Balancing Ambition With Reality

Financing a Just Transition in the GCC

In the global pursuit of achieving net-zero emissions, sustainable finance plays a pivotal role, particularly in regions like the GCC, where a shift away from the dominant oil and gas sector is imperative. However, this transition, particularly in the GCC where the oil and gas sector plays such a large role in the economy, cannot happen overnight. Indeed, there are challenges and considerations associated with financing the just transition in the GCC that call for a harmonised and sustainable strategy aligned with the ambitious social and environmental goals set by these countries.

The scale of financing required for the transition is substantial, with estimates from the International Monetary Fund (IMF) indicating a gap of US$3 to $6 trillion annually until 2050 to meet the Paris Agreement's temperature and adaptation goals. Current global climate finance, primarily through debt funding, falls significantly short, amounting to only about US$630 billion annually.[1] Economic uncertainties and geopolitical conflicts have further strained government and sovereign wealth fund contributions, compelling private financial institutions to step up. The IMF predicts that by 2030, private finance will need to cover approximately 80 percent of climate mitigation investment needs in emerging markets and developing economies.[2]

Against this backdrop, GCC countries have adopted a multi-dimensional, multi-stakeholder approach to sustainable finance. Notable initiatives include Saudi Arabia's Public Investment Fund, which published its Green Finance Framework and successfully issued green bonds in 2022 and 2023. Similarly, the UAE, as the host of COP28, made a net-zero 2050 pledge and established the UAE Sustainable Finance Working Group (SFWG) in 2019. More recently, in August 2023, the UAE Banks Federation reported that six major UAE banks have committed over US$51.8 BN in green financing for various projects.[3]

Despite these positive strides, barriers persist in attracting private investment to the transition. Alignment and clarity on terminology, goals, and the role of private financial institutions remain key considerations. The visibility of returns is also crucial, as traditional return on investment methods often overlook positive impacts, hindering their recognition as income-generating investments. Additionally, the long-term uncertainties and risks associated with environmental investments pose challenges, making them less attractive compared to shorter-term options.

Compounding these challenges are the region's longstanding social and environmental concerns, exacerbated by climate change. Desertification, air pollution, and water shortages have become pressing issues, intensified by rapid economic development over the last two decades. Efforts to address these concerns and integrate climate change risks into the financial fabric of the GCC have gained momentum. The UAE SFWG, for instance, launched the 'Principles for the Effective Management of Climate-related Financial Risks' in November 2023, establishing minimum standards for managing such risks across the financial sector. Another key area is climate stress testing by central banks, which supports in managing risks around climate change, increase transparency, and signal the importance of these risks to the financial system. In 2022, the Central Bank of the UAE piloted a top-down stress test based on three scenarios drawn from the Network for Greening the Financial System that focused on climate change transitional risks. The Saudi Central Bank also piloted a climate stress test in the same year.

While the GCC has made strides in sustainable financing, the unique challenges of the region's natural topography makes accounting for climate change risks increasingly important. Successfully navigating these challenges requires alignment among GCC governments and financial institutions, striking a balance between climate urgency and financial pragmatism. As the region progresses on the global journey towards net zero, it is crucial to evaluate this progress with a dual-focused dimension, considering both regional nuances and the broader context. Ultimately, achieving a just transition in the GCC demands innovative solutions that mitigate financial risks while advancing environmental sustainability.

Endnotes

1 Ananthakrishnan Prasad, Elena Loukoianova, Alan Xiaochen Feng, and William Oman, "Mobilizing Private Climate Financing in Emerging Market and Developing Economies," IMF Staff Climate Note 2022/007, 1, https://www.imf.org/en/Publications/staff-climate-notes/Issues/2022/07/26/Mobilizing-Private-Climate-Financing-in-Emerging-Market-and-Developing-Economies-520585

2 International Monetary Fund, Global Financial Stability Report: Financial and Climate Policies for a High Interest Rate Era, October 2023, xii, https://www.imf.org/en/Publications/GFSR/Issues/2023/10/10/global-financial-stability-report-october-2023

3 Delisha Fernandes, "UAE Banks Commit $51.8b in green financing," IBS Intelligence, 22 August 2023, https://ibsintelligence.com/ibsi-news/uae-banks-commit-51-8-b-towards-green-financing/

VIDYA MANOHARAN
Director
Strategic Communications Middle East
vidya.manoharan@fticonsulting.com

LAYAN SHADID
Senior Consultant
Strategic Communications Middle East
layan.shadid@fticonsulting.com