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THE SCALING UP OF DEVELOPMENT FINANCE INSTITUTIONS IN CLIMATE FINANCE PROVISION TO SUPPORT LOCALISATION AND WORKER TRANSITIONS

By Joan Stott and Adrian Chikowore

SUMMARY[1]

This policy brief examines the extent to which development finance institutions (DFIs) are geared towards playing a role in climate action, with a focus on localisation strategies and worker transitions using the Industrial Development Corporation (IDC) in South Africa as a case study. It argues that for DFIs to be positioned to meet the challenges of the climate emergency, their mandates, sources of capital, ways of lending and governance must work together in a mutually reinforcing and symbiotic way to serve the shift towards a just transition. Our analysis of the IDC against these four pillars reveals that while the IDCs mandate is progressively oriented towards supporting green industrialisation and a just transition; it is unable to meet this mandate as its focus remains in the mining energy complex, a highly capital-intensive fossil fuel-based set of activities. This outcome is as a result of the dysfunctions within the other three pillars. Since the IDC is classified as a "self-financing" development bank, it relies on returns from its investments and capital markets to mobilise the finance for its investments. The implication is that it borrows at commercial interest rates and is vulnerable to capital markets which thereby undermines its ability to advance patient capital.

Consequently, we show how the IDC operates like a commercial bank as it is a conservative investor, advancing finance at commercial rates with no associated grace periods and taking a highly risk-averse risk profile position. Finally, we consider how the governance of the IDC may help explain why the IDC has not met its mandate. We find that the IDC has a private sector bias as six out of 10 of its board members are from the large mining, energy, finance firms and most of whom have served for 9-13 years.

CONTENTS

WE MAKE THE FOLLOWING RECOMMENDATIONS:

1. The IDC's mandate and classification as a Schedule 2 entity be reviewed with the option to access additional for financial support from the government. This includes:
   a. capital injections of up to R100 billion from the fiscus (as per recommendations from the IEJ's "Assertive Fiscal Policy in an Equitable and Worker-Centric Climate Response")
   b. Potentially more than R180 billion through monetary policy initiatives (as per recommendations from the IEJ's "Leveraging Monetary Policy to Support the Transitional Needs of South African Workers")
   c. Guarantees on loans in excess of 10 to 15 years.
2. The recapitalisation of the IDC will support the restructuring of its balance sheet and investment portfolio. These restructuring measures include:
   a. Providing more loans over longer time periods, at concessional rates, and with grace periods of more than five years.
   b. Reducing its profit motive to a level that covers operating costs over a three year period.
   c. Adjusting its risk ratios and thresholds, including the debt-to-equity ratio (60% up to 75%), and liquidity ratio (less than 100%), among others.
3. The IDC needs to review its governance structures to:
   a. Install a Board of Directors including representatives of civil society, workers, government and the private sector - especially those involved in the green transition
   b. Be more open and transparent in making information on strategies, policies and plans publicly available. This includes aligning its reporting to the Green Finance Taxonomy.

INTRODUCTION

The urgency of addressing climate change has reinforced the critical role of public financial institutions in mobilising resources for sustainable development. DFIs and public banks are uniquely positioned to drive climate finance initiatives, particularly in fostering localised solutions and ensuring just transitions for workers affected by the shift to a low-carbon economy and just transition. As countries strive to meet their commitments under the Paris Agreement, climate finance provided by public DFIs has become an essential mechanism for enabling equitable green transitions.

This policy brief examines the pivotal role that DFIs play in financing climate action, with a focus on localisation strategies and worker transitions. Using the IDC in South Africa as a case study, it highlights how DFIs can contribute effectively to equitable and sustainable climate goals while addressing the socio-economic challenges posed by the transition to a green economy. It also gives an analysis of the challenges hindering the scaling up of climate finance and proposes an optimal public banking model for DFIs to mobilise the necessary resources for a Just Energy Transition (JET) in South Africa. Moreover, experiences from the South African case provide an opportunity to derive lessons to other countries on how DFIs can enhance climate finance mobilisation, while addressing the transitional needs of workers and fostering a just and sustainable economic shift.

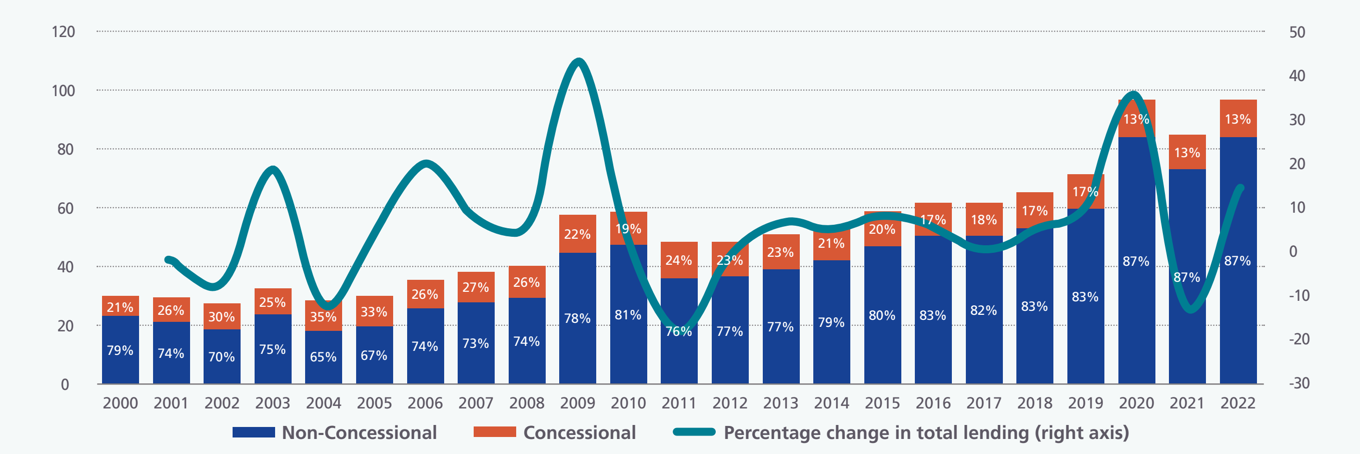
THE ROLE OF DFIS IN CLIMATE FINANCE AND SOUTH AFRICA'S CLIMATE FINANCING LANDSCAPE

Public DFIs have increasingly been positioned as key players in financing climate adaptation and mitigation efforts. Governments worldwide have repurposed national DFIs to fund renewable energy projects, climate resilience initiatives, and sustainable infrastructure.

The 2015 Addis Ababa Action Agenda (AAAA) highlighted the potential of public banks to drive climate finance, however, reliance on private-sector financing to address climate challenges has proven inadequate. Multilateral development banks (MDBs), which traditionally provide significant development finance, have struggled to scale their lending to meet climate finance needs. For example, between 2000 and 2022, annual disbursements from MDBs increased from \$30 billion to \$96 billion—an insufficient pace given the global scale of the climate challenges (Figure 1).

Using the IDC in South Africa as a case study, it highlights how DFIs can contribute effectively to equitable and sustainable climate goals while addressing the socio-economic challenges posed by the transition to a green economy.

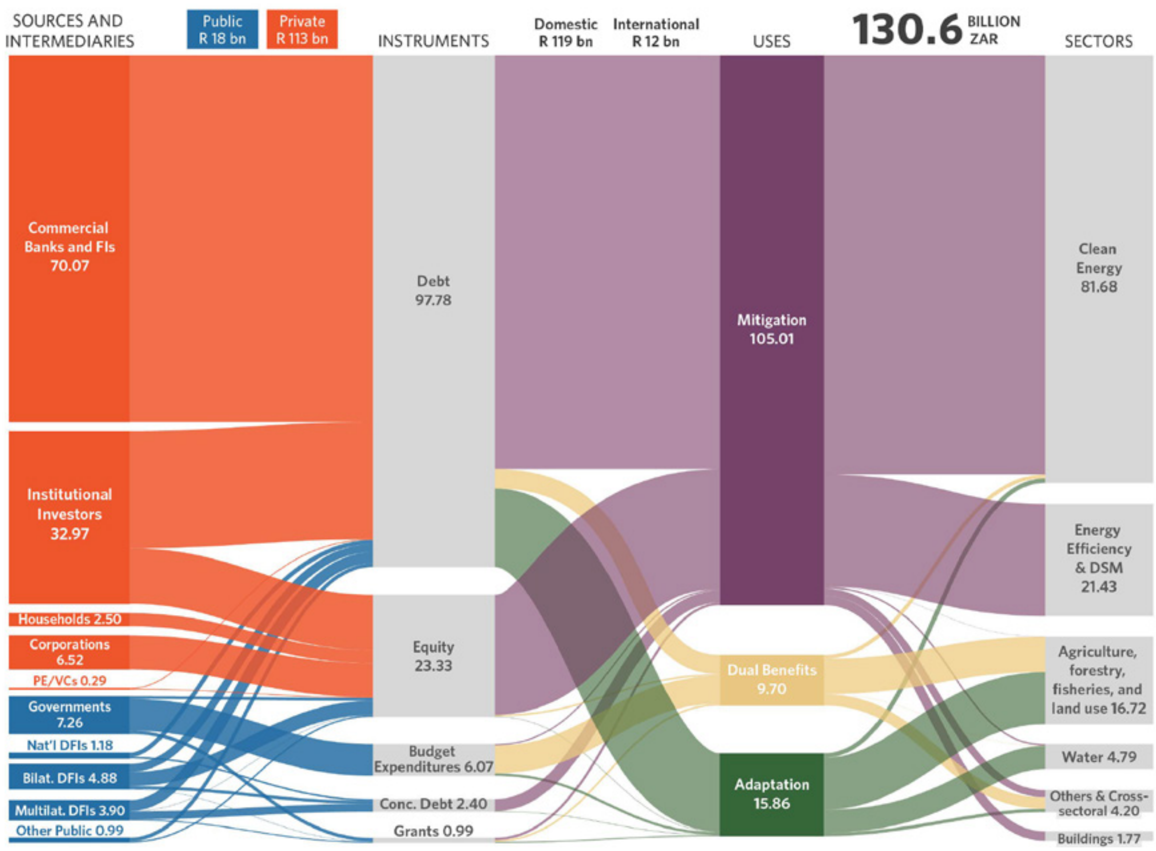
Figure 1: Lending by MDBs 2000-2022



Source: WB International Debt Statistics database, 2024.

Climate finance mobilisation and provision in South Africa is characterised by a mix of public and private international and domestic finance. The Presidential Climate Commission (PCC) estimates South Africa's annual climate financing needs at between R334 billion and R535 billion. This is in order to achieve its net-zero goal by 2050, and NDCs by 2030, respectively (de Aragão Fernandes *et al.* 2023). Between 2019 and 2021, annual average climate finance only amounted to R131 billion per year (Figure 2). Despite this being double the annual average received over the previous period (2017/2018), it is only a third of the lower bound estimate of required finance. Private sector funding accounted for 86% of the total. 98% of private financing was sourced from within South Africa, with 92% coming from commercial sources and 8% being made up by corporates, philanthropists, donors and households (de Aragão Fernandes *et al.* 2023). Figure 2 provides the total financing tracked for 2023.

Figure 2: Tracked climate finance in South Africa, 2023 (R billion)



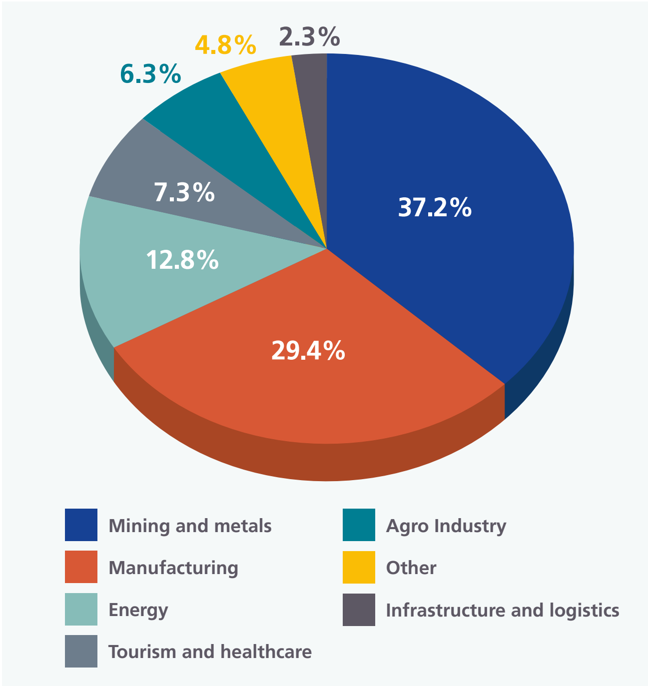
Source: de Aragão Fernandes et al. 2023, p3.

DFIs only contributed 7.6% to climate finance in 2023 in South Africa, with the majority in the form of debt. The biggest funders out of the DFIs seem to be bilateral creditors, which would be institutions like Kreditanstalt für Wiederaufbau (KfW a German development bank), Agence Française de Développement (AFD - a French development agency), and other external national development banks. South Africa's own DFIs (like the IDC), contributed R1.9 billion over the year. 81% of finance in 2023 was directed into mitigation projects, while adaptation only accounted for 12% (de Aragão Fernandes *et al.* 2023). This is in contrast to the annual average of 39% of climate finance going towards adaptation across Africa in 2022 (CPI 2022). Regarding the type of instruments, grants declined from an annual average of 5% from 2017 and 2018 to 1% between 2019 and 2021. As a proportion of debt, concessional lending has also decreased. We use the IDC as a case study to understand what underpins this poor performance.

CRITICALLY UNPACKING THE OPERATIONALISATION OF THE IDC'S MANDATE

Following the government's commitments to a just energy transition, there is an emphasis on renewable energy through independent power producers, as integral to meeting nationally determined contributions (NDC) targets, while expanding the country's generation capacity. Climate and economic resilience will be built while assisting clients in recovering from extreme weather events or drastic changes in production and ecosystems. Regional value chains are recognised as opportunities for pushing beneficiation towards industrialisation, while lowering greenhouse gas emissions and fostering a green transition for inclusive and sustainable growth. (IDCa 2024).

Figure 3: Exposure of the IDC's portfolio by sector, 2024

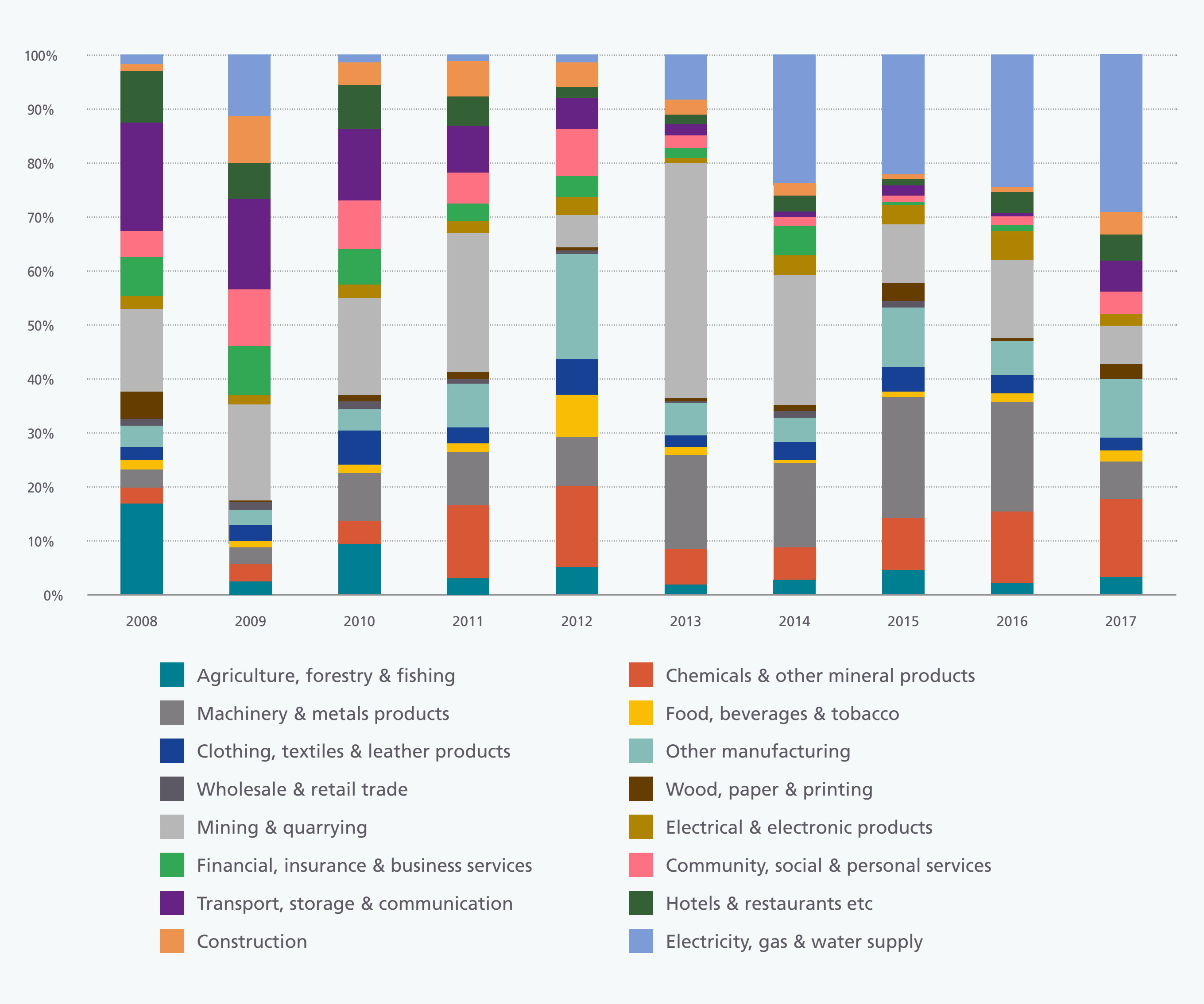


Source: IDCa 2024.

There is, however, little evidence of the diversification towards green industrialisation, as the IDC's exposure is still skewed towards carbon-intensive and mining sectors, as per Figure 3, where in fiscal year 2024, 37.2% out of a portfolio value of R94 billion, was in the mining and metals sector, with 29.4% in manufacturing and 12.8% in energy (IDCa 2024). Figure 4 below, similar to Figure 3, depicts the characterisation of the MEFC, which is fossil fuel based and still dominates the IDC's portfolio of investments. Sectors such as chemicals, petrochemicals and mining and metals take up a large share of the IDC's investment portfolio while investments in downstream manufacturing are significantly less. Between 2008 and 2017 there was a meaningful shift towards electricity, gas and water supply, as well as construction, chemicals and other mineral products and electrical and electronic products as a result of IDC's investments in South Africa's Renewable Energy Independent Power Producers Programme (REIPPP) (Goga *et al.* 2019).

Climate and economic resilience will be built while assisting clients in recovering from extreme weather events or drastic changes in production and ecosystems.

Figure 4: IDC sectoral funding, 2008 - 2017



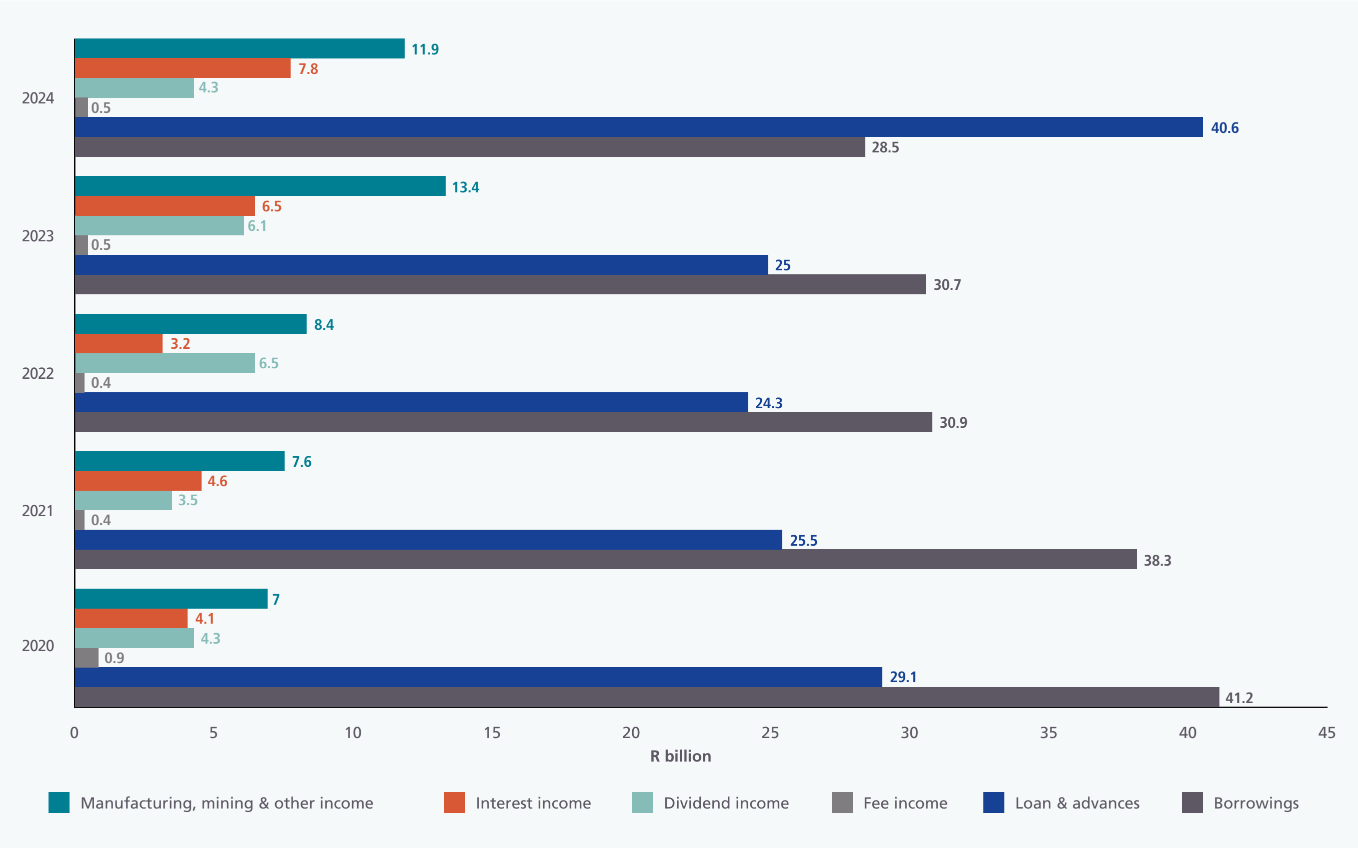
Source: Goga et al. 2019.

The discussions that follow use Morais *et al.*'s (2023) framework to critically analyse the possible reasons for which the IDC is unable to meet its mandate by analysing its sources of capital, ways of lending and governance.

THE IDC AND SOURCES OF CAPITAL

The IDC is classified as a Schedule 2[2] entity under the Public Finance Management Act (1999) (PFMA). This means they are not financed from the National Revenue Fund, taxes or other statutory contributions (Goga *et al.*, 2019; and PFMA, 1999). Therefore the IDC relies on internally generated funds such as dividends, loan repayments and interest charges, advances, and debt, to fund its balance sheet. Figure 5 below shows the sources of revenue for the IDC Group. In addition to income generated from dividends (from listed and non-listed investments (IDC 2020) and interest, the IDC supplements its capital with loan advances received and additional borrowings. Loan advances represent short-term credit given to the IDC to use as working capital. The IDC can use these funds to cover daily operating expenses, the same way a consumer would use an overdraft facility on their credit card. Additional borrowings are loans taken out by the IDC to fund their expenses over the short or medium term. The IDC can also choose to re-issue these borrowings or loans to clients. The re-issuance of loans generates funds through fees and interest for the IDC. Therefore, the IDC competes with commercial financial institutions to access capital from capital markets to supplement its internally generated funds.

Figure 5: IDC Group revenue, borrowings and loan advances 2020 - 2024



Source: IDCa 2024.

It is alarming to observe that loan advances have increased markedly between 2023 and 2024 (see Figure 5). This signals that the IDC is growing more reliant on credit to fund its daily activities. Borrowings, on the other hand, are declining steadily, dropping 31% over the last five years. In the study done by Goga *et al.* (2019), they expressed an increase in borrowings between 2009 and 2017 as reflective of an increased appetite for loan funding given the IDC's model of matching equity funding with equity investment and liabilities with loan-based funding. The trend shown in Figure 5, however, indicates the IDC is now operating in a very short-term environment - most likely between three and 12 months - where credit is accessed and repaid in an ongoing cycle. Depending on the risk profile of the IDC, interest rates on advances could be lower or higher than those on borrowings (SARB 2015). This could be the result of the downgrading of the IDC's credit rating, making it harder to access capital markets. The downgrading is associated with a constrained operating environment given the precarious global and national economic and political conditions since Covid-19. Essentially, the IDCs self-financing model makes it vulnerable to capital market shocks. In the next section on ways of lending, we argue that this impairs its abilities to advance patient capital for the JET and to take counter-cyclical measures.

THE IDC AND WAYS OF LENDING

The IDC Board of Directors set up a "prudential policy upper limit" of 60% for the Group's gearing ratio[3] (IDC 2023 p32). This is a financial "sustainability guideline" according to the 2024 Integrated Report (p111) and indicates that the IDC Board is concerned about its risk profile in the market, opting to keep its own debt in check and maintain a good credit rating. Since 2021/2022, the IDC has maintained a debt-to-equity ratio of well below its prudential limit; and in 2023, it had declined to 46%. The IDC, however, does not appear to have used this higher level of a greater focus on equity to investments as this would force the IDC to play a more active role in investment in sectors and client's projects - either through greater capital injections into projects or - both through constant evaluation of returns and ensuring the success of projects by providing technical assistance and capacity building services. This may be because a focus on equity-driven operations also limits the ability of the IDC to earn money off these activities in the short term. By using debt, the IDC can resell this credit to clients and have a steady source of income, as each month's interest payments come due (IDC 2023; IDCa 2024). Equity on the other hand takes much longer to produce income and can be quite volatile and dependent on market conditions.

The IDC has both on and off-balance sheet projects.[4] On balance sheet projects are funded mainly through loans which are given at the market rate (non-concessional) or 1 - 2% below (concessional). Table 1 gives an overview of the current funding schemes offered by the IDC and their associated lending rates. Unfortunately, this is not more competitive than commercial banks operating in South Africa, but is aligned with the increase in loan advances to the IDC in recent years (IDCa 2024). That is, the IDC is itself borrowing more from capital markets to cover its operations and is therefore exposed to high or non-concessional interest rates. Secondly, any borrowings it uses to fund investments must be paid back at rates that cover the cost of borrowing for the IDC. It should also be noted that the IDC's website does not include any information about grace periods offered to clients. From one of our interviews, we learnt that there is typically an interest moratorium granted for the first 12 months if a deal includes structuring considerations. Deals may include stays on capital repayments, but this is not very common. In both cases though, this is done on a case-by-case basis (Interview 2025).

Table 1: IDC's current funding schemes and associated interest rates and fees

FUNDING SCHEME	LENDING RATES AND FEES
AFD Green Energy Fund	Normal risk pricing capped at prime + 1.6% or an equivalent fixed rate; Standard IDC fees.
The Agri-industrial Fund	Mainly grant funding. Debt funding is determined case-by-case.
Downstream Steel Industry Competitiveness Fund	SMEs (value of R80 million or less or an annual turnover of R100 million or less): • First R50 million - 2.5% fixed for 5 years • R50 million to R75 million (max) - prime for 5 years SMEs (value of more than R80 million or annual turnover above R100 million) • Prime with a maximum discount period of 5 years. Large companies (annual turnover of R123.5 million or less) • First R30 million at the lower of: · Prime · IDC risk pricing less 2% · R30 million to R75 million · IDC risk pricing less 1.5% Large companies (annual turnover of R123.5 million or more) • First 30 million at lower of: · Prime · IDC risk pricing less 1.5% · R30 million to R75 million · IDC risk pricing less 2% Maximum discount period of 5 years Standard IDC fees apply Guarantees and subsidy on guarantee fees.
Furniture Industry Challenge Fund	• Manufacturing competitiveness enhancement pricing: 0% • IDC pricing: prime less 0.2% (subject to change) • Subordinated loans – IDC risk pricing. • Raising and commitment fees are excluded for manufacturing competitiveness enhancement funding. All other standard fees are applicable.
Gro-e youth Scheme	• More than 26% youth-owned – prime less 2% • More than 50% youth-owned – prime less 3% • If first withdrawal not within 12 months, pricing reverts to normal IDC pricing • Standard IDC fees apply.
Manufacturing Competitiveness Enhancement Programme (MCEP)	Fixed rates of 0% - 2.5%.
SMEs and MIDCAP COMPANIES	Normal IDC risk pricing less 0.3%.
Unemployment Insurance Fund II	• Pricing currently between 8.64% and 10.94%. Fixed for seven years before reverting to IDC's risk pricing • Discounts based on developmental scores, black industrialist status and job efficiency at the time of the application. • Standard IDC fees apply.

Source: IDC website (13 February 2024), author's collation.

The prevailing fees and rates (Table 1), as well as trends in loan advances and borrowings (Figure 5), also mean there is reluctance by the IDC for long-term financing of up to 20 to 30 years. This extended long-term investment horizon (20 to 30 years) is what is required for the just transition. Returns on such investments are uncertain over this prolonged extended period of time and thus would limit the IDC's ability to finance other projects while remaining profitable and this remains a going concern.

THE IDC AND GOVERNANCE

An analysis of the governance of the IDC via the structure of the board, its training and experience we note that it is less aligned with fair representation of sectors of the socio-economic fraternity (civil society, trade union & industry) and does not fulfil this aspect of Marois's framework of governance on equal representation of stakeholders (2021 and 2023). The 10-member board has a private sector bias. At least six Board members are from the private sector and one represents small-, medium- and micro-sized enterprises (SMMEs). Three board members represent the government: one represents the Department of Trade, Industry and Competition (DTIC); one is the former chief executive officer (CEO) of the National Empowerment Fund[5] (NEF); and the other is the CEO of the IDC. There is only one trade union representative. When we analyse the sectors that the private sector members of the board represent, we observe that they are mostly associated with the IDC's largest clients and large firms from mining, energy and finance. Other sectors represented include power, asset management and private equity, private investment, and small business development.

While the IDC complies with domestic legislation, a study by the Centre for Environmental Rights (CER) found that the IDC scored very poorly when considering international standards and elements of transparency and accountability (CER 2020). The CER assessed six DFIs,[6] including the IDC and the Development Bank of Southern Africa (DBSA). The methodology grouped criteria into seven themes, including transparency and accountability; climate change; corruption; human rights; gender equality; health; and nature. This was done across DFI operations in the financial sector and the power generation sector and only considered publicly available information (CER 2020). Out of the six DFIs studied, the IDC came last - scoring 0.8 out of a potential score of 10. This was mainly due to the IDC scoring zero in several themes. The CER observed that formal policies are not publically available for the IDC, with information only provided in the integrated annual reports and corporate plans. This detail, however, is insufficient to be compliant with some international standards (CER 2020).

CONCLUSION AND RECOMMENDATIONS

Following an underwhelming climate finance discourse in 2024 where the new collective quantified goal (NCQG) was underwhelming, debates in the climate finance space will be preoccupied with the reform of the global financial architecture, policy processes relating to the Baku to Belim Roadmap and increasing climate finance from $300 billion to $1.3 trillion by 2035 at the 30th meeting of the Conference of the Parties (COP30) (ECCO 2025). South Africa is also chairing the Group of 20 (G20) for the first time. Within this milieu, it is important that the country's domestic goals to achieve the JET are not misplaced. From this brief's analysis, it is clear that existing levels of finance, as well as instruments, are falling far short of expectations and requirements. Even locally in South Africa, the largest DFI, the IDC, is failing to leverage sufficient capital to fulfill its mandate by moving towards the JET in a progressive and comprehensive manner. The JET financing mechanism (JET-FM) proposed the need for public finance to potentially play a greater role in derisking, but also for greater collaboration between the government and the IDC, DBSA, and NEF to reduce current fragmentation across projects (PCC 2024). These recommendations acknowledge that in order for the JET to be successful, issues around scalability, burdensome bureaucratic hurdles, limited project preparation support, and a reactive stance in project sourcing, need to be improved (PCC 2024). In lieu of the above, the IEJ recommends that the Government of South Africa should:

1. REVIEW IDCS CLASSIFICATION AND SUPPORT ITS RECAPITALISATION BY LEVERAGING FISCAL AND MONETARY POLICY INSTRUMENTS:

a. In terms of budget support, this can be done through raising existing taxes or new taxes, ring-fencing existing taxes into climate-specific funding pools, or via on-budget grants, such as traditional overseas development assistance. This can include instituting carbon pricing, earmarking existing revenues and retirement tax reform. The proposals result in a domestic resource mobilisation that is to the tune of R90 billion a year for climate priorities. (IEJ 2025a)
b. In terms of monetary policy instruments that can be mobilised for the JET. South African government needs to review and utilise the under-exploited liquidity from South Africa's retirement industry. IEJ, (2025b) points out that there must be a return "to a maximum offshore investment limit of 30% which would increase onshore assets held by the retirement industry by an estimated R600 billion, with the current

infrastructure investment exposure limit being worth an additional estimated R180 billion in that scenario.

c. In terms of guarantees, this could be reserved for loans that are in excess of 10 or 15 years.

2. PROMOTE THE SCALING UP OF CONCESSIONAL LENDING, EQUITY INJECTIONS AND GRANT FINANCING

The recapitalisation of the IDC through the above policy instruments, will improve the IDCs ways of lending by scaling up commercial lending and grant financing. This will help the IDC to take on projects that have longer time horizons such as 20 to 30 years, and that are focused on public goods, traditionally deemed too risky for private investment. These are specifically the types of investments needed to transition to a green economy in a socially just and worker-centred way. Some of the more specific recommendations include:

a. Scaling up commercial lending at 2% below prime.
b. The IDC structures its loan book with longer-term debt to fund longer-term projects. This will still earn interest equivalent to, or greater than, existing income - just over a longer time period.
c. The IDC needs to decrease its profit and dividend motive in the way that it currently operates. Profit should be reduced to a value equivalent to 36 months of operating costs, including a reserve fund of 2 years. This will create additional room for more concessions on loans, and taking on riskier, longer-term projects.
d. Install grace periods at a minimum of 5 years.
e. The IDC adjusts its risk ratios and thresholds around the:
   - Debt to equity ratio: This should be closer to 75% given the integral importance of this institution in the JET especially if the government is able to provide capital and guarantees, and financial sector policies around risk are amended.
   - Liquidity ratio: This should be less than 100%, allowing for the IDC's need to take on additional risk in its activities.
   - Credit loss ratio and net interest income loss: these should both be raised in order for the IDC to move away from its focus on profits to taking on riskier but necessary social transition projects.
   - The average probability of default ratio: this should be adjusted in line with increased government support, a larger debt-to-equity ratio and the taking on of riskier projects.

C. REFORM DFI GOVERNANCE AND OPERATING MODEL

The IDC is fulfilling governance standards as per domestic legislation, but it is failing to provide a full picture of its operations and practices in line with broader international standards and commitments. In addition, the lack of publicly available policies on things such as environmental and social responsibility, climate change and corporate responsibility, leaves a void of information on how closely aligned the IDC truly is to achieving South Africa's Sustainable Development Goals (SDGs), National Development Plan (NDP), NDCs and JET in a pro-worker, pro-climate and socioeconomically just way. The IDC Board is currently demographically representative but remains aligned with the neoliberal ideals and operations of the MEFC. More board members are from the mining, energy and financial sectors, and they hold or have vested interests in these areas. As such;

a. The IDC should therefore reconsider the composition of its Board of Directors so that it represents all sectors of society and industry. This should include representatives from civil society, government and the private sector.
b. The government should reflect the shareholder position as with DTIC and this should also include key policy departments tasked with the green transition, such as environmental affairs, agriculture, or even the planning, monitoring and evaluation.
c. The private sector should be inclusive of the aspirational low-carbon economy and include representatives from manufacturing, and agriculture, as well as energy, small business and the circular economy.
d. Trade union representation should be across industries, not only in sectors in which the IDC operates. In addition to expanding the representation of economic participants, the IDC should consider reinvigorating its Board with newer members on a more regular basis - perhaps even establishing a maximum tenure for members.
e. Overall, the IDC should make more of its information by way of policies and strategies publicly available. This includes aligning its reporting to the Green Finance Taxonomy.

The IDC is among a few agencies that were not affected by the corruption scandals that plagued the government. Therefore, this must be done in a manner that ensures that the IDC's good standing is retained.

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ENDNOTES

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2. Schedule 2 public entities are business enterprises that are classified as major public entities in the PFMA of 1999. These entities are required to generate revenue to fund their operations, but some may also receive government support in the form of subsidies or guarantees.
3. A company's gearing ratio shows the extent to which a company uses debt and equity to fund its operations. A ratio of 60% indicates that only 40% of the company's costs are paid for using revenue, equity or income and the remainder is covered by debt. Creditors and investors use the gearing ratio to assess the potential risk of a company.
4. On balance sheet projects are directly funded and managed by the IDC, while off-balance sheet projects are funded by another entity and managed by the IDC (for example a government department's infrastructure project, or projects funded by international DFIs).
5. The NEF is a subsidiary of the IDC.
6. DFIs included in the study were the EIB, DBSA, AfDB, NDB, IDC and Netherlands Finance Development Company (FMO).