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ASSERTIVE FISCAL POLICY IN AN EQUITABLE AND WORKER- CENTRIC CLIMATE RESPONSE



How and why should a country like South Africa commit scarce domestic fiscal resources in responding to the climate crisis?

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KEY INSIGHTS

There are accelerating costs being imposed on the domestic economy, and there are opportunities being missed, which require a more fiscally assertive domestic response. Market failure means the private sector is unlikely to respond at sufficient scale or with enough of a focus on equity. Instead, we require fiscally assertive governments to take the lead, which includes more domestic resource mobilisation, earmarking some revenue for climate priorities, and pooling such revenue sources into a climate response fund to enhance credibility and predictability.



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RECOMMENDATIONS

1. Sovereign green bonds:

- Issue green infrastructure bonds to finance renewable energy grids, ensuring state-led control and democratic accountability.
- Advocate for a slower fiscal glide path, allowing for R100bn in bond issuance annually for 2026/27 and 2027/28.

2. Carbon pricing:

- Establish a predictable carbon tax pathway, targeting R500 per tonne CO₂ by 2040, generating R50bn annually.
- Allocate revenues to green industrial policies and a climate response fund.

3. Earmarking existing revenues:

- Dedicate 30% of General Fuel Levy (GFL) revenue (~R28 billion annually) and all Mineral and Petroleum Resource Royalty revenues (~R15 billion annually) to climate priorities.

4. Public spending reforms:

- Rationalise government structures to reduce inefficiencies, with estimated savings of R26.4bn annually. Allocate 50% of these savings to climate responses.

5. Retirement tax reform:

- Reduce the cap on retirement contribution deductions, generating R20bn in fiscal savings. Direct these funds to climate priorities to enhance equity.

6. Climate response fund:

- Pool earmarked revenues into a central fund focused on adaptation and equity, addressing worker transitions, regional disparities, and household vulnerabilities.

The combined impact of these proposals oriented to domestic resource mobilisation (DRM) generates around R100bn a year for climate priorities, a substantial starting point and a clear indication that the country is serious about climate change. This signalling is, in turn, indispensable to unlocking large-scale concessional and commercial finance over the years 2030 to 2050, to complete the essential transition.

INTRODUCTION

How and why should a country like South Africa commit scarce domestic fiscal resources in responding to the climate crisis?

The primary responsibility for taking and financing urgent action falls on those developed countries whose industrialisation is the cause of the problem, and many commentators suggest that the private sector can deliver most of what is required, if an enabling environment

is created. The fiscal role of emerging market and developing economy (EMDE) governments would appear to be quite limited.

However, there are accelerating costs being imposed on the domestic economy, and there are opportunities being missed, which require a more fiscally assertive domestic response, whether volumes of non-domestic public and private support materialise or not.

There is an urgent need to look more critically at the blended finance model (BFM) which informs South Africa's just energy transition (JET) (Presidential Climate Commission, 2022), because there is not enough recognition of the nature and scope of market failure in the thinking underpinning the BFM. There is also an urgent need to look at what domestic resource mobilisation options are feasibly available, to illustrate what is fiscally possible if the political and social will exists.

The kinds of fiscal policies that are needed would enable South Africa to take far more direct control over its future, in terms of its response to the harm that will be caused by climate change, while also positioning it to seize the opportunity that climate action can yield for the economy, and in a way that can deliver positive socio-economic outcomes for workers.

ANALYSIS

International public, concessional, bi-lateral or multi-lateral finance to poorer countries must play an important role predominantly in supporting those countries which will be at the receiving end of climate-related impacts they are not responsible for, and specifically supporting non-carbon intensive development trajectories in areas such as energy and transport in these countries.

At the same time, sovereign countries should take as much control of their destiny as possible by deploying domestic, public resources to tackle the threat to citizens' lives and livelihoods posed by climate change. This is the only way to capture potential domestic gains, such as green industrial policy gains. It would also ensure equitability in the energy transition, specifically for displaced workers and for poorer South African households, who will be vulnerable to higher energy costs, as huge capital outlays are integrated into tariffs and long-term tariff agreements with private actors.

The financing approach underpinning South Africa's JET is that of blended finance (Presidential Climate Commission), in which governments are seen as de-riskers of the delivery space, with private capital providing the rest (including finance) through public-private partnerships. They are typically justified with reference to the alleged superior efficiency of the private sector and the fiscal constraints governments currently face.

BFM come with real risks, however. The volume of finance coming through may simply not be enough, or sufficiently predictable, for public interest goals. Or volume may be sufficient, but the overall distribution of costs and benefits may not be fair, due to poor initial design, capture by vested interests, or second and third round negotiations which move away from the initial terms of an agreement. BFM approaches also typically run outside the national budgeting system, and so are unlikely to have the transparency that is actually needed, given what is at stake; without transparency, meaningful accountability (including from the legislature) also becomes harder, if not impossible, to achieve.

Underpinning these challenges is the reality of the likelihood of market failure in many key elements of climate responses. Much green infrastructure in transport and energy systems will exhibit natural monopoly attributes, and so will be vulnerable to over-pricing and under-provision. Equity problems are likely to be pervasive, including that poorer households are more likely to suffer catastrophic losses of livelihood and assets, and that there will be employment losses in some sectors, which will not be automatically offset by gains in others. Adaptation spend is also likely to be insufficient, because of information gaps, myopia, and coordination and cooperation failures. Finally, developing particular markets or sectors is rarely the preserve of individual firms, which may carry large private risk but only recoup moderate private returns, as other players enter.

In general, public interventions aimed at mitigating market failure can be financed from general government revenue or from revenue streams earmarked for that purpose. In the case of climate responses, earmarking and pooling of revenue sources into a climate response fund is recommended. With a focus on climate-related priorities such as adaptation and equity, such a fund could bring enhanced credibility, predictability and flexibility to South Africa's climate work.

RECOMMENDATIONS

Our recommendations identify key fiscal tools that need to inform a more assertive fiscal response, both in terms of behavioural change and domestic resource mobilisation for domestic climate priorities which, if left to the market, will be under-addressed or not addressed at all.

FISCAL SPACE AND SOVEREIGN GREEN BONDS

The South African state needs to take the lead in renewable energy (RE) grid financing through issuance of an initial green infrastructure bond. Doing so would be an important market-making move, would establish

real credibility for larger-scale RE infrastructure build (which should bring costs of capital down), would provide further assurance to RE generation firms, and would ensure that core aspects of RE infrastructure would remain under state control and meaningful democratic scrutiny and accountability, in areas such as pricing and access.

The fiscal glide path from 2026/27 onward should bring the overall borrowing requirement down at a slower rate than proposed, and specifically should provide for climate bond issuance of R100bn in 2026/27 and in 2027/28, generating a gross borrowing requirement of about 6.3% rather than 5.1%, for both these years, and a total debt stock that tops out at around 77% of GDP in 2026/27 before decreasing. This would allow a true state-led initiation of RE grid infrastructure financing before private sector investment is pulled in.

CARBON PRICING

A recent IMF paper (International Monetary Fund, 2023) estimates that SA's effective carbon tax rate was less than R7 per ton in 2021/22, compared to the statutory rate of R134 by end 2022, and to a Paris-aligned rate of about R1 000 per tonne of CO₂. Unsurprisingly, given the low effective rate, carbon tax revenue has also been negligible to date.

To instill predictability and credibility, a carbon tax rate pathway is needed for the years up to 2040. We provide such a pathway, with an effective rate of at least R500 per tonne CO₂ in 2040, still far short of Paris-aligned rates. This generates about R50bn a year in 2040, and we believe all carbon tax revenue should be recycled for climate response purposes: half should go to green industrial policy interventions and half to the proposed climate response fund.

GENERAL FUEL LEVY

The General Fuel Levy (GFL) is a tax on petrol / diesel levied on motorists, and raises the overall price of carbon in South Africa, although this is not its primary policy aim. In 2022/23, revenue from the GFL was R81bn, and for 2023/24 the estimate is R93bn (National Treasury, 2024). The GFL can be an important and appropriate source of revenue for the climate response fund, and we proposed that 30% of its revenue should be allocated to the fund.

THE MINERAL AND PETROLEUM RESOURCES ROYALTY

South Africa introduced a Mineral and Petroleum Resource Royalty (MPRR) in 2008 to compensate the state as custodian / owner of mineral resources for the permanent loss of mineral resources mined. South Africa

is a 'resource curse' economy in many respects, with levels of inequality that are fairly typical of economies rich in natural resources, and with the social and political challenges arising from that inequality.

In 2022/23, revenue from the MPRR was about R25bn, and in R2023/24 it was R16bn (National Treasury, 2024). We propose that all MPRR revenues should be earmarked for the climate response fund, adding a minimum of R15bn a year to predictable revenue for the fund.

PUBLIC SPEND EFFICIENCY REFORMS AND RESOURCES FOR CLIMATE RESPONSE

Over time the structure of the South African state has become cumbersome to the point of generating significant additional coordinatory costs which exceed the value of the structures created. Rational re-structuring needs to be a priority, in order to enhance the social return on public spending. It is not about smaller government, but about bringing more structural coherence into government. A secondary but important gain from such re-structuring is actual fiscal savings, and we believe that a share of realised fiscal savings, obtained through re-structuring efforts, should be earmarked for climate responses.

We consider some departmental mergers, reconsider expenditure that occurs through provincial premier offices and provincial legislatures, and excessive transversal expenditures in areas like government communications and marketing spend, as well as ICT spend and the use of consultants and professionals.

The fiscal savings associated with efficiency-orientated reforms could, in our initial analysis, total R26.4bn, of which we believe half (R13.2bn) could be allocated for an initial period to climate responses.

REDUCING REGRESSIVITY IN RETIREMENT DEDUCTIONS

The current deduction framework in support of retirement provision is highly regressive, and reform in this regard holds great potential, both for climate response financing and for a fairer system than is currently the case. The current deductions are simply too generous to richer South Africans, and changes are possible which continue to incentivise retirement contributions but would reduce costs to the fiscus and free up resources for cash transfers.

The most plausible change, to make the system more equitable, would be to reduce the cap on permissible retirement deductions. Currently, it is set too high and in practice amounts to virtually all retirement contributions being tax deductible. With an annual cap of R100 000, fiscal savings would be in the region of R20bn.

We believe that fiscal savings which eliminate the more regressive element of retirement contribution support should be allocated to the climate response in full.

A CLIMATE RESPONSE FUND FOR ADAPTATION AND EQUITY

In the preceding sections we have sought to show how domestic resources can be mobilised by earmarking, a carbon tax and a gentler fiscal glide. There are a number of reasons why these revenue streams should be pooled together, we believe, into a climate response fund focused on the adaptation and equity spend aspects of climate change and the response to it.

A climate response fund would harness funds to cover likely shortages in the quantum of adaptation spend, to support a just transition for affected workers in Mpumalanga, and more generally to help address inequity in climate impacts and the ability to adapt to them amongst South African households.

CONCLUSION

The combined impact of these DRM-oriented proposals generates around R100bn a year for climate priorities, a substantial starting point and a clear indication that the country is serious about climate change.

This positioning, with a fundamentally more assertive and creative approach to domestic fiscal policy and allocation, is, in turn, indispensable to unlocking large-scale concessional and commercial finance over the years 2030 to 2050, to complete an economic transition that is essential if South African lives and livelihoods are to be protected.

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