sector financing needs, while declining, are expected to remain in the range of 14 percent of GDP annually until 2025/26 (about 8 percent of GDP excluding short-term debt rollover)** (Table 3). As in the past, these needs should be mainly funded in domestic currency, taking advantage of the depth of the local financial market. Further, the authorities are planning to borrow approximately US\$8.5 billion in foreign currency denominated debt, including about US\$2 billion per year from development partners. The World Bank is expected to contribute to US\$1 billion through this operation, which is only around 2 percent of total financing requirement, but it also provides critical support through technical assistance and its capacity to mobilize other partners. The authorities will also use some of the cash balances, to the order of 0.8 percent of GDP annually, to reduce borrowing requirements. Financing needs are expected to remain elevated over 2026/27-2028/29, around 13 percent of GDP.

Table 3. Financing requirements and sources, 2020/21-26/27

	2020/21	2021/22	2022/23 e	2023/24 f	2024/25 f	2025/26 f	2026/27 f	2027/28 f	2028/29 f
Percent of GDP	Actual			Projections					
Financing needs	17.5	12.9	12.2	14.1	13.8	14.8	13.0	14.3	12.9
Consolidated Government Balance (incl. Eskom deal)	9.9	4.6	4.2	5.9	5.5	6.0	4.5	4.4	4.2
Domestic short-term amortizations	6.4	7.2	6.7	6.0	6.3	6.4	6.6	6.8	6.9
Medium and long-term amortizations	1.2	1.0	1.3	2.3	2.1	2.3	1.9	3.1	1.8
Domestic	0.9	1.0	1.1	1.6	1.6	1.6	1.5	2.9	1.4
Foreign	0.3	0.1	0.2	0.6	0.5	0.7	0.4	0.2	0.4
Financing sources	17.5	12.9	12.2	14.1	13.8	14.8	13.0	14.3	12.9
Domestic short-term loans	8.1	7.1	6.3	6.7	6.8	7.0	7.2	7.4	7.6
Domestic long-term loans	9.3	5.3	5.1	5.4	5.7	6.6	4.9	6.0	4.5
Foreign loans	1.6	0.5	1.0	0.6	0.5	1.0	0.9	0.9	0.8
of which: World Bank	0.0	0.0	0.2	0.3	0.0	0.0	0.0	0.0	0.0
of which: other partners	1.6	0.2	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Change in cash and other balances	-1.7	0.5	0.1	1.3	0.7	0.2	0.0	0.0	0.0
Reduction in NFA of public entities	0.1	-0.5	-0.4	0.1	0.2	-0.1	0.0	0.0	0.0

Sources: National authorities and World Bank estimates.

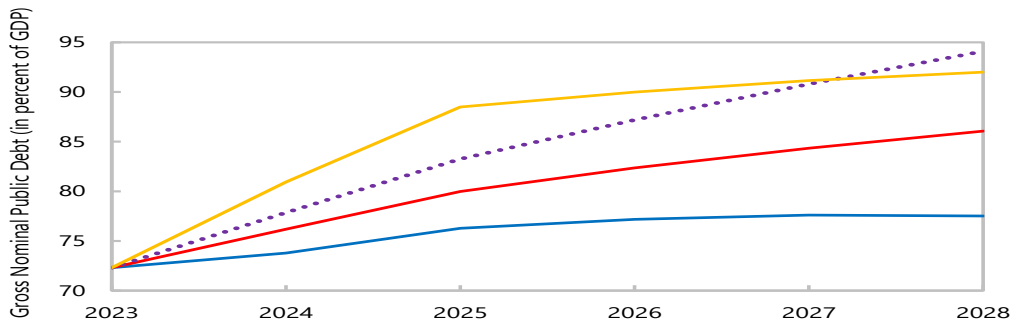
23. **South Africa’s public debt has increased sharply since the pandemic, while its composition remains predominantly in local currency and with long-term maturities.** Public debt to GDP increased from 57.2 percent in 2019/20 to 71.1 percent in 2022/23, and it is projected to reach 72.3 percent at the end of 2023/24. More

¹⁵ The reforms supported by this operation will only have a fiscal cost through the Eskom Debt Relief, which is accounted in the projections. The other measures (tax incentives, the budgetary support to the Free Basic Electricity Program and the Bounce Back Scheme) have a total cost of less of 1 percent of public revenue.



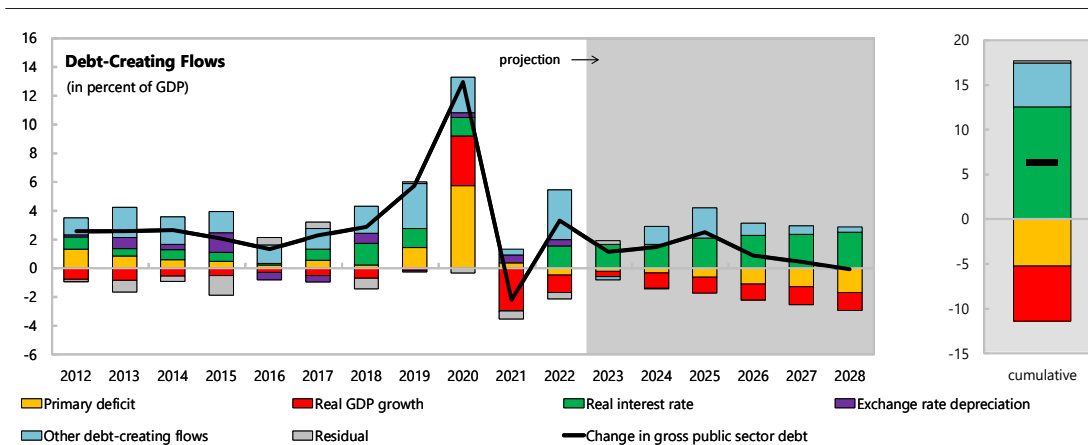
than 90 percent of total public debt is denominated in local currency with an average maturity of about 12 years (one of the longest among middle-income countries). Foreign investors have traditionally demonstrated an appetite for local currency denominated public bonds issued by NT, holding about one-fourth of total domestic debt even if this share has declined in recent years.

Figure 1: Public debt is projected to increase until 2026 and will stabilize onward in the baseline scenario



Source: World Bank Debt Sustainability Analysis, September 2023.

Figure 2. Debt creating flows, 2012-2028



Source: World Bank Debt Sustainability Analysis, September 2023.

24. **South Africa’s public debt is assessed as sustainable based on the projected prudent fiscal path.** Public debt to GDP is projected to increase to 72.3 percent in 2023/24 and to peak at 77.6 percent in 2027 and start declining thereafter (Figures 1 and 2). This baseline scenario assumes the implementation of the authorities’ medium-term fiscal plans described above. Interest rates for 2023/24 are assumed to stay broadly in line with market rates so far this year. They are assumed to decrease gradually over the projection period, but they should remain higher than in the period before the pandemic, which is consistent with global outlook projected by the World Bank. The composition of debt is projected to remain predominantly in local currency and with long-term maturities, though new issuances are projected to have slightly shorter maturities. It also reflects the partial debt takeover of Eskom, which is the explicit recognition of existing contingent liabilities as about 90 percent of Eskom’s debt is guaranteed by NT. The increasing primary balances are critical to ensure debt sustainability and



compensate for the projected increase in debt-service payments and unfavorable debt dynamics with average implicit interest rates increasing from 7.4 percent in 2022/23 to 8 percent by 2028/29. Interest payments are expected to reach 21 percent of total revenue in 2028, up from about 16 percent in 2022.

25. **The baseline scenario is subject to substantial external and domestic risks.** The medium-term GDP growth path, already moderate, could be further reduced by exogenous shocks (e.g., extreme climate events, lower commodity prices) and by a slowdown in reform implementation in the face of vested interests and a difficult political economy context ahead of the 2024 general elections. Next year's planned general election could delay reaching consensus around much-needed structural reforms. The main risk is arguably on the domestic front as the fiscal trajectory is highly vulnerable to lower-than-expected growth, which would affect revenue and increase the fiscal effort required to stabilize public debt. Spending slippages on wages, social grants, and transfers to financially distressed SOEs would also put fiscal sustainability at risk. These risks are magnified in an environment of poor governance and corruption. Contingent liabilities are significant: the total amount of approved guarantees to public institutions was estimated at R478.5 billion (6.8 percent of GDP) at end-March 2023. However, the great majority is with Eskom and hence the overall risk is mitigated by the ongoing debt-relief arrangement supported by this operation. Externally, a sudden reversal in portfolio investment flows caused by an increase in global interest rates or a deterioration of the country's risk could further raise the cost of public borrowing. A shift in capital flows would lead to a depreciation of the Rand, additional inflationary pressures, and further increases in domestic interest rates and debt-service costs. These risks would lead debt to increase without stabilizing over the forecast horizon.

26. **South Africa's macroeconomic framework is assessed as adequate for the proposed operation despite the significant risks highlighted above.** This assessment is based on the GoSA's commitment to prudent macroeconomic policies and plans to accelerate structural reforms, including those in the energy sector supported by this operation. By promoting a more enabling environment that improves long-term energy security, these reforms should help to accelerate economic growth, which would improve debt dynamics and help preserve fiscal sustainability in the long term. For example, an increase of the average annual growth from 1.7 to 2.2 percent over the 2026-2028 period would reduce the debt-stabilizing primary balance from 1.7 percent of GDP to 1.2 percent of GDP. They will also reduce fiscal risks by improving Eskom's financial balance sheet in the medium-term, which has burdened the national government budget over the past decade. Fiscal risks are further mitigated by government's good track record in managing expenditure pressures over the past two years, and generally strong public financial management (South Africa's budget processes remain among international best practices, ranking number 2 in the world on budget transparency based on the 2021 Open Budget Survey). Debt sustainability risks are also mitigated by the composition of public debt, and the large domestic savings base, which makes it less vulnerable to external shocks associated with the exchange rate and global interest rates, even though public borrowing remains exposed to domestic commercial banks that are by far the main holder of public debt. South Africa also benefits from the high credibility of the SARB, the flexible exchange rate regime, and the well-developed local financial markets.

2.3. IMF RELATIONS

27. **The GoSA is on a standard 12-month consultation cycle with the IMF.** The World Bank and the IMF have been collaborating closely on the macroeconomic framework and structural reform agenda in the context of the post-pandemic recovery. In July 2020, the Executive Board of the IMF approved a US\$4.3 billion loan to South Africa under its Rapid Financing Instrument (RFI). In August 2021, as part of the IMF's general allocation of Special Drawing Rights (SDR), South Africa received SDR 2,924.4 million. The Executive Board of the IMF concluded an Article IV consultation on May 22, 2023 (Annex 3).



3. GOVERNMENT PROGRAM

28. **South Africa's Economic Reconstruction and Recovery Plan (ERRP), adopted in October 2020, outlines an ambitious reform agenda to break the country's cycle of high inequality and low growth and to spur recovery in the wake of the COVID-19 pandemic.**¹⁶ The ERRP is complemented by a series of sectoral strategies and plans that provide key building blocks toward a sustainable and low-carbon energy transition including:

- **Updated Nationally Determined Contribution (NDC), 2021.** South Africa committed to GHG mitigation targets by 2025 and by 2030 through implementation of a combination of carbon pricing and mitigation policies (i.e., the carbon tax, carbon budgets, and sectoral emissions targets), promotion of RE and decommissioning of coal power (e.g., the 2019 Integrated Resource Plan (IRP)), and the Green Transport Strategy.
- **Just Energy Transition Framework in the Minerals and Energy Sectors (JET Framework), March 2022.** This framework supports the decarbonization of the minerals and energy sectors in a socially acceptable way while contributing to the economic development of the country in line with the IRP 2019. The JET Framework is structured around three pillars: (1) planning to enable a people-centric and collaborative transition founded on the principles of inclusivity, openness, and transparency to ensure that no one is left behind; (2) implementation focused on harnessing the socio-economic value of mitigation, adaptation, and social inclusion programs while mitigating/managing the adverse impacts the transition may have on the coal value chain; and (3) monitoring and evaluation to examine the progress on JET.
- **Energy Action Plan, July 2022.** This plan, led by the National Energy Crisis Commission (NECOM), is built on five priorities: (i) fix Eskom and improve the availability of existing supply of electricity; (ii) enable and accelerate private investment in generation capacity;¹⁷ (iii) accelerate procurement of new capacity from RE and gas and boost battery storage; (iv) unleash businesses and households to invest in rooftop solar; and (v) fundamentally transform the electricity sector to achieve long-term energy security.
- **Just Transition Framework (JTF), August 2022.** South Africa defines the Just Transition as a transformative change for all South Africans to adapt to the adverse impacts of climate change and that leads to net zero GHG emissions by 2050. The country sees this transition as consistent with its development goals to ensure decent work for all, achieve social inclusion, and eradicate poverty. The JTF provides a roadmap to a low-carbon economy and climate resilient society.¹⁸ In November 2002, the Just Energy Transition-Investment Plan (JET-IP) identified the main investment needs to achieve a just and low carbon transition for the period 2023-2027.¹⁹

PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. **The DPL supports the GoSA's reform efforts to advance the restructuring of the power sector to promote long-term energy security and support a low carbon transition.** The magnitude of the crisis has

¹⁶ Government of South Africa. 2020. Building a New Economy, Highlights of the Reconstruction and Recovery Plan, p. 8.

¹⁷ This includes facilitating the development of embedded generation by removing licensing requirements and reducing administrative processing times. It also includes measures for Eskom to purchase extra capacity available from private producers and the development of Eskom's land lease program.

¹⁸ Presidential Climate Commission. 2022. Framework for a Just Transition in South Africa.

¹⁹ About 60 percent of the plan (ZAR647 billion) focuses on the electricity sector: decommissioning of the retiring coal generation fleet; developing RE generation at scale and pace (solar, wind, batteries, and green hydrogen); strengthening the transmission grid infrastructure to accommodate the shift to RE; and modernizing the electricity distribution system.



incentivized policymakers to take several actions that will help transform the sector despite the presence of vested interests that had slow down reforms in the past. This operation is part of a multi-donor effort to support the government’s program and complements other ongoing activities, such as the JET-IP, and dedicated technical assistance. It is anchored on two mutually reinforcing pillars and eight prior actions that were identified jointly with the GoSA and other development partners as part of a participatory and coordinated process (Annex 1):

- **Pillar One:** Advance the restructuring of the power sector to promote long-term energy security by supporting the unbundling of Eskom, redirecting its resources toward new investments in transmission, while ensuring continued support for low-income households in a context of increasing electricity tariffs.
- **Pillar Two:** Support the implementation of a low carbon transition by encouraging private investments in renewable energy generation and strengthening the use of carbon pricing instruments.

30. **These two pillars balance the urgency to address the energy crisis with the commitment to advance a low-carbon and just transition.** The main analytical underpinning for this operation is the CCDR, which outlines that RE is a least-cost option for a sustainable, just, and low carbon transition in South Africa. The operation also builds on the dialogue and technical assistance provided through Programmatic ASAs (P-ASA) in the energy sector and climate change and the World Bank’s Partnership for Market Readiness (Annex 5).

31. **The design of the DPL draws from the experience of the 2022 South Africa Covid-19 Response DPL (P174246), the first ever World Bank’s budget support operation in South Africa, and in similar operations supporting energy reforms in other countries.** The main lesson is to closely align the reforms with government priorities to ensure full ownership. It should also focus on a few specific but strategic reforms that, once implemented, will be hard to reverse. The reforms supported by this DPL should be interpreted as critical first steps of the Theory of Change supported by this operation (Annex 6).

32. **This operation has been assessed for Climate Co-Benefits (CCB) and is aligned with the goals of the Paris Agreement (Annex 7).** All prior actions are aligned with the mitigation goals of the Paris Agreement and are not likely to cause a significant increase in GHG emissions or lead to any persistent barriers to transition to low-GHG emissions. Prior Actions 1, 2, 5, 6, 7, and 8 directly support a transition to a low-carbon economy.

33. **The DPL has been screened for climate and disaster risks and is assessed to have no to low risk.** While certain climate hazards – namely drought, flooding, and wildfire – threaten South Africa and are on trend to worsen, the risk of such threats impacting this operation are assessed to be low given the operation’s focus on regulatory and policy changes. Risk of climate hazards adversely affecting the prior actions’ contribution to the PDO is also low.

4.2. PRIOR ACTIONS AND RESULTS

PILLAR 1: ADVANCE THE RESTRUCTURING OF THE POWER SECTOR TO PROMOTE LONG-TERM ENERGY SECURITY

Objective 1.1. Support the unbundling of Eskom and mechanisms to reinforce investments in transmission

Rationale

34. **After substantial delays since its approval in October 2019, the unbundling of Eskom has gained new momentum as part of the Energy Action Plan.** The separation (unbundling) of key activities (generation, transmission, and distribution) across the power sector value chain is an important first step to increase the efficiency in electricity services. Government, through NECT, has prioritized the legal unbundling of NECT (as a subsidiary of Eskom), which will act as the TSO in charge of the operation of the transmission system as part



of the transition toward an independent TSO. By reducing the vertical integration in the power sector, the operationalization of NTCSA (through a legal unbundling) represents the first step toward reducing the vertical integration in the sector and supports fostering a competitive market, as defined in the Cabinet approved "Roadmap for Eskom in a Reformed Electricity Market" of 2019. However, the unbundling of Eskom's generation and distribution divisions are yet to proceed.

35. **Starting in 2019, Eskom implemented the internal systems required to transfer its Transmission Division to NTCSA, but additional steps are needed for its operationalization.** To complete the legal unbundling of Eskom Transmission Division and operationalize NTCSA (as a wholly owned subsidiary of Eskom), the following activities should be completed: i) the Minister of Public Enterprises appoints the NTCSA board; ii) NERSA issues a transmission license to NTCSA;²⁰ and iii) lenders provide consent to the legal unbundling process as the transmission assets now in the hands of Eskom Transmission Division will be handed over to an Eskom subsidiary, NTCSA.²¹

Substance of the prior actions

- **Prior Action #1:** The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.
- **Prior Action #2:** The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to *inter alia*: (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.

36. **The licensing process, Prior Action #1, is a regulatory requirement to support the legal unbundling of Eskom's Transmission division as NTCSA will be in charge of the transmission system operation.** The transmission license is a necessary condition to legally unbundle the transmission sector. Under the current legal arrangements, the transmission license will allow NTCSA to operate and maintain the transmission system and perform the following key roles to ensure the integrity of the interconnected power system: (i) transmission network service provider; (ii) system operator; (iii) transmission system planner; and (iv) grid code secretariat. According to NERSA, the transmission license provides the regulatory requirements for NTCSA to be operationalized.²² This licensing process, as explained below, needs to be complemented with additional licenses and legal changes, as proposed in the Electricity Regulation Act (ERA) Amendment Bill, to allow the development of an open market platform.

37. **The amendments to the ERA, Prior Action #2, will provide the legal framework to establish a separate TSO, an open electricity market, create mechanisms to complement investments in transmission, and allow NERSA to develop required regulations.** The ERA Amendment Bill will: (i) assign the duties, powers and functions of the TSO, including transitional measures that end up in the establishment of a separate TSO, to create a wholesale power market under a single buyer model (through a central procurement agency) with an open market platform that allows for competitive electricity trading; (ii) provide access to the transmission network on a non-discriminatory basis with published tariffs applicable to all eligible consumers; (iii) give power to DMRE

²⁰ NTCSA has also applied to NERSA for a trading license and an import/export license. These additional licenses are required for NTCSA to buy and sell power on a for profit basis. NERSA announced the approval of these two additional licenses on September 18, 2023.

²¹ The Eskom board provided to the Minister of Public Enterprises a list of possible candidates for the NTCSA board. Eskom has also approached lenders to obtain the required letters of consent.

²² NERSA. Media Statement of July 28, 2023. Energy Regulatory Decisions of Meeting Number 262 of July 27, 2023.



to procure electricity transmission infrastructure for the purposes of ensuring security of supply, including the possibility of attracting private sector participation; (iv) unbundle tariffs for vertically integrated licensees; and (v) strengthen the role of NERSA.

Roadmap for the medium-term

38. **Building on these actions, the legal unbundling of Eskom transmission, through the operationalization of NTCSA, requires additional reforms to move the power sector from its current crisis towards a path of long-term sustainability.** The operationalization of NTCSA is a first step toward long-term energy security but the government roadmap for Eskom needs to be completed with the legal unbundling of the generation and distribution divisions and complemented with the development of an adequate enabling environment. Priorities are to: (i) address the long-term sustainability of the distribution sector (including municipalities); (ii) promote the development of the transmission network based on system requirements and in a financially sustainable manner²³; (iii) ensure the independence of the TSO from Eskom Holdings to support transparency, competition, and non-discrimination access to the grid; and (iv) define the mechanisms to transition away from the central procurement agency towards a full wholesale competitive market. The long-term sustainability of the power sector will require deepening the participation of the private sector across the sector value chain, which should be allowed to compete in a transparent and non-discriminatory manner with the incumbent service providers. This includes the development of an adequate wheeling framework for transmission.

39. **Expected results:** By March 2025, South Africa is expected to have operationalized NTCSA, with the required licenses from the regulator. Its board will have been nominated, including with members from the private sector. The de facto processing time allowed to NERSA to respond to a license application will be cut from 60 days to 45 days.

Objective 1.2: Improve Eskom’s financial position to increase investments in transmission, while ensuring continued support for poor households in a context of rising electricity tariffs

Rationale

40. **After years of inadequate policies, Eskom faces substantial challenges to invest in the grid as the focus has been directed toward keeping in power plants in operation and repaying increasing level of financial expenses.** Eskom reported that transmission infrastructure has deteriorated to an extent that may pose a risk to energy availability. Furthermore, financial constraints are hampering Distribution from executing its mandate of building and maintaining distribution assets and servicing the customer.²⁴ Over the past three years, in average, Eskom developed 125 km of new transmission lines per year; going forward, Eskom estimates that the transmission grid alone requires about 1,400 km of new transmission lines per year and investments in the magnitude of R178 billion to 2031 to enable new generation capacity, particularly from renewable sources in the west. In parallel, Eskom’s balance sheet has severely deteriorated because of high operational expenses, excessive debt service payments, and below cost tariffs. Despite reporting operational profits, net losses were as large as R25 billion (US\$1.67 billion) in FY21 and R12.3 billion (US\$821 million) in FY22 with a total debt of R396 billion (equivalent to US\$27.3 billion) at end-March 2022, representing about 8.6 percent of South Africa’s GDP. Between FY2020 and FY2023, Eskom received about R110 billion (about US\$6.5 billion) in cash injection from NT to remain solvent.²⁵ Major credit rating agencies have downgraded Eskom, which is now rated at sub-

²³ Vesting new powers on DMRE to develop transmission, as proposed in the draft ERA Amendment Bill, should be used as an exceptional mechanism.

²⁴ Eskom Annual Reports.

²⁵ Eskom Annual Reports.



investment grade level (Fitch: B and Moody's: Caa1), compared to Sovereign rating at Fitch: BB- and Moody's: Ba2.

41. **To narrow the gap between electricity tariffs and supply costs, NERSA approved successive increases in electricity tariffs of about 40 percent during 2020-22, with further tariff increases planned for 2023-24.** As of December 2022, the average price of electricity was 0.155 US\$/kWh for households and 0.074 US\$/kWh for businesses (including taxes). In 2023, NERSA approved an increase in electricity tariff of 18.65 percent (applicable since April 1), and an additional 12.74 percent that will become effective from April 1, 2024.²⁶

Substance of the prior actions

- **Prior Action #3:** The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance and transmission.
- **Prior Action #4:** The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the *Appropriation Act* which *inter alia* mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.

42. **To improve Eskom's financial position and address its structural challenges, the Government has approved debt relief plan with a series of conditions (Prior Action #3).** The Eskom Debt Relief plan provides R254 billion in conditional financing that it's earmarked to repay Eskom's loans (about R168 billion in capital and R86 billion in interest) over the next three years. The conditional loan is equivalent to approximately 7.2 percent of GDP. To access this debt relief, under the form of a zero-interest loan, Eskom is required to comply with conditions defined by NT, which include:

- No new development of greenfield generation;
- Eskom will redirect capital expenditure to transmission and distribution (T&D) and those required to meet minimum emission standards and flue-gas desulfurization;
- No new borrowing for Eskom, unless written permission is granted by the Minister of Finance; and
- There will be a reduction in Eskom's R350 billion guarantee framework agreement with the government in line with NT's recommendations.

Once the conditions are met for any portion of the amount of the loan, Eskom will issue ordinary shares to the Estate equal to the amount of such portion.

43. **The Minister of Finance will be responsible for ensuring that Eskom implements the conditions. Eskom will be required to provide regular progress updates (expected to be on a quarterly basis) on these to NT and Department of Public Enterprise.** The debt relief plan aims to supplement the recently approved tariff increase and assist to free up financial resources for Eskom so that the utility can focus on investments into new transmission and distribution. By restricting Eskom's investments in generation, the Debt Relief complements government's reforms aimed to deepen private investments in RE generation, as supported by prior actions #5 and #6 presented below.

44. **The Eskom Debt Relief plan is complemented by measures to mitigate the continuous accumulation of municipal arrears, which hinder Eskom's commercial viability.** The outstanding debt owed to Eskom by the

²⁶ Total electricity losses in Eskom represented 11 percent of the total demand in 2022. However, total municipal arrears continue to be the key financial issue for Eskom. In 2022, Eskom reported that municipal arrears reached R44.8 billion (~US\$3.1 billion) at the end of FY22.



municipalities, which reached R56.3 billion by end-December 2022, needs to be addressed with a sense of urgency. While a comprehensive solution is complex, NT unveiled a Municipal Debt Relief program on March 31, 2023, through which Eskom will write-off municipal arrears over a three-year period under the condition that municipalities take specific steps to improve service sustainability, which will be monitored quarterly.²⁷ In addition, the ERA Amendment Bill is expected to further strengthen regulatory powers to amend license conditions, including municipal distribution licenses.

45. **Concurrently, the success of the debt relief plan will require significant improvements in Eskom's internal efficiency.** In April 2023, Eskom shared an updated Corporate Plan (approved by the Eskom Board of Directors) that aligns with the Eskom Debt Relief plan and includes, inter alia, internal measures to implement an intensive reliability maintenance program, support operational excellence and reduce unplanned outages—a key aspect identified to mitigate the impact of load shedding in the short-term. Eskom is also transitioning to a new senior leadership that will need to redouble efforts to improve governance and implement internal reforms to strengthen the financial and operational sustainability of the holding.

46. **The regular tariff review process that led to an 18.65 percent tariff adjustment by NERSA was followed by an important policy decision from the GoSA to protect the poorest households (Prior Action #4).** By increasing the budget allocation to the Free Basic Electricity (FBE), the authorities cushion about 2.3 million indigent households (about 1/5 of the total living in the country). The FBE program provides a voucher for 50 kWh/month of free electricity, enough for basic household electricity use. This program is financed by unconditional transfers from NT, which are divided via the electricity component of the local government Equitable Share Formula among 278 municipalities.²⁸ Municipalities are responsible for identifying recipient households, which should be classified as indigent or qualify for the pensioner's rebate.²⁹ To benefit from the program, the household needs to have a prepaid meter in which the voucher (token) is uploaded on monthly basis (any excess of consumption is paid by the customer at the applicable tariff rate). Over the past few years, the number of beneficiaries has increased by 200,000 households nationwide and the amount of subsidy per household from R4,400 in FY2018/19 to R4,900 in FY2020/21.³⁰

Roadmap for the medium-term

47. **Concerted effort across government and Eskom management are required to address weak governance, procurement, and operational efficiency that hinder Eskom's long-term sustainability.** The financial viability of Eskom is closely linked with the first objective of the program supported by this operation. The implementation of the unbundling process, the operationalization of NTCSA, and the implementation of subsequent layers of reforms, including those required to address the crisis at the municipal distribution level, contribute to the

²⁷ MFMA Circular 124. These conditions include no borrowing by participating municipalities that should also strictly comply with their payment to Eskom backed up by the adoption of reporting and budgetary mechanisms approved by NT such as implementing proactive lifestyle audits; conducting reviews of conflicts of interest and upgraded conflict of interest declaration system; strengthening ethics and anti-fraud frameworks; enhancing consequence management; instituting disciplinary charges against employees and suppliers; and reforms to procurement and supply chain management.

²⁸ The equitable share includes an allowance for basic services, community services, and administration. It was revised in 2013 as follows: Equitable Share= Basic Services + (Institutional Component + Community Services) x Revenue Adjustment +/- Correction and Stability amount.

²⁹ There are two sets of rules to determine eligibility: A household affordability test and a consumption limit. In the municipality of Cape Town, for instance, the consumption limit is set at 250 kWh per month, while the affordability test is determined if the household qualifies as indigent depending on the following criteria: i)(i) earn a combined income of less than R7500; (ii) is the registered owner of the property and live at the house full-time; (iii) use home mainly for residential purposes; and (iv) has a pre-paid meter.

³⁰ The recently adopted directive on the municipal debt enforce municipalities to use the funds transferred to the FBE for payments to Eskom, reducing the risk of leakage.



company's ability to return to a path of financial sustainability. However, while the Eskom Debt Relief provides vital financial space, addressing the above-mentioned longstanding challenges will urgently need coordinated efforts between government and Eskom management. Restoring the reliability of the existing fleet (minimizing the use of diesel generation) and implementing investments in transmission necessary to unlock bottlenecks that hinder the rapid deployment of new RE will be essential next steps. The GoSA will also need to clarify how Eskom will facilitate private sector participation for T&D through viable partnership arrangements, including risk mitigation, strengthening institutional capacity, and contract management expertise. The authorities should further clarify the implications, if any, of the Eskom Debt-Relief on the JET Program beyond the retirement and repurposing of the Komati coal power plant (supported by the World Bank under the Eskom JET project [P177398]), as per the government's IRP, which envisages decommissioning 5 GWs of old and inefficient coal plants between 2024 and 2030.

48. **Expected results:** The Eskom Debt Relief (including the conditions as presented in paragraph 42) will improve the utility's financial position and increase NTCSA's transmission capacity. The first result will be: (i) a reduction in Eskom debt/asset ratio from 52.8 percent to 41 percent between FY22 and FY24; and (ii) an increase in Eskom operating profit margin (EBITDA/Revenues) from 14.7 percent to 19 percent. The second result will be measured by an increase of 2,600 MVA in new transmission transformer capacity installed and commissioned in NTCSA network. The expected result associated with Prior Action #4 is a projected increase in the percentage of households benefiting from FBE increases from 23 percent to 35 percent.

PILLAR 2: SUPPORT THE IMPLEMENTATION OF A LOW CARBON TRANSITION

Objective 2.1 Increase private investments in renewable generation capacity

Rationale

49. **Accelerating the roll out of least cost RE is required to reduce load shedding and support a low carbon transition.** Nonetheless, reducing load shedding also requires increased availability of the existing generation fleet. Since 2011, South Africa has relied on the Renewable Energy Independent Power Producer Procurement Program (REIPPPP) to support the development of large-scale RE generation. While the first four bid windows of the REIPPPP (2011-2014) successfully mobilized 6 GW of new RE, recent bid windows failed to quickly mobilize new generation due to delays in reaching financial close which included limitations to secure transmission capacity. As part of the Energy Action Plan and in complement to the Eskom Debt Relief, the GoSA aims to encourage private sector participation in RE generation by (i) streamlining the administrative procedures for new private generators; (ii) extending specific tax incentives to businesses and households, and (iii) providing financial assistance to small and medium enterprises and individuals.³¹

Substance of the prior actions

- **Prior Action #5:** The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.
- **Prior Action #6:** The Borrower has approved the Budget 2023 which provides tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.
- **Prior Action #7:** The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that

³¹ Several initiatives are being tried including a pilot project in Cape Town where residential and commercial users can opt to feed electricity back into the grid; and a tariff restructuring approved by NERSA for residential consumers with small-scale embedded generation that includes a net billing offset rate.



provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.

50. **Prior Action #5, implemented since December 2022, has already led to a significant increase in the registration of new embedded generation projects with NERSA, up from 32 MW in the first quarter of 2022 to 2,427 MW in the first quarter of 2023.** The amended of Schedule 2, removed any threshold requirement for the licensing of projects that sell electricity directly to private consumers (embedded generation). Previously, a DMRE license was required for any embedded generation facility of 100MW and above. This change has allowed the private sector to streamline the design and development of embedded RE generation. As the registered projects gradually reach financial closure and construction, they will ease the pressure on the existing generation.

51. **To encourage households and businesses to invest more rapidly in RE, tax incentive programs have been extended in the 2023 Budget (Prior Action #6, Box 1).** These incentives are, however, relatively modest to limit their implications on the government’s revenue (the losses are estimated at less than 0.1 percent of GDP). Since they only cover the income tax, they principally target large taxpayers.

Box 1: Extension of tax incentive programs included in the 2023 Budget

The tax incentive to businesses that adopt RE has been temporarily expanded to help alleviate the energy crisis. The current incentive allows businesses to deduct the costs of qualifying investments in wind, concentrated solar, hydropower below 30 megawatts (MW), biomass, and photovoltaic (PV) projects above 1 MW that create a cash flow benefit in the early years of a project. Businesses can deduct 50 percent of the costs in the first year, 30 percent in the second, and 20 percent in the third year. Under the expanded incentive, businesses will be able to claim a 125 percent deduction in the first year for all RE projects with no thresholds on generation capacity. The adjusted incentive will only be available for new investments between March 1, 2023 and February 28, 2025.

To increase electricity generation from solar PV, government has introduced a rooftop solar tax incentive for individuals. Between March 1, 2023 and February 29, 2024, individuals can receive a tax rebate to the value of 25 percent of the cost of any new and unused solar PV panels. To qualify, the solar panels must be purchased and installed at a private residence, and a certificate of compliance for the installation must be issued before February 29, 2024. The rebate can be used to offset the individual’s personal income tax liability for the 2023/24 tax year up to a maximum of R15,000 per individual.³²

52. **The Energy Bounce Back Scheme supports individuals and enterprises, including those in the informal sector, to invest in RE to mitigate load shedding (Prior Action #7).** Commercial banks are incentivized to extend loans at reasonable prices and maturities to households and enterprises (including micro enterprises and informal business) that want to purchase or lease RE equipment. To further encourage the scheme, loans could also be provided to energy services companies so they can accelerate the installation of solar equipment with their clients and to finance the working capital needs of businesses in the green energy value chain, allowing low-income customers access to RE without the need to face significant upfront costs or taking large amounts of debt. The GoSA provides a 20 percent first-loss guarantee on all these loans, which has been financed by a budget allocation of R8 billion for the 12 months duration of the scheme.³³ The scheme was launched in August 2023, with the initial participation of three commercial banks and will run for one single year. The target is to reach about 1,000MW of new RE supported by the scheme with a 30 percent of the beneficiaries being women

³² Indicative prices for solar panels in South Africa range from R2,500 to R3,500 per panel (with a capacity range of 400-500 Wp).

³³ The fiscal cost has already been included in the budget as the scheme is funded by the unused guarantee that was set aside in the Reserve Bank in 2022/23.



led households and/or businesses.

Roadmap for the medium-term

53. **While the above initiatives support private investment in generation, the capacity to connect new RE to the grid remains a major bottleneck.** Therefore, as emphasized in Pillar 1, the development of a wheeling framework by NERSA that supports transparent and non-discriminatory access to the grid based on international best practices will be an anticipated reform. In addition, streamlining the application process by establishing a one-stop shop will further reduce transaction costs and assist to bring electricity onto the grid faster.

54. **Expected results:** By March 2025, and in comparison, to end-2022, significant improvement in private participation is expected, including 3,000 MW of new RE registered with NERSA and connected to the grid;³⁴ and R55 billion in private capital mobilized in new RE registered with NERSA. It is expected that at least 7500 businesses will have used the tax incentives provided for renewable energy. The bounce back mechanism is expected to promote 500MW of new, small-scale RE with one-third of the beneficiaries expected to be women. Prior Actions 5, 6 and 7 are assessed to receive CCB based on their expected contribution to GHG mitigation.

Objective 2.2 Strengthen the use of carbon pricing instruments.

Rationale

55. **South Africa has committed to a low-carbon energy transition, in which carbon pricing plays an important role** to incentivize businesses and households to shift their behaviors toward low-emitting activities in a cost-efficient manner.³⁵ The two main instruments employed to date are a carbon tax – introduced in June 2019 – and a domestic carbon market. A key design feature of the South African carbon tax is the offset allowance, which provides flexibility to firms to reduce their carbon tax liability by investing in projects that reduce emissions in South Africa. The allowance lets taxpayers meet 5 to 10 percent of their carbon tax liability (depending on industry) with offsets. This system has been operational since July 2020; to date, 13,588,850 tCO₂e³⁶ have been retired (purchased), which is equivalent to removing approximately 2.7 million gasoline-powered passenger vehicles from the road for one year. The offset system also encouraged GHG emission reductions in sectors not directly covered by the tax, such as public transport, agriculture, forestry, and other land use (AFOLU), and waste. Compared with other carbon taxes implemented globally, South Africa’s carbon tax is notable for its comprehensive coverage of GHG gases; while its carbon price is relatively low, it is comparable with other middle-income countries imposing a carbon tax.³⁷

Substance of the prior actions

- **Prior Action #8:** The Borrower has enacted the 2022 Taxation Law Amendment Act which *inter alia* amends the Carbon Tax Act to gradually increase the carbon tax rate.

56. **South Africa’s carbon tax is implemented in two phases.** Phase I serves as a pilot to allow firms to adjust to the required annual GHG reporting. In the context of the post COVID-19 recovery, the 2022 Budget extended Phase I until December 2025. To compensate for this extension, the GoSA accelerated the scheduled tax increase from 2023 to 2030 by enacting in January 2023 the 2022 Taxation Laws Amendments Act. Such acceleration will

³⁴ This would be equivalent to about 1/3 of the electricity capacity produced between 2011 and 2022.

³⁵ Parry, I. 2019. Putting a Price on Pollution: Carbon-Pricing Strategies Could Hold the Key to Meeting the World’s Climate Stabilization Goals. Finance and Development, December 2019.

³⁶ This is the official value as of September 3, 2023.

³⁷ Ian Parry, Simon Black, and Karlygash Zhunussova. 2022. “Carbon Taxes or Emissions Trading Systems? Instrument Choice and Design” IMF Staff Climate Note 2022/006, International Monetary Fund, Washington, DC.



multiply by three the carbon tax rate during this period (Table 4). Its inclusion in the law will ensure transparency and provide certainty in the implementation of the carbon tax.³⁸ It will also help the country move toward the updated NDC mitigation goals set in 2021.

Table 4. Evolution of Changes to South Africa’s Carbon Tax Rate Structure³⁹

Carbon Tax Rate (per tCO2e) Structuring under Carbon Tax Act 2019	Revised Carbon Tax Rate (per tCO2e) Structuring under the 2022 Taxation Laws Amendments Act
2019 = ZAR120/US\$6.27	2023 = ZAR159/US\$8.31
2020 = ZAR127/US\$6.63	2024 = ZAR190/US\$9.93
2021 = ZAR134/US\$7.00	2025 = ZAR236/US\$12.33
2022 = ZAR144/US\$7.53	2026 = ZR308/US\$16.01
<i>Between June 2019 and December 2022, the rate increased annually by the percentage of consumer price inflation plus two percent.</i>	2027 = ZAR347/US\$18.14
	2028 = ZAR385/US\$20.12
	2029 = ZAR424/US\$22.16
	2030 = ZAR462/US\$24.15

Source: NT, 2023 Budget Review.

Roadmap for the medium-term

57. **To achieve its NDC mitigation target, South Africa will need to further reform its carbon tax and implement additional mitigation policies.** While South Africa’s carbon tax rate and revenues are comparable to other middle-income countries that impose a carbon tax, the country must reduce the tax allowances and increase the effective tax rate.^{40,41} The country will need also to follow through with investments in renewable energy as articulated in the IRP, as well as with implementation of mandatory carbon budgets and sectoral emissions targets (SETs). Carbon budgeting is the process of allocating a GHG emissions allocation to a facility for a five-year period. A voluntary phase began in 2016. SETs outline sectoral-specific targets for GHG mitigation, as well as the plans and measures to achieve them. DFFE will propose a SET for each sector, which will need to be negotiated and agreed with the relevant line ministries. SETs for the highest emitting sectors are expected to be finalized end-March 2024. Changes to the domestic carbon market could help increase its liquidity and further drive cost-effective GHG mitigation. South Africa is exploring development of domestic standards to issue and validate carbon credits by domestic service providers.⁴² Such a standard could help prioritize offsets that generate sustainable development co-benefits and employment opportunities in South Africa, while also increasing the number of credits available on the market.

58. **A draft Climate Change Bill currently before Parliament represents important legislation to support the climate agenda.** The Climate Change Bill, when signed into law, will: (i) form the first legal framework in South Africa to respond to the impacts of climate change; and (ii) provide an architecture for a coordinated, integrated, and whole-of-economy response to climate change (that includes national, provincial, and municipal government). The current version of the Bill requires every organ of the state that performs a function affected by climate change to coordinate and harmonize its policies, measures, programs, and decisions to ensure climate risks are mitigated. Importantly, carbon budgeting becomes mandatory when the bill is enacted and includes

³⁸ NT, 2023 Budget Review, February 2023.

³⁹ U.S. dollar amounts are based on a USD/ZAR exchange rate of US\$1.00=ZAR18.83.

⁴⁰ Phase 1 of the Carbon Tax includes a basic tax-free allowance of 60 percent for all activities and additional allowances between 5-10 percent for some specific activities. In Budget 2022, the Minister of Finance announced that the basic tax-free allowance will gradually phase away beginning 1 January 2026.

⁴¹ See Qu, Haonan, Suphachol Suphachalasai, Sneha Thube, and Sébastien Walker. “South Africa Carbon Pricing and Climate Mitigation Policy.” IMF Selected Issues Paper (SIP/2023/040). Washington, D.C.: International Monetary Fund.

⁴² Another potential way to increase liquidity is to open the carbon market to international market players in line with the Article 6 of the Paris Climate Agreement, which allows countries to voluntarily cooperate with each other to achieve emission reduction targets set out in their NDCs and avoid double counting so that global emission reductions are not overestimated.



punitive measures for noncompliance.

59. **Expected results:** Prior Action #8 is expected to increase carbon tax revenues by about 52 percent between March 2023 and March 2025 (from R1.397 billion to R2.117 billion).⁴³ Carbon tax revenues represent about .03 percent of GDP, which is on par with nearly all other countries that implement a carbon tax.⁴⁴ This prior action is assessed to receive CCB based on expected contribution to GHG mitigation.

4.3. LINK TO CPF, OTHER BANK OPERATIONS, AND THE WORLD BANK STRATEGY

60. **The DPL aligns with the World Bank CPF for South Africa FY22-FY26** (Report No. 154318-ZA), discussed by the Board on July 22, 2021, and priorities from the regional and corporate strategies.⁴⁵ The CPF builds flexibility to respond to the government's financing needs and emerging priorities on two focus areas and objectives, which are relevant for this operation: (i) *Under Focus Area 1:* Promote increased competition and improved business environment for sustainable growth; Objective 1.2: Greater climate change resilience and environmentally sustainable investments in selected sectors; and (ii) *Under Focus Area 3:* Improve Infrastructure Investment Framework and Selected Infrastructure Services; Objective 3.2: Improved Infrastructure Services by Selected SOEs. This operation supports World Bank's priorities of supporting climate change mitigation efforts.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

61. **The GoSA has proceeded with extensive consultations in developing its Just Transition Framework.** Under the leadership of the Presidential Climate Commission (PCC), a series of meetings have been organized with key stakeholders, including with development partners but also local authorities and communities. To coordinate the preparation of this DPL, the government created a working group that includes the Canadian, French, and German governments as well as the African Development Bank (AfDB). More broadly, the consultations between the GoSA and development partners is now well established to support South Africa in its effort to address the energy crisis and advance the low carbon transition.

4. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

62. **This operation supports the GoSA's aspiration to ensure the energy transition is just, critical in a country that remains one of the most unequal in the world with high poverty and unemployment rates.** This operation is expected to have three key positive impacts on poverty. First, the projected increase in private investment in RE generation (Prior Actions #5, #6 and #7) will create new jobs as those are generally more labor intensive than coal-fire facilities.⁴⁶ This impact is difficult to quantify with precision but, in the longer term, the CCDR estimated that 200,000 direct and 400,000 indirect jobs could be generated by 2050. A requirement will be the skilling and reskilling of the workforce, including through the development of education and training programs, Active Labor Market Programs, and labor market flexibility. Second, through Prior Action #4, this operation will protect about

⁴³ NT collected R1,397,618 in its fiscal year ending in March 2022.

⁴⁴ Ian W.H. Parry ; Simon Black ; Karlygash Zhunussova, Carbon Taxes or Emissions Trading Systems? Instrument Choice and Design. 2022. © International Monetary Fund.

⁴⁵ World Bank; International Finance Corporation; Multilateral Investment Guarantee Agency. 2021. Country Partnership Framework for the Republic of South Africa for the Period FY22-FY26. World Bank, Washington, DC. © World Bank.

⁴⁶ There is a growing and extensive literature demonstrating that renewable energy facilities are more labor-intensive than coal or fuel facilities. The estimated total job creation per GWH is about 8 times higher for solar than coal-fired projects during their lifetime (Source: Jaden Kim and Adil Mohommad, Jobs Impact of Green Energy, IMF Working Paper, WP/22/101).



2.3 million poor households (approximately 1/5 of the total) against the regressive impact of the most recent electricity tariff increase. Poor households spend, on average, 7 percent of their income on energy compared with 3 percent for the highest quintile.⁴⁷ They also have fewer options to adjust consumption patterns or use alternative energy sources.⁴⁸ Finally, prior Action #7 directly supports financially constrained household and businesses by facilitating access to commercial credit. It specifically targets women and in particular black women owned businesses.

63. This operation supports a gradual increase in the carbon tax rate, which could disproportionately affect the poor if tax-liable entities pass on their costs to consumers (Prior Action #8). However, this risk is safeguarded in the timeframe of the proposed operation due to the extensive list of exemptions until 2025 (end of Phase 1).⁴⁹ In addition, several tax and revenue recycling measures have been introduced to minimize negative impacts associated with the carbon tax, such as the Energy Efficiency Savings (EES) Tax Incentive, which has been extended through 2025.

64. The main positive impact on the poor associated with this DPL is expected to manifest over time through two mutually reinforcing channels. Load shedding is estimated to have costed about 2.5 percentage points of GDP loss and directly impacted over 350,000 jobs in 2022 as businesses had to (temporarily) shut down their operations, redirect their resources toward energy supply rather than productive investments, and address additional costs associated with increasing insecurity and negative impacts on their communication and water systems. The gradual reduction in load shedding that will be achieved through new power generation and transmission capacity, supported by this operation, will boost economic activity (particularly in energy intensive sectors such as mining, utilities, manufacturing, and support services), job creation, and improve service delivery on other sectors, such as water and sanitation. It will also positively impact education and health services. A reduction in load shedding will also benefit small and medium enterprises as well as poor households that are the most vulnerable to electricity shortages.

65. The second channel will be through the reduction in GHG emissions that will be achieved by the gradual change in energy mix toward cleaner sources. Building on the analysis from the CCDR, lower emissions will (i) reduce air and water pollution, with substantial benefits on human capital and the quality of living conditions; and (ii) improve the country's competitiveness in international markets by lowering the carbon footprint of exports that are at risk to be penalized by the European Union.⁵⁰

66. This operation, through an accompanying TA (Box 2), will support the government's effort to minimize the social impact of the decommissioning of existing coal-fired plants on employment and local communities. This TA will focus on labor market reforms, gender impacts, and support to local communities. It will complement other technical and analytical support provided by the World Bank, including the Climate Change Development P-ASA and Energy Sector P-ASA, and the recently approved Eskom Just Energy Transition Project that support this effort in the Mpumalanga province where about 85 percent of the country's coal-related activities are concentrated.⁵¹

⁴⁷ The increase in electricity tariff of 18 percent implemented since April 1 is projected to raise the spending on electricity by 1.3 percent for the poorest and 0.5 percent for the wealthiest, every else equal.

⁴⁸ Since energy poverty in South Africa has a strong gender, racial, and geographical dimension, the impacts of increased electricity prices are likely to be more acute among female-headed households and black female-headed households.

⁴⁹ Eskom is not liable to the carbon tax in Phase 1, but it pays the electricity generation levy, which serves as a proxy carbon tax.

⁵⁰ For more details on these co-benefits, see CCDR, op, cit.

⁵¹ These include transfers to other Eskom facilities/operations (for Eskom workers), re-skilling/upskilling for deployment in the renewables, capacity development for suppliers, and contract workers.



Box 2. TA and Capacity Building for Managing the Social Impacts of Climate Change and the Low Carbon Transition

In support of Canada’s Feminist International Assistance Policy, a TA program of US\$4.8 million (CAD6.5 million) has been designed to promote the Just Transition in South Africa. The objective is to strengthen the capacity, adaptability, and efficiency of social and employment services that support women, youth, and other vulnerable groups affected by the short- and long-term impacts of climate change. It will be implemented over a two-year period in conjunction with the proposed DPL and a complementary policy loan from the Government of Canada’s Sovereign Loan Program.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

67. **South Africa has a robust legislative system for assessing and managing impacts on its environment, forests, and natural resources.** As described in detailed in the Program Document of the 2022 DPL, environmental rights are enshrined in the South African Constitution and in the wide range of environmental laws at national, provincial, and local government levels. South Africa also has policies and strategies for the country’s short- and long-term development toward a low carbon economy. The legal framework requires disclosure of information and public participation for all projects requiring an environmental approval. The capacity and track record of the DFFE to manage environmental risk and monitor and enforce environmental legislative requirements associated with development initiatives are well-established.

68. **The Prior Actions of this DPL have a positive or neutral impact on the environment, forests, and other natural resources.**⁵² Pillar 2 directly promotes access to cleaner energy and reduces the demand on coal electricity generation, while Pillar 1 supports the transformation of the electricity market toward a greater RE utilization. The unbundling and diversification of the energy sector, as well as private sector participation, is expected to improve increase electricity supply – especially from RE sources – thus reducing energy losses and contributing to the strengthening of environmental compliance. Under the NEMA, energy projects with installations greater than 10 MW still require an environmental approval from the relevant authority, therefore the impacts associated with these installations are still adequately assessed and mitigated to avoid or reduce adverse impacts on the environment, forests, and other natural resources. A guideline for RE projects was developed by the Department of Environmental Affairs (now DFFE) in 2015, to further ensure identification of impacts and approaches to mitigate impacts associated with these projects. The establishment of strategic areas within the Renewable Energy Development Zones allows for a faster environmental approval process, which further facilitates private sector investment in the energy sector. While the overall impacts of Prior Actions #5 and #6 are positive, the long-term impacts of an increase in hazardous electronic waste associated with spent solar panels and batteries may be adverse. South Africa has made significant strides in establishing regulations to manage electronic waste, including solar panels; however, facilities to recycle or dispose of electronic waste should be further developed.⁵³

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

69. **South Africa’s financial management system is adequate for supporting the DPL as evidenced by the 2014 Public Expenditure and Financial Accountability (PEFA) assessment and the ongoing implementation of several Public Financial Management (PFM) reforms.** The PFM systems, as guided by the PFM Act, provide a sound

⁵² There are allegations of forced labor in the production of solar panels and components. This DPL focuses on policies and institutional reforms in South Africa. DPL proceeds are not earmarked to any specific purpose, including the manufacture or procurement of solar panels or components.

⁵³ The Extended Producer Responsibility (EPR) Regulations and Amendment (December 2021, March 2021) outline how electronic waste (including renewable energy equipment) should be disposed. Arrangements to fully implement the regulations (including ensuring disposal facilities) are still being rolled out. If the EPR regulations are fully implemented, there should be no gap in the long term.



basis for resource allocation according to priorities and outlines the duties of national and provincial government as well as public entities. The PFM Act establishes two main government funds: (i) the National Revenue Fund (NRF), where all government revenue, both domestic and foreign, are deposited; and (ii) the Reconstruction and Development Programmes (RDP) Fund, where all development assistance funds are deposited. Appropriation out of the NRF is only by parliamentary approval, while the RDP Fund is based on financing agreements with each development partner and national priorities.

70. The GoSA is committed to strengthening existing PFM systems. South Africa has consistently reinforced its reputation as a global leader in budget transparency, ranked second out of 120 countries in the 2021 Open Budget Index conducted by the International Budget Project. The budget, published annually, is publicly available. The main reforms aim to address weaknesses, identified in 2014 PEFA and other reports such as the annual Auditor General reports, in the supply chain management resulting from irregular expenditure, unauthorized spending, and wasteful and fruitless expenditures, non-compliance with legislation, and several auditees producing mediocre quality financial statements. The government is professionalizing the public service. Several development partners (European Union, GIZ, DFID, USAID, and the Governments of France, Ireland, and Belgium) are supporting the Government to implement these reforms.

71. The Accountant General is responsible for the preparation of consolidated financial statements and for improving the timeliness, accuracy, and efficiency of financial reporting. Departments prepare their own financial statements, which are audited by June 30 and sent to the Accountant General for consolidation. Consolidated audited financial statements are published for public access on the NT website. Concurrently, SARB financial statements are reviewed by independent external auditors, who have issued an unqualified audit report for the period to March 31, 2023. The IMF has not undertaken a safeguard assessment on the SARB.

72. The DPL is a single tranche of US\$1 billion disbursed upon satisfactory implementation of the development policy program. The operation would follow the IBRD's disbursement procedures for DPLs and would not be linked to specific expenditures. Once the Financing Agreement becomes effective and a withdrawal application has been received, the IBRD will deposit the loan proceeds into an account designated by the Government at the SARB—provided the IBRD is satisfied with the program being carried out by the Government and with the appropriateness of the country's macroeconomic policy framework. The deposit will be part of the country's foreign exchange reserves. The Government will credit the local-currency equivalent in the budget management system using the prevailing exchange rate. As a due diligence measure, the Government will provide the IBRD with confirmation that the amount of the loan proceeds has been accounted for in the country's budget management system, with an indication of the exchange rate applied and the date of transfer, and that the account used to deposit loan proceeds is part of the country's foreign exchange reserves. Confirmation will be expected within 30 days of disbursement. If the proceeds of the loan are used for excluded expenditures as defined in the Financing Agreement, the IBRD will require a direct refund of an amount equal to payment, promptly upon notice from the IBRD. Amounts refunded to the World Bank upon such a request will be canceled. No dedicated account is required since the control environment is assessed to be adequate.

73. Accounting and Auditing requirements. The accounting and auditing of loan proceeds will be the responsibility of the Accountant General and Auditor General. Government procedures will be followed to manage, record, and report the loan proceeds and related payments. Loan proceeds shall be subject to external audit by the Auditor General under the normal auditing arrangements applicable to the Government. The IBRD will have access to these audits. The control environment is adequate, and no additional fiduciary requirements shall apply.

5.4. MONITORING, EVALUATION, AND ACCOUNTABILITY



74. **The World Bank, NT, and the NECOM, at the Presidency of the Republic of South Africa, have agreed to jointly monitor the result indicators of this operation.** The NECOM has already built a dashboard to monitor the implementation of the Energy Action Plan which can easily be adapted, with the support of the World Bank, to include selected indicators of the Government’s response and support a platform for government to work with citizens, civil society, and business. In doing so, the World Bank builds on years of sharing international good practice in performance monitoring and evaluation.

75. **South African Public Procurement Performance:** Created in 2013, the Office of the Chief Procurement Officer under the NT is responsible for South Africa’s procurement legal framework and policies. The current procurement legal and regulatory framework is fragmented, and supply chain management appears to be the weakest component across all levels of government and public entities, driving most inefficiencies and irregularities. Despite recent reforms, the public procurement system in South Africa exhibits systemic signs of corruption and political interferences (see also *Report of the Judicial Commission of Inquiry into State Capture, 2022* or the so-called ZONDO report). Reports from the General Auditor have emphasized the lack of audit submissions, irregular expenditures, contracts awarded to employees and their families without necessary declaration of interest or increased material non-compliance with legislation. The introduction of the *e-tenders portal*, which provides a free single point of access to information on all tenders (invitations, corrigendum, and award notices), has been a step toward improved transparency. It requires displaying current tender opportunities as well as contract information for awarded tenders that exceeds the R500,000 threshold for National, Provincial and Public entities and the R200,000 threshold for Local government Institutions. Although some information on awarded contracts is provided on the site, it is frequently out-of-date and, in some cases, incomplete due to the reluctance of several organizations to share award information. Following the Promotion of Access to Information Act (2000) and of Administrative Justice Act (2000), the public and civil society can gain access to pertinent information or cause the Public Protector of South Africa to investigate allegations.

76. **Public procurement reform agenda:** The GoSA submitted to Parliament in May 2023 the new Public Procurement Bill. The priority is to establish a single regulatory system and oversight authority (Public Procurement Office) with jurisdiction over the whole public procurement system, including all organs of state currently under the Public Finance Management Act and the Municipal Finance Management Act. The Bill also aims to improve transparency by compelling reporting on aspects of the public procurement system and facilitating the use of information technology. The lack of capacity, skills, and knowledge of public procurement practitioners is regularly identified as a main obstacle to increase public procurement efficiency. Further, inadequate planning and monitoring in supply chain management are systemic issues that hinder public procurement as a strategic governance tool. To further improve the public procurement system, NT started a comprehensive National Procurement Performance assessment with the leadership of the OECD jointly with the World Bank and AfDB in May 2023.

77. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank’s independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, because of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank’s attention, and



<http://www.worldbank.org/GRS>. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit <https://accountability.worldbank.org>.



5. SUMMARY OF RISKS AND MITIGATION

78. **The overall risk to PDO achievement is assessed as high, reflecting the ratings of all risks (Table 6).** Key risks associated with this operation and their proposed mitigation are highlighted below.

79. **Political and governance risks are rated as high.** Presidential elections scheduled in mid-2024 are expected to be contested based on the results of the 2021 local elections and the ongoing political debate. Several claims of high-level corruption have emerged, including from the recently finalized ZONDO report. State capture in the energy sector attracts great public attention due to the magnitude of the energy crisis, exacerbating social and economic tensions. Those risks could impact the approval of the ERA Amendment Bill or the implementation of reforms, especially in the context of a program that requires sustained measure over the medium term. To mitigate these risks, the World Bank has strengthened its dialogue with the authorities, including through the CPF, and will closely monitor the situation, with the support of other partners engaged in the preparation of this operation. Many of the reforms supported by this operation are anchored at the Presidency, as they support the implementation of the Energy Action Plan. To reduce the risk of policy reversal under a new administration, some of the reforms supported by this operation have already led to a change in the structure of the market, with the emergence of private embedded generation and small-scale rooftop generation.

80. **Macroeconomic risks are substantial and play out through multiple channels.** External risks include the projected decline in global demand, sustained high interest rates on international markets, volatile commodity prices, and climate-related shocks. Domestically, the main risk is the current energy crisis as the magnitude of load shedding (and potential total collapse of the electricity grid) could further derail economic growth and the labor market in the short-term. Another risk would be slower implementation of the fiscal consolidation effort, which is necessary to maintain public debt on a sustainable path. The reduction in revenue from trade, faster-than-anticipated spending due to social pressure to increase public wages and the distribution of grants, and the potential financial distress of large SOEs and local governments could all affect the central government balance sheet. These risks are mitigated by the reforms supported in this operation that should enhance economic growth and alleviate the fiscal dangers over time.

81. **Sector strategies and policy risks are high.** The energy sector is in crisis, with heavy and increasing load shedding, as the result of misguided policies, state capture, plant sabotage, and delayed investments and maintenance over the past 25 years. The government has started to act but will need to sustain reforms and implement additional measures over the medium-term. Effective implementation is also necessary, while the sector's record has been poor, partly reflecting conflicting views among top decision-makers and vested interests. This operation will help mitigate some of the above risks by supporting the first steps toward a transformation of the electricity market. By promoting private investment in embedded generation and supporting a conditional Eskom bailout, the energy mix will rely less on fossil fuels and the number of operators will increase, reducing the monopolistic powers of Eskom generation, thus making these reforms harder to reverse.

82. **Technical design risks are high.** At the government request, the DPL is prepared as a stand-alone operation and while it is anchored on recent strategies for the energy sector and climate change, the operation is expected to support government efforts to promote long-term energy security and a low carbon transition which will require additional and subsequent reforms. There is a risk that, without a programmatic approach to support subsequent reforms, the program may be delayed or stalled. This risk is mitigated by the continuous engagement and dialogue between the development partners (including the World Bank) and the GoSA, including through analytical work and technical assistance.



83. **Institutional capacity for implementation and sustainability risks are high.** Despite its strategies and plans, implementation delays have been a permanent challenge that affect both government departments and Eskom. The creation of NECOM mitigates some of the risks by ensuring accountability on the implementation of existing plans at the highest level. However, NECOM has limited internal implementation capacity and relies on other departments to implement activities under the Energy Action Plan, including the recently created Ministry of Electricity. Stronger coordination will be required to streamline implementation.

84. **Stakeholder risks are high and related to political risks.** The ruling African National Congress (ANC), trade unions, and other stakeholders within the governing party’s alliance have historically been cautious about borrowing from IFIs due to the perception of surrendered policy autonomy, which could present an implementation risk for this program. In addition, misalignment and fragmentation exists across government on the direction of the reform program and Eskom’s unbundling. The COVID-19 shock, together with the current energy emergency and higher borrowing costs, have motivated GoSA to access IFI development financing. Continued stakeholder ownership of the actions this DPL supports will help mitigate stakeholder risk.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	● High
2. Macroeconomic	● Substantial
3. Sector Strategies and Policies	● High
4. Technical Design of Project or Program	● High
5. Institutional Capacity for Implementation and Sustainability	● High
6. Fiduciary	● Moderate
7. Environment and Social	● Moderate
8. Stakeholders	● High
9. Other	
Overall	● High



ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions	Expected results (by March 31, 2025)
Pillar 1: Advance the restructuring of the power sector to promote long-term energy security	
1. The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.	<ul style="list-style-type: none"> Percentage of independent non-executive members appointed to the NTCSA Board. Baseline = 0; Target = 25%.
2. The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to <i>inter alia</i> : (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.	<ul style="list-style-type: none"> Processing time for NERSA to consider applications for the registration of electricity generation facilities. Baseline = 60 days; Target = 45 days.
3. The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance with the Minimum Emission Standards and flue gas desulfurization and transmission.	<ul style="list-style-type: none"> Eskom debt/asset ratio. Baseline: 52.8%; target: 41%. Eskom operating profit margin (EBITDA/Revenue). Baseline: 14.7%; Target: 19%. Amount of new transformer capacity installed and commissioned in NTCSA network (MVA). Baseline: 0; Target: 2600.
4. The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the <i>Appropriation Act</i> which <i>inter alia</i> mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.	<ul style="list-style-type: none"> Percentage of households receiving Free Basic Electricity as a percentage of LGES funded poor households. Baseline: 23%; Target 35%.
Pillar 2: Support the implementation of a low carbon transition	
5. The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.	<ul style="list-style-type: none"> Amount of MW of new Renewable Energy registered with NERSA and connected to the grid. Baseline: 259; Target: 3,000. Amount of private capital mobilized in new Renewable Energy registered with NERSA and connected to the grid. Baseline: R1,455 million; Target: R55,000 million.
6. The Borrower has approved the 2023 Budget Review which proposes tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.	<ul style="list-style-type: none"> Number of businesses benefiting from renewable energy tax incentives. Baseline: 0; Target: 7500.
7. The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.	<ul style="list-style-type: none"> Amount of MW of new decentralized renewable energy solutions financed with support of the EBB. Baseline: 0; Target 500 MW. Percentage of women-led households and businesses that accessed financing for new decentralized renewable energy solutions with support of the EBB. Baseline: 0; Target 30%.
8. The Borrower has enacted the 2022 Taxation Law Amendment Act which <i>inter alia</i> amends the Carbon Tax Act to gradually increase the carbon tax rate.	<ul style="list-style-type: none"> Revenue collected from the carbon tax. Baseline: R1,397 million; Target: R2,117 million.



ANNEX 2: LETTER OF DEVELOPMENT POLICY



**MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA**

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Ref: M3141212(1215/2023)

Ms Marie-Francoise Marie Nelly
Country Director
World Bank Group
442 Rodericks Road
LYNNWOOD
0002

Dear Ms. Marie Nelly,

RE: LETTER OF DEVELOPMENT POLICY

On behalf of the Government of South Africa, I am writing to request the support of the World Bank for a second Development Policy Operation (DPO) loan of USD 1 billion to assist our country undertake interventions and reforms to address the current electricity challenge. We are undertaking these important measures as detailed in this letter to scale up the country's energy supply in line with our objectives for a just energy transition and our international climate change commitments. This letter outlines the policy reform program under this requested policy-based operation with a focus on (i) enhancing energy security measures over the short and medium-term; (ii) strengthening governance, efficiency, and performance of the energy sector in the long-term and (iii) support the decarbonisation of the economy and enhancing the socio-economic benefits of the energy transition on the poor.

i. Addressing the energy challenge in a difficult economic environment

South Africa has been experiencing an energy shortage for over a decade with a managed loadshedding program that has been introduced to stabilise the grid. With a generation shortfall estimated at 6000 MW, the country is navigating through this energy challenge while still recovering from the lingering effects of COVID-19 and facing heightened and evolving domestic and global economic and financial risks.



The negative impacts of loadshedding on the economy, high inflation, rising borrowing costs, logistics system inefficiencies and slowing global trade and growth has led to the current GDP growth projection for 2023 of 0.9 per cent for the South African economy (2023 Budget Review). This is a significant downward revision from the 1.4 per cent envisaged at the time of the 2022 Medium Term Budget Policy Statement. This level of growth is much lower than what is required to make a meaningful impact to the country's high levels of unemployment and the rate of poverty. Furthermore, the current investment and employment levels remain lower than before the COVID19 pandemic and lag the overall recovery in real GDP.

Since the publication of the 2023 Budget Review, several downside risks to the economic outlook have materialised, alongside the emergence of new risks. Domestic structural constraints in electricity and logistics have worsened with a higher cost of living and rising borrowing costs weighing on consumption and investment even further. Additionally, idiosyncratic factors have led to weakness in South Africa's financial assets and introduced volatility in financial markets, weighing even further on an already fragile growth outlook.

Regrettably, significant risks to the economy remain. A weakening global environment and persistent domestic structural constraints bode ill for the durability of the recovery. South Africa's fiscal space remains limited while risks are stark owing to high borrowing costs and spending pressures. Monetary policy is now contractionary due to the response to persistent inflationary pressures. Disruptive energy cuts are expected to continue for most of 2023 and remain a drag on productive capacity over the medium term.

We view the urgent implementation of structural reforms led by energy sector reforms as a priority to materially improve the growth of the South African economy over the medium term. The government is committed to stay the course in ensuring a clear and stable macroeconomic and fiscal framework. We are undertaking a rapid and decisive implementation of economic reforms, particularly to reduce load shedding and improving the efficiency of our freight rail network. We are fast tracking the implementation of many of these reforms through Operation Vulindlela, a joint initiative of the Presidency and National Treasury focusing on accelerating the implementation of 35 priority reforms that have been identified based on their potential impact on economic growth and job creation. Critically, we expect these structural reforms to transform a

number of key sectors to achieve long-term sustainability and raise potential growth. In addition to the energy sector reforms that will be covered in this letter, other impactful reforms underway are:

- Logistics: The recently adopted Freight Logistics Roadmap provides a clear reform path for resolving immediate operational challenges driving the decline of rail and ports and to develop interventions required to fundamentally restructure the logistics sector. This includes the establishment of the Infrastructure Manager within Transnet Freight Rail and the Transport Economic Regulator to facilitate competition.
- Communication services: To reduce the cost and improve the quality of digital communication services for the economy, the auction of high demand spectrum has been concluded. Work is underway to finalise analogue switch-off to allocate the remaining spectrum. The regulator has commenced work to facilitate the introduction of a secondary market for spectrum trading.
- Visa regime and skills: Progress with visa regime reforms includes publishing the revised Critical Skills List and implementing and upgrading the eVisa system, now expanded to a total of 34 countries. A comprehensive review of the work visa system to facilitate skilled immigration has been finalised and Revised Immigration Regulations are being finalised.

ii. Urgent measures to expand electricity supply

Recognizing the adverse impact of the energy challenge, Cabinet is fast tracking measures and reforms to



increase South Africa's energy supply and reduce loadshedding. In this regard, the President announced in July 2022 the Energy Action Plan to end loadshedding and achieve long term energy security. The implementation of this Plan is overseen by the National Energy Crisis Committee (NECOM) which is chaired by the President and comprises of all relevant government departments and Eskom. In addition, a new Ministry of Electricity has been established to further direct efforts for implementation of this Plan.

This Energy Action Plan has the following five key interventions:

1. Fix Eskom and improve the availability of existing energy supply.
2. Enable and accelerate private investment in the generation capacity.
3. Accelerate procurement of new capacity from renewables, gas, and battery storage.
4. Use the tax system to incentivise businesses to invest in renewable energy and households to invest in rooftop solar.
5. Fundamentally transform the South African energy sector to achieve long term energy security.

To date, several initiatives under implementation are showing early signs of success in speeding up investments in generation capacity, particularly for renewable energy. We expect these initiatives to add more than enough capacity to the grid in the next 12 to 24 months to end loadshedding.

- More than 100 projects are at various stages of development by the private sector as they respond to the recent removal of the licensing requirement under the amended schedule 2 of the Electricity Regulation Act, 2006 (ERA). This represents over 10 000 MW of new renewable energy capacity.
- Initiatives under our accelerated procurement of new generation capacity through the Risk Mitigation Independent Power Producer Programme (RMIPPPP) and the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) will add over 3 500 MW to the existing energy supply.
- Programmes by Eskom, such as the Standard Offer and Emergency Generation Programme, are expected to add up to 1 350 MW to the energy supply.
- Our tax incentives for businesses and individuals to support small-scale solar embedded generation are expected to complement other interventions and add further energy supply to the grid.

We are eliminating and simplifying stringent administrative hurdles to fast-track more investments in the generation and transmission infrastructure in the short term. The new Energy Security Bill ("Omnibus Bill") will accelerate the expansion of renewable energy sources by removing regulatory impediments to energy projects. The One Stop Shop will provide a single-entry point for all energy-related project applications. Government is also developing a national wheeling framework to enable private generators to transmit power across the distribution and transmission network.

iii. Measures supported under this operation for transformation of the South African electricity industry

The energy crisis that is facing our country calls for bold measures in the short term, together with difficult long-term reforms that will transform and modernise the electricity industry. We wish to partner with you on this DPO as we commit to these historic reforms. These reforms aim to restructure and modernise the electricity industry, improve the financial health and unbundle the electricity utility, crowd in large investments into renewable energy, strengthen our carbon tax to decarbonise industries and provide fiscal support for electricity access to small businesses and indigent households.

- a. Restructuring and unbundling the electricity industry for a modern, competitive, and future-oriented sector.** In 2019 we published the Roadmap for Eskom in a Reformed Electricity Supply Industry, recognising



the need to unbundle the utility to reduce the risk it poses to the country through its dependence on the fiscus and its inability to adequately supply the economy with power. We identified the establishment of a transmission entity among the immediate interventions to foster competition and encourage the use of diverse sources and multiple suppliers of electricity. Through these reforms, South Africa's electricity sector should transition into a market with wholesale competition, to be facilitated by non-discriminatory access to the transmission grid, with market functions performed by system and market operators. The roadmap outlined proposals to enable restructuring, including addressing Eskom's unsustainable debt, cost structure and financial sustainability. We believe that these measures will support the long-term sustainability of the sector and ensure security of energy supply.

- Cabinet approved in March 2023 the Electricity Regulation Act (ERA) Amendment Bill and the Minister for the Department of Mineral Resources and Energy has tabled it before Parliament. The ERA Amendment Bill provides for the legislative requirements to support the objective of unbundling and restructuring the sector, by among other things, establishing a Transmission System Operator (TSO) with the functions of operating the integrated power system and providing for the market platform.⁵⁴ Opening the sector to further private participation at scale will provide for greater generation capacity for cleaner technologies. Given the urgency of the reforms associated with this ERA Amendment Bill, we will take the necessary steps to ensure that it is approved by Parliament within the current political cycle.
- Progress is being made in unbundling Eskom into generation, transmission, and distribution entities. The ERA Amendment Bill deems the establishment of the National Transmission Company of South Africa (NTCSA) as the TSO, elevating the significance of unbundling and completing the process of operationalising the entity. The NTCSA has been established as a separate subsidiary of Eskom and the process to appoint its Board is underway. NERSA is undertaking the process to provide the NTCSA with the 3 licenses required for its operationalisation. with the transmission license approved on 27 July.⁵⁵
- Ensuring the financial health of the energy industry is very important. The government has taken measures to relieve a share of Eskom's unsustainable debt and is enforcing payment of the utility's arrears by municipalities with the goal of strengthening the utility's balance sheet, enabling it to restructure and undertake the investments in transmission infrastructure and maintenance of the current power plants. The government has set up a debt relief arrangement covering R254 billion⁵⁶ of Eskom debt with strict conditions to safeguard public money. As part of considering additional conditions to improve efficiency of operations, we have appointed a consortium of independent experts to review all Eskom plants and recommend measures to be presented to the Eskom Board in the next few months. We announced the Eskom Debt Relief in the 2023 Budget Review and Parliament has finalised to approve the Eskom Debt Relief Bill. The debt relief to Eskom includes a component directed to municipalities that offer an opportunity to settle the debt owed by them to Eskom through an application-based support to write-off arrear debt over a period of three years once the applicant municipality meets certain conditions.⁵⁷

b. Supporting large scale investments in renewable energy. The government is cutting red tape and introducing incentives to facilitate private investment in renewable energy at significant scale to support

⁵⁴ The TSO will also be responsible for managing existing private sector renewable energy supply contracts during the transition phase to ensure market stability.

⁵⁵ NERSA is currently undertaking processes to also extend the two licenses for trading and import/export activities.

⁵⁶ This is made up of R168 billion in capital and R86 billion in interest over the next three years.

⁵⁷ The Municipal Debt Relief package was issued through a MFMA Circular 124 on 31 March 2023.



efforts for energy security.

- The Department of Mineral Resources and Energy has published the amended Schedule 2 of the Electricity Regulation Act to remove the licensing threshold (previously set at 100 MW) for generation facilities and to enable easier registration of projects of a larger size.
- To encourage businesses and households to invest in solar and other renewables to add to the country's electricity generation capacity, temporary tax incentives have been introduced by the National Treasury and the South African Revenue Services (SARS) from 1 March 2023.⁵⁸ These tax measures were announced in our 2023 Budget Review, with the draft of the 2023 draft Taxation Laws Amendment Bill published for public comments.

C. Accelerating the decarbonisation of the economy. A framework to guide South Africa's response to climate change is provided for through the Climate Change Bill which is currently before Parliament. The Bill sets out additional mitigation measures including carbon budgets⁵⁹ and sector emission targets as well as adaptation responses to reduce the impacts of climate change and to strengthen the country's resilience to climate-related disasters.

- South Africa introduced the Carbon Tax Act in June 2019 to give effect to the polluter pays principle and steer the country on a decarbonisation path. The first phase of the tax was initially planned up to December 2022. It includes several tax-free allowances and a relatively low tax rate to facilitate a transition period as the economy adjusts to carbon pricing. In the 2022 Budget the first phase of the carbon tax was extended by three years from 1 January 2023 to 31 December 2025. In addition to the extension, the price trajectory of the carbon tax was announced.⁶⁰ This' includes the tax rate for the first six years of the second phase, which starts in 2026. As announced in the Budget, it is proposed that a higher carbon tax rate of R640 per tonne of carbon dioxide equivalent will apply to greenhouse gas emissions exceeding the carbon budget.⁶¹

d. Fiscal measures supporting electricity access for the poor and small businesses. We will enhance our support that is covering a portion of the cost of electricity access for the poor and enable additional lending by financial institutions for solar energy investments to small businesses and households.

- Our government provides valuable support to the poor for electricity access through the Free Basic Electricity (FBE) program. This is an unconditional grant provided under our Local Government Equitable Share transfers that are managed by the local government authorities and are targeting indigent households (with 2.3 million households benefiting in 2020/21). Through this program we have made an additional allocated of R 1.1 billion available for 2023 to shield the current beneficiaries from the recent electricity tariff increase of 15.1% by NERSA and to cover the cost of

⁵⁸ Individuals will be eligible for a tax rebate of 25 percent of the cost of solar PV panels for a one-year period (capped at R15,000 per individual) while businesses can deduct 125 percent of the cost of assets used in the generation of electricity from renewable energy sources for a two-year period.

⁵⁹ The carbon budgets are defined as limits on caps on company greenhouse gas emissions for a five-year period.

⁶⁰ Effective 1 January 2023, the carbon tax rate increased from R144 to R159 per tonne of carbon dioxide equivalent. The rate will increase as follows in the calendar years that follow: R190 (2024), R236 (2025), R308 (2026), R347 (2027), R385 (2028), R424 (2029), R462 (2030). The rate of the carbon tax can be adjusted by the Minister of Finance in 2025 and thereafter at three-year intervals to take into account the impact of exchange rate movements on the comparability of the rate to global carbon pricing.

⁶¹ These amendments will be legislated once the Climate Change Bill is enacted, at which time the carbon budget allowance under the carbon tax will fall away as this was implemented to encourage companies to participate in the DFFE's voluntary carbon budgets programme until carbon budgets are mandatory.



supporting new beneficiaries into the scheme.

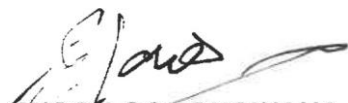
- The current loadshedding is a significant constraint for economic activities of small businesses and households. Through an arrangement with the South African Reserve Bank, the National Treasury will enable banks to extend additional lending to small businesses, households and energy services companies that want to borrow for their investments in solar power. This will be done through an Energy Bounce Back Scheme that was launched on 8 August to provide guarantees for banks' solar-related loans to small and medium enterprises on a 20 percent first-loss basis.

We are confident that these measures will advance our energy sector while also helping South Africa achieve its ambitious commitment made in its updated NDC in terms of the UNFCCC — to reduce the country's carbon emissions by 2030 to within a target range that is compatible with limiting global temperature increase to 1.5⁰.⁶² We are also guided by the Just Transition Framework that was developed by our Presidential Climate Commission and adopted by Cabinet in August 2022 to ensure that our interventions in the electricity industry are consistent with just transition imperatives to particularly protect jobs, and more importantly create new and better employment opportunities through green investments. Our commitment to a just transition is evidenced by the recently concluded comprehensive consultations that the government has undertaken through the PCC on the Just Energy Transition Investment Plan (JET-IP).⁶³

iv. Conclusion

Your support as [THE LENDER] is critical as our country faces this significant challenge of energy shortage and loadshedding which has been devastating to the economy and to our development aspirations. With your valued partnership, our government has committed itself to stay the course and implement these historic, timely and critical reforms in the energy sector, while endeavoring to achieve our international commitments on climate change and our just transition objectives.

Yours sincerely,



ENOCH GODONGWANA,
MINISTER OF FINANCE
DATE: 12/09/2023

⁶²South Africa updated NDC revised its target range for emissions reduction for 2025 to 398 510 and for 2030 to 350 — 420 Metric tons of Carbon Dioxide equivalent (Mt CO₂-eq).

⁶³ The PCC concluded several rounds of consultations on the JET-IP with stakeholders, including with youth, business leaders, civil society, local government, organised labour, and the faith community. The Commission has also conducted community consultations in Mpumalanga, Limpopo and Northern Cape provinces, and held a national colloquium open to all stakeholders.



ANNEX 3: FUND RELATIONS ANNEX

IMF Executive Board Concludes 2023 Article IV Consultation with South Africa FOR IMMEDIATE RELEASE Washington, DC – June 6, 2023:

On May 22, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation⁶⁴ with South Africa. South Africa's economy is facing mounting economic and social challenges. Growth moderated from 4.9 percent in 2021 to 2.0 percent in 2022 as the country was buffeted by Russia's war in Ukraine, global monetary policy tightening, severe floods, and an unprecedented energy crisis. Business and consumer confidence and investor sentiment remain weak, and the sovereign spread for South Africa remains higher than the pre-pandemic level. The average employment level in 2022 was still about 5 percent lower than in 2019, threatening social cohesion.

Headline inflation has risen above the South African Reserve Bank (SARB)'s 3–6 percent target range amid higher food and energy prices. Inflation expectations have inched up but remained within the target range. In 2022, the current account balance decreased to a -0.5% GDP deficit from a 3.7% GDP surplus in 2021, due to lower commodity prices and logistical bottlenecks. This, together with tighter global financial conditions, shifts in investors sentiment, and increased domestic political uncertainty have weakened the rand.

The fiscal deficit has continued to narrow, reaching 4.2 percent of GDP in FY2022/23, from 4.8 percent in FY2021/22, thanks to buoyant revenue and expenditure restraint. Despite this improvement, the government debt-to-GDP ratio is estimated to have increased to 70 percent. The SARB has proactively raised interest rates to bring down inflation within the target range and anchor inflation expectations, continuing the removal of monetary accommodation.

Looking ahead real GDP growth is projected at 0.1 percent in 2023, reflecting a significant increase in the intensity of power outages, and weaker commodity prices and external environment. Annual growth is expected at about 1½ percent over the medium term, as longstanding structural impediments, such as product and labor market rigidities and human capital constraints offset expected improvements in energy supply, higher private spending on energy-related infrastructure, and a more supportive external environment. The growth level would be too low to create enough jobs to absorb the new labor market entrants. The fiscal position is projected to deteriorate due to weakening mineral revenue, the Eskom debt relief arrangement, wage bill pressures, and rising debt service. As a result, public debt is not expected to stabilize. Headline inflation would return to the midpoint of the target range by end 2024. The current account deficit is projected to deteriorate to about 2½ percent of GDP in the near term. The outlook is subject to significant uncertainty related to the pace of reform domestically and the challenging external environment.

Executive Board Assessment ⁶⁵

While recognizing South Africa's strong fundamentals, Directors noted that the post-pandemic recovery is petering out amid several shocks, exacerbating economic and social challenges in a context of elevated poverty and inequality. They stressed the urgency of reforms to promote the sustained and inclusive growth needed to address these

⁶⁴ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board

⁶⁵ At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.IMF.org/external/np/sec/misc/qualifiers.htm>.



challenges.

Directors commended the South African Reserve Bank's commitment to price stability and endorsed the pace of monetary policy normalization, which should bring inflation back within the target. They recommended maintaining a data dependent approach to monetary policy decisions. Directors supported enhancing the inflation targeting framework by formalizing the current focus on the midpoint of the target range and lowering the inflation target, as conditions allow and with adequate communication.

Directors praised the recent reduction in the fiscal deficit, reflecting efforts to contain public spending and improve revenue administration. They encouraged stronger fiscal consolidation under a credible medium-term framework to put public debt on a firmly declining path while protecting productive investment and well-targeted social spending. This should be supported by reforms to the fiscal framework, procurement system, and public investment management.

Directors welcomed the resilience of the financial sector, particularly amid the recent global financial market volatility. They called for continued implementation of the FSAP recommendations to strengthen the financial safety net and supervision. Directors acknowledged that while advancing fiscal consolidation will mitigate risks from the sovereign financial nexus, carefully calibrated and communicated prudential measures could play a complementary role while being mindful of procyclicality and potential unintended consequences on financial institutions' balance sheets.

Directors emphasized that promoting a sustainable, inclusive, and green recovery requires reforms that foster private investment, a balanced energy transition, and good governance. They recommended further measures to reform SOEs, open key network industries to private sector participation, reduce the regulatory burden, and enhance labor market flexibility and the quality of education to tackle high structural unemployment. Directors recognized that resolving the ongoing energy crisis remains the top priority, providing an opportunity to accelerate the rollout of renewables. They supported steadfast implementation of the government's energy transition plan and emphasized the importance of well-targeted fiscal support for affected communities and workers. Directors also recommended to forcefully tackle governance weaknesses and corruption. They noted that timely implementation of the Financial Action Task Force's action plan is crucial to exit its grey list swiftly.



ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Advance the restructuring of the power sector to promote long-term energy security.		
PA1: The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.	Neutral	Neutral
PA2: The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to <i>inter alia</i> : (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.	Neutral	Neutral
PA3: The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance with the Minimum Emission Standards and flue gas desulfurization and transmission.	Positive through higher possibilities for renewable projects to connect to the grid	Positive as it will increase the energy supply, improving access and reducing load shedding
PA4: The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the <i>Appropriation Act</i> which <i>inter alia</i> mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.	Neutral	Positive. as it cushions indigent households against higher electricity tariffs
Pillar 2: Support the implementation of a low carbon transition.		
PA5: The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.	Positive as it reduces the entry costs to renewable projects	Positive through the expected impacts on the supply of energy and job creation
PA6: The Borrower has approved the 2023 Budget Review which proposes tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.	Positive as it reduces the cost to implement renewable energy	Neutral as the tax incentives are targeted to formal businesses and taxpayers ⁶⁶
PA7: The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.	Positive as it encourages more renewable energy	Positive
PA8: The Borrower has enacted the 2022 Taxation Law Amendment Act which <i>inter alia</i> amends the Carbon Tax Act to gradually increase the carbon tax rate.	Positive as it encourages a cost-effective low carbon investment	Neutral. The tax has been designed to minimize the negative impacts on consumers

⁶⁶ There are allegations of forced labor in the production of solar panels and components. This DPL focuses on policies and institutional reforms in South Africa. DPL proceeds are not earmarked to any specific purpose, including the manufacture or procurement of solar panels or components.



ANNEX 5: DPL PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS

Prior Actions	Analytical Underpinnings
Pillar 1: Advance the restructuring of the power sector to promote long-term energy security.	
PA1: The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.	Energy PASAs [P172682] and [P180424] Country Climate and Development Report (CCDR)
PA2: The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to <i>inter alia</i> : (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.	Energy PASAs [P172682] and [P180424] Country Climate and Development Report (CCDR)
PA3: The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance with the Minimum Emission Standards and flue gas desulfurization and transmission.	Energy PASAs [P172682] and [P180424] Country Climate and Development Report (CCDR)
PA4: The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the <i>Appropriation Act</i> which <i>inter alia</i> mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.	Country Climate and Development Report (CCDR)
Pillar 2: Support the implementation of a low carbon transition	
PA5: The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.	Supporting NDC Implementation [P172748] Country Climate and Development Report (CCDR)
PA6: The Borrower has approved the 2023 Budget Review which proposes tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.	Country Climate and Development Report (CCDR)
PA7: The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.	Energy PASAs [P172682] and [P180424] Supporting NDC Implementation [P172748]
PA8: The Borrower has enacted the 2022 Taxation Law Amendment Act which <i>inter alia</i> amends the Carbon Tax Act to gradually increase the carbon tax rate.	Country Climate and Development Report (CCDR) Partnership for Market Readiness, [P155885] Supporting NDC Implementation [P172748] Tax Policy to Reduce Carbon Emission in South Africa, 2009



ANNEX 6: THEORY OF CHANGE SUPPORTED BY THIS DPL

Overarching goal	Advance the restructuring of the power sector to promote long-term energy security and support a low carbon transition	
Medium term outcomes/ Intermediary results (by March 2025)	Improve energy security <ul style="list-style-type: none"> •Operationalize NTCSA •Reduce Eskom debt. •Improve Eskom operational margin •Increase investments in transmission. •Reduce NERSA licensing processing time •Increase coverage of FBE program 	Reduce GHG Emissions <ul style="list-style-type: none"> •Increase new embedded renewable generation - 3000 MW. •Increased private capital mobilized in new Renewable Energy registered with NERSA – R55 billion. •Number of beneficiaries from the bounce back mechanism – 1/3 women •21% increase in revenue collected from the carbon tax.
Pillars/ Policy areas	Advance the restructuring of the power sector to promote long-term energy security	Support a low carbon transition
Short-term actions	<ul style="list-style-type: none"> •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, distribution and environmental compliance. •Increases budgetary allocation to municipalities for FBE. 	<ul style="list-style-type: none"> •Remove licensing threshold for new embedded generation projects (only registration with NERSA required). •Establish a guarantee fund (bounce back) to support SMEs and individuals that purchase or lease RE equipment •Adopt tax incentives for solar panel installations for residential and commercial installations. •Approve gradual increase in the carbon tax rate.
Medium-term actions	<ul style="list-style-type: none"> •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. 	<ul style="list-style-type: none"> •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 and increase effective carbon tax rate. •Adopt framework for Domestic Carbon Standards. •Promulgate the Climate Change Bill. •Implement the mandatory phase of the Carbon Budget policy and introduce sectoral emissions targets.



ANNEX 7: DETAILED ASSESSMENT OF SELECT PRIOR ACTIONS FOR ALIGNMENT WITH THE GOALS OF THE PARIS CLIMATE AGREEMENT

Project Development Objective: To advance the restructuring of the power sector to promote long-term energy security and support a low carbon transition	
Step 1: Is the operation consistent with South Africa’s climate commitments and relevant strategies as well as the CCDR?	Yes. The operation is aligned with South Africa’s low-carbon trajectory and mitigation target as articulated in its NDC (July 2021). It is also consistent with key national and sectoral strategies, including the Just Energy Transition Framework in the Minerals and Energy Sectors (March 2022) Energy Action Plan (July 2022); Just Transition Framework (August 2022) and the Just Energy Transition-Investment Plan (November 2022). It operationalizes several recommendations of the South Africa CCDR (November 2022) including to strengthen the financial sustainability of the power sector, unbundle the electricity sector, promote private investment in renewables, and increase the carbon tax. The operation is also aligned with South Africa’s National Climate Change Adaptation Strategy (August 2020), which calls for increased decentralization of energy generation to make the energy sector more resilience to climate-related disruptions.
Mitigation goals: assessing and reducing risks	
Pillar 1: Advance the restructuring of the power sector to promote long-term energy security by supporting the unbundling of Eskom, redirecting its resources toward new investments in transmission, while ensuring continued support for low-income households in a context of increasing electricity tariffs.	
PA1: The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. This PA supports the unbundling of South Africa’s electricity sector, which is consistent with a long-term decarbonization pathway. Operationalization of the Transmission System Operator is expected to have a neutral impact on GHG emissions. An open market electricity platform will make it easier for electricity generated from renewables to reach consumers and carries a low risk of locking in carbon-intensive behaviors. Renewable generation is the least-cost option in South Africa and investment in new generation is expected to favor renewable energy. Further, because of the Eskom Debt Relief (see PA3), Eskom, which has a monopoly over current coal-fired power in South Africa, is not able to make any new investment in generation.
PA2: The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to <i>inter alia</i> : (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. This PA supports the unbundling of South Africa’s electricity sector, which is consistent with a long-term decarbonization pathway. Establishment of the Transmission System Operator and strengthening the National Energy Regulator are expected to have a neutral impact on GHG emissions. An open market electricity



	platform will make it easier for electricity generated from renewables to reach consumers and carries a low risk of locking in carbon-intensive behaviors. Renewable generation is the least-cost option in South Africa and investment in new generation is expected to favor renewable energy. Further, because of the Eskom Debt Relief, Eskom, which has a monopoly over current coal-fired power in South Africa, is not able to make any new investment in generation.
Conclusion of Prior Action 2:	PA2 is Paris Aligned.
PA3: The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance with the Minimum Emission Standards and flue gas desulfurization and transmission.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. This PA supports the improvement of Eskom’s financial position. Because of such improvement in the cash position, the company is expected to have the ability to finance activities to invest in the grid and remain environmentally compliant. To access the Debt Relief plan, Eskom is required to stop any investment in greenfield generation projects (preventing the lock-in of new carbon-intensive generation) while allows capital expenditure on transmission and distribution (which are considered universally aligned) and environmental compliance.
Conclusion of Prior Action 3:	PA3 is Paris Aligned.
PA4: The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the <i>Appropriation Act</i> which <i>inter alia</i> mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. The FBE program provides 50 kWh/month of electricity to about 2 million indigent households. This is enough to power basic lighting, heat water with a kettle, power a small TV, and charge a phone. It is one of the government’s strategies to improve reliable electricity access. It is also aligned with South Africa’s commitment to ensure that its transition to a low-carbon economy is just. While connection to the grid currently means households rely on coal-fired power, in the future it would mean that they would benefit from renewable energy as more renewable energy is mixed into the grid. Without the FBE, these households would not be connected to the national grid and may resort to using biomass for an energy source.
Conclusion of Prior Action 4:	PA4 is Paris Aligned
Pillar 2: Support the implementation of a low carbon transition	
PA5: The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. Solar and wind energy are the least cost options for new generation in South Africa, even before new subsidies to encourage their uptake. New investments in embedded generation are, therefore, expected to be exclusively for renewable sources, supporting a greening of the country’s energy mix and a reduction in GHG emissions. Further, the overwhelming majority of coal-fired power infrastructure in South Africa is owned and operated by



	Eskom, the state-owned utility. As a result of the recent Eskom Debt Relief plan (see PA3), Eskom is not permitted to invest in any new generation for the next three years. In the long run, this prior action supports decarbonization.
Conclusion of Prior Action 5:	PA5 is Paris Aligned.
PA6: The Borrower has approved the 2023 Budget Review which proposes tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. The prior action encourages investment in renewable energy at a time when households and businesses are increasingly turning to alternative generation options in response to a prolonged and profound energy crisis. Given the crisis, consumers could opt for traditional fossil-fuel powered generators to meet their electricity needs during load shedding. Providing incentives to invest in solar could help influence consumer choice for low-carbon options. The generation of solar and other renewable energy, which is directly promoted by this PA, is considered universally aligned.
Conclusion of Prior Action 6:	PA6 is Paris Aligned.
PA7: The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. The prior action encourages investment in renewable energy at a time when households and businesses are increasingly turning to alternative generation options in response to a prolonged and profound energy crisis. Given the crisis, consumers could opt for traditional fossil-fuel powered generators to meet their electricity needs during load shedding. Providing incentives to invest in renewable technology could help influence consumer choice for low-carbon options. The generation of renewable energy, which is directly promoted by this PA, is considered universally aligned.
Conclusion of Prior Action 7:	PA7 is Paris Aligned.
PA8: The Borrower has enacted the Taxation Law Amendment Act No. 20 of 2022 which <i>inter alia</i> amends the Carbon Tax Act to gradually increase the carbon tax rate.	
Step M2.1: Is the prior action likely to cause a significant increase in GHG emissions?	No. The carbon tax is a fiscal measure designed to shift behavior away from carbon-intensive investment and activity and toward low-carbon alternatives.
Conclusion of Prior Action 8:	PA8 is Paris Aligned.
Mitigation Goals: Conclusion of the Paris Alignment Assessment for the operation: Paris Aligned.	
Adaptation and resilience goals: assessing and managing the risks	
Pillar 1: Advance the restructuring of the power sector to promote long-term energy security by supporting the unbundling of Eskom, redirecting its resources toward new investments in transmission, while ensuring continued support for low-income households in a context of increasing electricity tariffs	
PA1: The Borrower, through the National Energy Regulator of South Africa, has issued a license to the National Transmission Company of South Africa SOC Ltd to operate the transmission system.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. The PA aims supports operationalization of a new transmission company. Climate impacts do not pose a risk to the outcome of the PA.
Conclusion of Prior Action 1:	PA1 is Paris Aligned
PA2: The Borrower, through its Department of Mineral Resources and Energy, has submitted to Parliament for	



approval the Electricity Regulation Amendment Bill, which amends the 2006 Electricity Regulations Act to <i>inter alia</i> : (a) create a platform for opening the electricity market; (b) establish a Transmission System Operator and assign its responsibilities to the National Transmission Company South Africa SOC Ltd; and (c) strengthen the regulatory powers of the National Energy Regulator of South Africa.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior actions' contribution to the Development Objective(s)?	No. The PA aims at expanding access to the transmission network through regulation. Climate impacts do not pose a risk to the outcome of the PA.
Conclusion of Prior Action 2:	PA2 is Paris Aligned
PA3: The Borrower has enacted the 2023 Eskom Debt Relief Act and the 2023 Appropriation Act to enable National Treasury to provide interest free loans to Eskom to cover its debt obligations over the next three years conditional on restricting new borrowing and directing investments towards compliance with the Minimum Emission Standards and flue gas desulfurization and transmission	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. The Eskom Debt Relief plan (PA3) aims at improving the Eskom's financial position through incentives and conditions, which <i>inter alia</i> prohibit investment in greenfield generation projects (which could be exposed to climate risks.) The PA is expected to expand financial space for Eskom to invest in transmission infrastructure and thus build resilience to climate risks.
Conclusion of Prior Action 3:	PA3 is Paris Aligned.
PA4: The Borrower(a) through its parliament has approved the Budget Review 2023; and (b) enacted the <i>Appropriation Act</i> which <i>inter alia</i> mitigates the impact of the increase in electricity tariffs, implemented in April 2023, on indigent households through the Free Basic Electricity Program.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. Climate hazards are not expected to affect the increased affordability of electricity resulting from this PA.
Conclusion of Prior Action 4:	PA4 is Paris Aligned.
Pillar 2: Support the implementation of a low carbon transition	
PA5: The Borrower, through its Department of Mineral Resources and Energy, has amended Schedule 2 of the Electricity Regulation Act to provide licensing exemption to Embedded Generators to promote electricity generation from private developers.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. Most new generation resulting from this PA is expected to be solar energy, which is relatively resilient to climate impacts. Increased diversification and decentralization of electricity supply may help build resilience to climate-related disruptions to the grid.
Conclusion of Prior Action 5:	PA5 is Paris Aligned.
PA6: The Borrower has enacted the 2023 Appropriation Act which provides tax incentives for individuals investing in rooftop solar photovoltaic and expands renewable energy tax incentives for businesses.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. Climate risks are not expected to affect tax incentives for individuals and businesses to invest in solar and other renewable energy.
Conclusion of Prior Action 6:	PA6 is Paris Aligned.
PA7: The Borrower, through its National Treasury, has established an Energy Bounce-Back Scheme that provides a 20 percent first-loss guarantee on loans extended by commercial banks to small and medium enterprises and individuals that purchase or lease equipment for renewable energy.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the	No. Climate risks are not expected to affect incentive programs for individuals and businesses to invest in renewable energy.



prior action's contribution to the Development Objective(s)?	
Conclusion of Prior Action 7:	7 is Paris Aligned.
PA8: The Borrower has enacted the 2022 Taxation Law Amendment Act which <i>inter alia</i> amends the Carbon Tax Act to gradually increase the carbon tax rate.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objective(s)?	No. Climate risks are not expected to affect the increase in carbon tax rate.
Conclusion of Prior Action 8:	PA8 is Paris Aligned.
Adaptation Goals: Conclusion of the Paris Alignment Assessment for the operation: Paris Aligned.	
Overall conclusion of Paris Alignment Assessment: The operation is Paris Aligned	