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Linking Climate, Companies and Communities: A Framework for Evaluating the Just Transition

Introduction:

With the impacts of climate change worsening each year, many countries and companies are strengthening efforts to decarbonize, green their economies and build resilience for the future.

Achieving the goal of the Paris Agreement, which is to limit global warming to 1.5 degrees Celsius requires unprecedented change in how we do things. As history has often shown, changes of that scale can seriously disrupt workers and society. The energy transition has the potential to radically transform the global economy, resulting in significant risk and opportunities for the businesses, communities, governments, and individuals operating within it.

As these changes take place, momentum is growing around the concept of a just transition. The International Labour Organization (ILO) defines a "just transition" as "greening the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities and leaving no one behind."

From an investor standpoint, a just transition seeks to address the interconnected financially material issues of climate change, racial injustice, public health and economic inequity. For example, abruptly shutting down a coal plant might be a great decision from an environmental standpoint, but a company must consider the potential social impact and backlash from workers and the local communities that may be economically dependent on this business.

A company- or country-level climate transition plan that does not address critical social issues will likely pit the social wellbeing of its constituents squarely against their own and the rest of the world's broader decarbonization goals, hindering progress in both domains. In addition, credible transition plans have the potential to help enhance human capital, grow regenerative enterprise value, improve corporate reputations and reduce systemic risk.

We therefore believe that the just transition is becoming an increasingly important topic for investors. Understanding these issues will take time, as climate transition plans and decarbonization pathways are still in the beginning stages. Throughout this paper we highlight some examples of the just transition, including those companies and partnerships that are progressing well and others that have more work to do.

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Development: Now that many companies have established net zero goals, forward-looking companies, governments, as well as key sustainability standard-setters and policymakers, such as the Climate Action 100+ (CA100+) and the Global Reporting Initiative (GRI), are increasingly allocating time to understanding how the transition must occur to ensure it is fair to all key stakeholders. This includes taking job loss and growth into consideration, as well as the security of energy supplies, supply chain impacts, universal access to affordable energy and a fair distribution of transition costs and benefits.

Materiality: The investment industry's understanding of the financial materiality of the just transition is in its infancy; however, a growing focus on this topic appears inevitable and we would benefit from an improved understanding of the risks and opportunities related to it. The materiality of this question exists on two levels: the country level and the company level.

- Country-level materiality focuses on questions of policy, such as how much of the energy transition for less developed markets can be financed by developed markets? How much of the cost within a market is borne by companies versus taxpayers? And, at what pace does domestic policy incentivize the transition to occur?
- At a company-level, questions include how can companies help their workers adapt and grow new skills rather than just firing existing workers and replacing them with others?

Next steps:

We need to evaluate both national and corporate transition plans through a just transition framework to evaluate the likely effectiveness of an issuer's transition plan.

The increasing focus on a just transition

According to the World Economic Forum, a just transition is broadly premised on three concepts:

1. While likely to be a global net job creator, climate-driven economic change will disrupt, transform or create entire industries, workforces and professions.
2. These changes will disproportionately impact specific groups of workers and communities, especially in regions with specialized workforces.
3. Left unchecked, this will exacerbate unjust and enduring economic and social effects, thereby putting at risk the successful delivery of the transition.

Source: https://www3.weforum.org/docs/WEF_The_Chairpersons_Guide_to_a_Just_Transition_2022.pdf

The United Nations Framework Convention on Climate Change (UNFCC) estimates that the energy transition could negatively impact 1.47 billion jobs in sectors critical to climate stability:

- agriculture (1 billion)
- manufacturing (200 million)
- buildings (110 million)
- transport (88 million)
- energy (30 million)

Importantly, the just transition presents opportunities as well. Climate action, if conducted properly, has the potential to result in significant economic gains including a direct economic gain of $26 trillion by 2030 compared to business as usual and a net job creation of 24 million green jobs according to the International Labour Organization (ILO).

To better understand the just transition, we should examine the quantitative and the qualitative implications of climate strategies, so that all workers in the new economy are respected and able to contribute to thriving and resilient communities.

Where are we now?

Thus far, when evaluating whether a company will be successful in transitioning their business to be climate resilient, we have largely focused on carbon reduction goals. However, considerations of the social dimension of carbon reduction plans are equally important. This aspect starts by asking if companies have a just transition plan in place. The initiative Climate Action 100+ has integrated a just transition indicator into its disclosure framework for the first time in 2022. The GRI, used by many companies across the world as a sustainability reporting standard, has also included a just transition dimension which will require industries like coal to disclose a forward-looking plan to mitigate job losses and income impacts on workers and communities.

A framework for assessing just transition plans: key stakeholders

Just transition corporate governance and oversight

Since the plans implemented by businesses over the coming years will be pivotal to the world's decarbonization journey, leadership and governance are also key considerations when analyzing just transition plans. Decision-makers who fail to consider the social dimension of the transition may undermine the achievement of climate action ambitions and could face certain risks like reputational risk. Thus, strong leadership and governance across businesses is an important consideration to appropriately manage risks and leverage opportunities. To drive positive outcomes, corporate boards need to take a proactive role to ensure a just transition is a business priority.

What does a just transition look like in practice?

There are various micro and macro examples of climate transition plans that have failed or may fail due to the lack of a just transition plan. Others have succeeded or appeared poised to succeed because they were able to balance social and environmental considerations. These examples span both emerging and developing markets, highlighting that the just transition is a universal challenge to companies in all geographies. A few examples are described below.

Company case studies

Air Products

Air Products, an American chemical company, is developing a large new green hydrogen project in an area in Texas that's experienced economic decline due to a recent coal plant shutdown. This project has been aided by the new Inflation Reduction Act (IRA) legislation in the US, which includes green incentives, but it's a good example of finding a community that has an industrial skillset that can be retrained to enable a greener future.

Enel

This company employs approximately 75,000 people worldwide with 36,000 in Italy. Enel faced up to the challenge of the energy transition and the EU's tightening emissions limits by announcing the Futur-e Program, an initiative to close and repurpose legacy fossil fuel assets. In May 2017, it announced the closure of two large coal power plants by 2018 and a plan to close all its coal and lignite generation plants by 2030. Along with a 2050 carbon neutral target, ENEL announced the reconversion of 23 power stations with significant employment implications. The unions have always taken a very critical view of the "Future-e" plan and have been critical of the lack of information and their scarce involvement in these processes.

As a result, ENEL entered a social dialogue on a just transition framework agreement with its Italian union partners covering retention, redeployment, re-skilling and early retirement. It provides an example of a just transition plan that included provisions for recruitment using apprenticeship to ensure the knowledge transfer from elderly to younger workers. It also encourages mobility and training to optimize internal resources and dedicated training measures to ensure qualification and employability for the development of its new business.

Engie Australia

In November 2016, Engie announced the decision to close the Hazelwood Power station to reduce its carbon emissions. The state government responded by establishing the Latrobe Valley Authority (LVA) which began to engage unions, Engie and other power station owners, local government and community organizations. Four major initiatives evolved for assisting impacted workers and their families:

1. A Worker Transition Service to provide one-on-one transition services and skills development
2. Financial support for retraining workers directly employed by Engie and federal government training support for contract workers
3. A "Worker Transfer" scheme, to open jobs by launching early retirement schemes at other power stations in the sector
4. Regional revitalization with state government establishing a "special economic zone" with financial incentives to companies for creating jobs for displaced workers

Ford automotive

Ford announced plans to cut 1300 jobs in the UK over the next two years, and 3800 jobs across Europe, nearly 2800 of which are engineering jobs. Just one day before its European layoff, Ford announced an investment of $3.5 billion in a new electric vehicle (EV) battery plant in Michigan. Without a retraining or relocation program for these workers, Ford risks lowering morale and talent retention across its workforce, especially its skilled employees, in addition to potential strikes by unions in Germany and additional political intervention in its restructuring program. Growing concern for the auto industry's impact on workers in its shift from ICE to EV could impact the industry's ability to attract subsidies.

Solar supply chain

Almost half of polysilicon used to make photovoltaic panels for the solar industry is produced in China. Import bans driven in part by human rights concerns could significantly slow down the uptake of solar required for the energy transition. Siemens CEO Roland Busch warned in December 2021 that "If [forced labor] bans are issued, these could mean that we can no longer buy solar cells from China — then the energy transition will come to an end at this point." Can the concerns around human rights enable the development of an alternate solar supply chain in countries like India?

Just Energy Transitions Partnerships (JETPs)

At the country level, Just Energy Transitions Partnerships (JETPs) are emerging initiatives aimed at bridging the gap between developed and developing nations in moving towards clean energy.

JETPs are financing mechanisms. In a Partnership, wealthier nations fund a coal-dependent developing nation to support the country's own path to phase-out coal and transition towards clean energy while addressing the social consequences.[1] They involve mechanisms intended to help a selection of fossil fuel-dependent emerging economies make a just energy transition within their self-defined pathway with minimal disruption to their economic development.

JETPs are a nascent concept and are still very much in the process of developing as they are being created through ongoing experience rather than from preexisting frameworks. While JETPs are worth monitoring, we do not yet have enough information to meaningfully engage with stakeholders that have a critical role in helping the JETPs be accepted and effectively implemented. It also remains unproven how JETP partnerships translate into national climate policy changes, which is required for sustained climate progress by countries and companies.

Early progress of the JETP in countries like Indonesia highlight how the program could be more material going forward.

Indonesia

At the end of 2022, Indonesia was offered a $20 billion package from an even mix of public and private capital, with partners including the US, UK, Italy, Norway, Japan, Canada, Denmark, France and other developed nations. While no formal investment plan has been published yet, the stated aims of the JETP are to accelerate Indonesia's coal phase out which would peak its total power sector emissions by 2030 while also establishing a goal to reach net zero emissions in the power sector by 2050, bringing forward the country's net zero power sector emissions target by ten years. The plan would also accelerate the deployment of renewable energy so that renewable generation comprises at least 34 percent of all power generation by 2030.

While this $20 billion package represents a small piece of the $600 billion required to fully decarbonize the country's power sector, it is a precursor of the type of support that may be forthcoming from private and public sources.

Ultimately, the scalability of programs like JETPs will be worth monitoring as they will depend on whether emerging countries can create a credible just transition plan. While corporate success or failure in the transition is heavily dependent on national policy, corporate willingness to participate in the transition could determine whether they can stay ahead of the curve.

Indonesia's energy transition schemes

Energy transition scheme	CIF-ACT, ADB ETM, WBG	G7 IPG JETP-IDN	IDN ETMCP	PLN ETM	INA ETM
Committed/ indicated amount	CIF-ACT US$500 mn, ADB, WBG US$2.2 bn; GOI & private sector US$ 2bn	US$20 bn = US$10 bn public funds US$10 bn private capital	Contribution from GoI to be confirmed	PLN has indicated a need for US$726 bn until 2060	Undisclosed for CFPP retirement; US$2 bn for the Green Fund
Participants	**Climate fund:** CIF- ACT **MDBs:** ADB, WBG **Private:** IFC, ADB private sector	G7 countries + Denmark, EU, Norway **Private:** BoA, Citi, Deutsche Bank, HSBC, Macquarie, MUFG, Standard Chartered	Platform manager: PT SMI **Steering committee:** MOF, MEMR, MSOE, MOEF	PLN & partners	Indonesia Investment Authority (INA)**
Mode of financing	Grants, highly concessional loans, commercial loans, RBL, FIL through PT SMI, project loans	Grants, highly concessional loans, commercial loans, guarantees, technical assistance (TA)	GoI contribution (state budget), concessional loans, commercial loans, carbon credit revenues	A mix of equity, debt and grants	A mix of equity and debt
Coal retirement target	Up to 2 GW by 5-10 years	No GW target; to peak emissions from power sector at 290 MTCO2e by 2030	15 GW identified	6.7 GW of PLN's CFPPs by 2030	1.5 GW
RE target	400 MW installed RE and 90 MW storage	34% RE power mix by 2030		16 GW RE until 2030	

Next steps

The investment industry still lacks standardized frameworks for evaluating a company's or country's management of the just transition. That said, the following questions would enable us to begin our analysis in this area when engaging with companies:

1. What key stakeholders and issues do you need to prioritize for your climate transition to be successful and over what timeframe?
2. What is the impact of potential job losses on your firm and within the broader communities you operate in? How will you address them?
3. What are the supply chain impacts of your net zero framework, what are the most pressing issues to address with suppliers? What will your customers expect from you as a supplier in relation to the just transition?

Endnotes

[1] Source: What is Just Energy Transition Partnerships? - Green Network Asia

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