

# FINANCING MENA'S ENERGY TRANSITION: RISKS AND IMPLICATIONS

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The acceleration of the global energy transition poses critical challenges for the Middle East and North Africa (MENA), with the transformation evolving into an all-encompassing economic, social, and political project for the region.

As hydrocarbons form the very backbone of economies in the Middle East, the energy transition will have major implications for their economic and fiscal health. In contrast to most developed economies and some countries in Asia where energy is imported, fossil fuels in MENA continue to be a major source of (1) exports, ranging from 67% to over 95% as a share of merchandise exports for some of the region's largest players; (2) government (fiscal) revenues; and (3) income, with oil rents ranging from 16-40% as a share of GDP (Table 1). This over-dependence makes the transition more challenging as these countries must proactively diversify their energy sources despite the cost competitiveness of their fossil fuels while also contending with falling demand. Demand is likely to decline as a result of increasingly rigorous policies on carbon and climate, greater energy efficiencies (such as those derived from product improvements or switching to cleaner energy sources), and a [growing decoupling of energy consumption](#)

[from income in some advanced economies](#), as highlighted by IMF research. These demand-side factors, not to mention the supply-side ones, will cause the shift to be more costly for those undertaking "transition" investments. This is especially true for MENA economies, many of which already face high fiscal breakeven prices (Table 1) and need to embark on diversification drives, often spearheaded by the public sector, while they simultaneously lose oil and gas revenue.

As a consequence of these compounding challenges, the economics of the energy transition will involve difficult decisions regarding the social contracts these countries have established with their citizens and will exert pressure on their development plans.

The dramatic drop in petroleum prices in the third quarter of 2014 was pivotal in driving MENA oil and gas producers to launch ambitious reform programs aimed at widening their economic base, notably by developing their non-hydrocarbon and private sectors, thereby delinking economic growth from their natural resources. Since then, these plans to develop and strengthen the private sector have taken on varied forms,

**Table 1: MENA Exporter Hydrocarbon Dependence and Debt Profile**

APSP	Fiscal Breakeven Oil Price <sup>1</sup> (U.S. dollars per barrel)				Oil Rents <sup>2</sup> (% GDP)	Fuel Exports <sup>3</sup> (% Merchandise Exports)	Total Government Gross Debt (% GDP)			
	Projections						Projections			
	2019	2020	2021	2022			2019	2020	2021	2022
Algeria	106.3	90.4	169.6	138.3	14.4	96.1	45.8	53.1	63.3	73.9
Bahrain	80.6	100.4	88.2	85.8	2.2	42.1	102.1	132.9	129.4	134.2
Iran	197.8	304.3	242.8	259.2	20.4	68.7	47.9	42.8	36.6	36.2
Iraq	52.3	63.7	71.3	66.1	39.6	99.9	47.7	81.2	69.7	73.3
Kuwait	55.0	68.1	69.3	64.5	42.1	92.9	11.8	11.5	13.7	27.3
Libya	94.2	417.5	48.8	46.7	43.9	95.4	-	-	-	-
Oman	85.1	95.8	72.3	61.8	24.9	75.2	60.0	81.1	71.3	66.8
Qatar	50.0	46.2	43.1	40.4	16.9	81.8	62.3	71.8	59.8	53.9
Saudi Arabia	81.9	77.9	76.2	65.7	24.2	67.6	22.8	32.4	31.0	31.7
United Arab Emirate	61.7	68.2	64.6	60.4	16.2	71.5	26.8	38.3	37.1	39.2

Sources: International Monetary Fund (IMF); World Development Indicators (WDI)

<sup>1</sup>The oil price at which the fiscal balance is zero; Kuwait's fiscal breakeven oil price is before the compulsory 10 percent revenue transfer to the Future

<sup>2</sup> Iran's data is based on 2018

<sup>3</sup> 2020 or based on latest available data

Note: APSP is Average Petroleum Spot Price, a simple average of three spot prices: Dated Brent, West Texas Intermediate, and Dubai Fateh based on the IMF Primary Commodity Price System

**Table 2: MENA Exporter Fossil Fuel Subsidies**

	Total Subsidies (% GDP)		Oil Subsidies (Real 2020 Million USD)		
	2014	2020	2014	2015	2016
Algeria	6.3	5.8	9,239	6,437	3,531
Bahrain	6.7	0.9	780	449	158
Iran	19.0	4.7	58,833	27,576	16,771
Iraq	3.4	2.7	6,255	2,966	2,537
Kuwait	5.1	3.1	2,691	1,232	1,066
Libya	22.5	17.5	8,020	4,676	3,691
Oman	9.0		104	87	98
Qatar	3.0	0.3	1,477	528	249
Saudi Arabia	9.5	2.4	42,631	33,139	21,621
United Arab Emirates	4.4	1.6	3,969	712	357

Sources: International Energy Agency; WDI, and author calculations

although they typically rely heavily on government-funded projects, and sometimes they have taken a back seat when energy prices recover. In a renegotiation of sorts, several governments have also implemented fiscal reforms, including the removal of subsidies and the introduction of taxes. Table 2 reflects the changing dynamics of subsidies in the region, which began with the UAE’s lifting of fuel subsidies in 2015, and illustrates the rapid decline of oil subsidies in the period following the oil market volatility in 2014-16.

Nonetheless, growth in the private sector has lagged, and labor productivity in MENA has seen relative declines. Many of these economies are still characterized by the concentration of labor in the public sector, evidenced by large public wage bills. Ultimately, the inflow of hydrocarbon revenues, on the back of periods of elevated prices, has fostered a bloated public sector that absorbs national labor. This factor, along with structural challenges resulting from labor market rigidities, has contributed to preventing the development of internationally competitive domestic private sectors. This necessitates wide-ranging reforms in how governments transfer hydrocarbon wealth to their citizens. Countries need to rapidly address misaligned incentives in the old social contract that have conventionally relied on the rentier state model. Such incentives perpetuate challenges, including in labor dynamics, that could thwart their ability to generate high-value-added jobs and products, and ultimately their need to industrialize. There are no “quick wins” to bypass manufacturing, unfortunately, so enabling an export-oriented private sector supported by a skilled workforce is key.

Strengthening the private sector in these countries will require obtaining diverse sources of funding and tapping domestic, regional, and international financial markets, especially given

the limited availability of public funds and high debt levels (Table 1). Inadequate access to finance remains a constraint in some areas. While banking systems in the Gulf remain well-capitalized, those in other energy exporters, such as Algeria and Iraq, and more fragile countries remain weak. Financial institutions in the region are characterized by concentrated lending to the sovereign or government-led projects, which reflects the outsized role of the state, including exposure to national oil companies through syndicated bank loan financing. This presents several challenges, including the crowding out of small and medium-size enterprises.

In addition, the impending impact on bank portfolios and balance sheets of re-evaluation based on stranded assets and the effects of climate change may also create a liquidity squeeze, limiting private credit provision. Stranded assets are fossil fuel reserves that cannot be recovered due to changes in regulations, technology, and market direction, including pressures to prioritize spending on cleaner energy, but which banks have already taken into consideration when determining their provisions and capital requirements. [Nearly 60% of both oil and fossil methane gas and almost 90% of coal must remain in the ground by 2050 to keep global warming below 1.5° Celsius.](#) In addition to these unutilized reserves, the capital invested in the value chain (extraction, refining, transportation, etc.) and ancillary services can also become stranded. This point is increasingly important as stranded assets could form a systemic risk to financial stability — but so can climate change, whether or not it is related to hydrocarbon reserves. For example, MENA faces elevated water and environmental stress more broadly, but access to existing reserves in the region is also under threat from extreme heat and dust storms.

Given these increasing vulnerabilities, it is imperative for policymakers and financial regulators to put in place prudential frameworks that mitigate the negative impact of physical and transition risks on the financial sector. This is the only way to ensure a more resilient and sustainable path forward for MENA.

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