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MOHAMMED BIN RASHID SCHOOL OF GOVERNMENT

Financing a Green Transition in the Middle East

How governments can shape investment conditions and use financial tools to mobilise sustainable finance

Summary Report

In partnership with HSBC

Authors and Citation

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Executive Summary

Governments in the Middle East need to introduce new tools and frameworks to accelerate finance towards a green and sustainable transition.

Studying the green finance activities in Bahrain, Egypt, Kuwait, Iraq, Oman, Qatar, Saudi Arabia, and the United Arab Emirates shows that nearly all the key financing mechanisms and policy measures that encourage climate-compatible development are being used in at least one country. There remain, however, untapped opportunities in each country to capitalise on new tools or policies that shift finance towards investments that support a green and fair transition.

The financial system must be reoriented to meet the huge financing demands required to achieve the Sustainable Development Goals (SDGs).[1]

An additional

$230 Billion

must be mobilised annually in the Arab world to achieve **the UN SDGs.**

This investment gap underscores the importance of changing the architecture of the financial system and using financial mechanisms to mobilise both public and private sector finance towards sustainable investments. The growth in poverty caused by the COVID-19 pandemic coupled with the accelerating impacts of climate change highlight the urgency to make structural change in the financial system.

Governments in the Middle East have an especially important role in mobilising finance.

While most of the finance required for a low carbon transition will come from the private sector, this report focuses on opportunities for governments and quasi-government agencies to shape the ways in which finance can be mobilised and channelled.

Government expenditure as a percentage of GDP is high in much of the Arab world. In the countries studied, it averages:

State-owned enterprises are critical to countries' economies and to their environmental footprint. Sovereign wealth funds have government-controlled mandates and are among the largest in the world. The long-term continuity of governments in several countries also compels them to make long-term decisions with regard to sustainability, including its financing.

This study recommends two to four high-priority opportunities in each country, plus four additional recommendations that should be considered at a regional level.

These recommendations combine the insights and knowledge of experts across the region with extensive literature review and author analysis.

They are practical, country-specific, and have the potential for large-scale, near-term impact. The national recommendations respond to unique domestic circumstances and focus on areas where action is currently limited or absent, rather than suggesting that existing initiatives be strengthened or scaled up. The regional recommendations target areas where collaboration would deliver stronger returns than if the measures were pursued by each country individually. For almost all interventions, case studies are used to demonstrate that the tool or approach has been successfully deployed in the region.

The recommendations are divided between

The enabling environment

Financial and economic tools

The enabling environment is important because it creates the conditions that affect the viability of sustainable investments, including policy, regulatory and governance frameworks as well as programs or initiatives that help make finance flow.

Financial and economic tools are needed to raise and deploy capital, manage risks, and mobilise private sector investment.

The enabling environment should be adjusted to better align finance with long-term sustainability objectives.

Six elements of the enabling environment are explored in this report.

Awareness raising helps decision-makers understand the rationale that underlies sustainability.

Turning vision statements into **Financing strategies** that link a defined project pipeline with the most competitive financing options shows how ambition can be turned into action and helps ensure capital is efficiently deployed.

Green and sustainable taxonomies create a common language for investors, developers and policymakers, bringing clarity to investment options and helping to avoid greenwashing.

Taxonomies in turn support **climate-and nature-related disclosures**, which bring transparency to markets, expose risks, and facilitate foreign direct investment (FDI).

Market facilitators like Green Investment Banks and Super ESCOs overcome financial and non-financial barriers to unlock nascent markets.

Finally, **Central Banks** can use both soft power and regulatory levers to encourage sustainable investments, which helps them deliver on their core purpose of safeguarding financial stability.

Financial and economic instruments should be used to mobilise private sector finance and incentivise a green and fair transition.

The instruments explored in this report include:

- **Inclusive loans**
- **Guarantees and risk insurance**
- International **climate finance**
- **Debt instruments** such as green bonds and green sukuk
- **Debt-for-environment swaps**
- **Carbon pricing** instruments
- **State-owned enterprises (SOEs)**
- **Sovereign wealth funds (SWFs)**

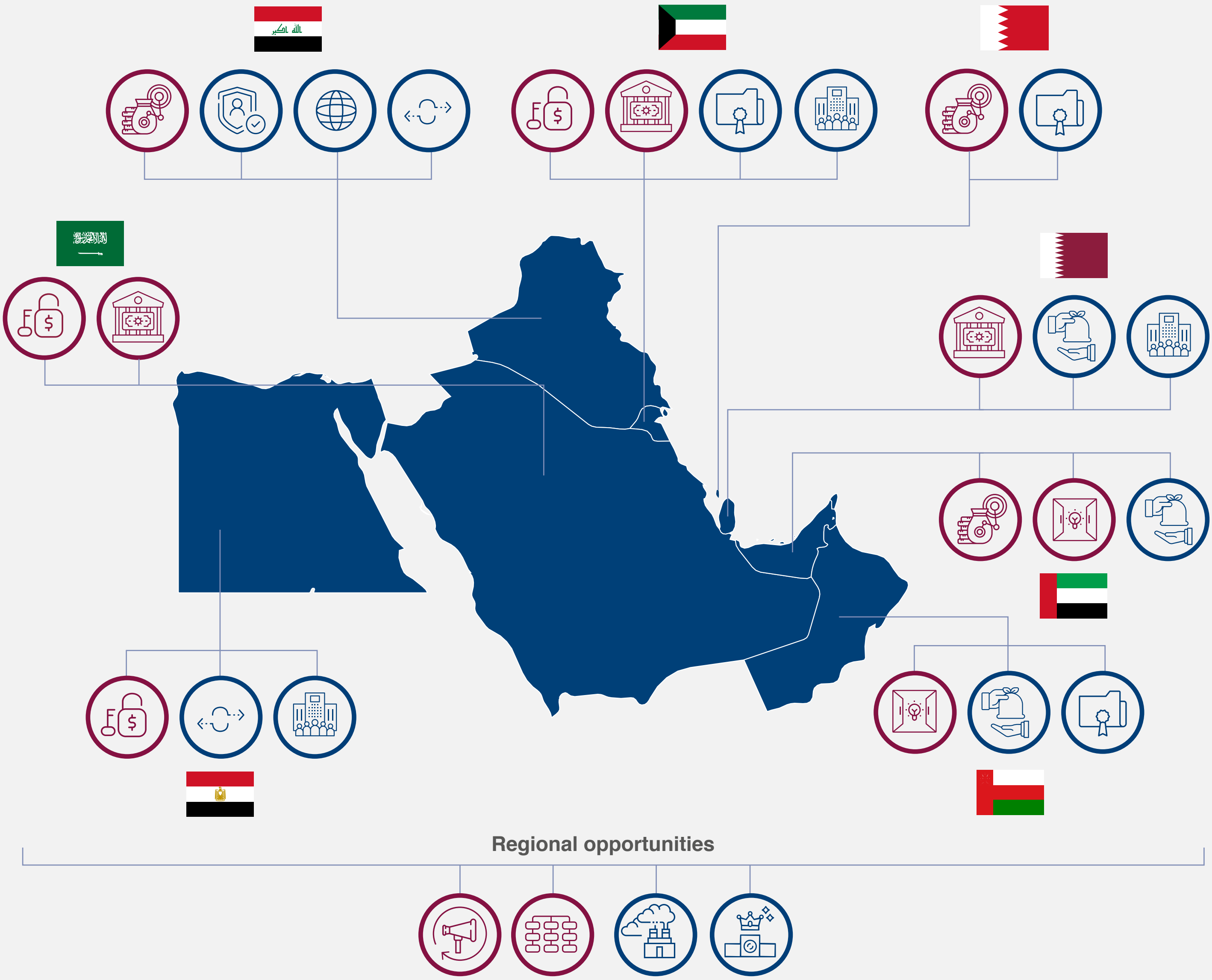
The report considers the role of SOEs and SWFs because of their investment power and centrality to economic transformation in several countries. Familiar tools and approaches such as feed-in tariffs, fossil fuel subsidy reform and tax credits for green products are universally effective, including in the countries in this report. They are not explored further in this report because there already exists extensive literature on their effectiveness.

The recommendations of this study should be coupled with broader policy options to accelerate finance towards a green and sustainable transition in the Middle East.

The recommendations of this report extend the findings of a related study on optimal policy choices to stimulate a **'better recovery' from COVID-19 in the Middle.**[3] Taken together, governments in the GCC countries plus Egypt and Iraq have an opportunity to mobilise finance and implement policies that reduce risks and capitalise on the opportunities afforded by a fair and environmentally sustainable transition.

These opportunities must be taken to strengthen social, economic and ecological resilience, and achieve sustainable development.

Summary of regional and national recommendations



Enabling environment

- Financing strategies
- Disclosures
- Market facilitators (Super ESCOs and Green Investment Banks)*
- Awareness
- Taxonomies
- Central banks

Financial tools

- Subsidies and inclusive loans
- Guarantees & risk insurance
- International climate finance
- State-owned enterprises
- Sovereign wealth funds
- Carbon pricing
- Green bonds / sukuk
- Swaps

Summary of Recommendations

The recommendations represent priority opportunities for governments to take new actions to finance a green and fair recovery.

All countries studied are taking steps to facilitate finance by strengthening the enabling environment and deploying financial mechanisms. Rather than recommending that existing initiatives be strengthened or scaled up, the recommendations target areas where action has been limited or absent. They seek to reflect each countries' unique contexts, capitalise on domestic circumstances, and address country-specific financial and non-financial barriers. Where relevant, they also identify existing agencies or initiatives that could implement the recommendation.

REGIONAL

ENABLING ENVIRONMENT

Develop a regional sustainability taxonomy

Clear definitions for terms like **'sustainable'**, **'green'** and **'transition finance'** are needed to identify the activities or investments that deliver on environmental and social objectives.[4] Developing a harmonised regional taxonomy or classification system would provide **a common language for sustainable finance.**

It would bring:

- **Security to investors**
- **Underpin common standards**
- **Labels and disclosures to avoid greenwashing**
- **Mitigate market fragmentation**
- **Strengthen regional integration and the interoperability of the financial sector**[5]

It is recommended that a **regional taxonomy be developed** through an entity like the UN Regional Collaboration Centre Dubai or the Gulf Cooperation Council, and integrated into national-level primary and secondary legislation utilising national enforcement mechanisms. Countries are just beginning to establish national taxonomies, but **there remains an immediate opportunity for regional collaboration to minimise the need to retrofit systems later**.

Build understanding of sustainability's benefits and the risks of inaction

Understanding the rationale that underpins sustainability is a critical first step to motivating change. Building awareness at a regional level through platforms like the UN Regional Collaboration Centre Dubai or Egypt's Regional Centre for Sustainable Finance, or through initiatives like the Arab Youth Council for Climate Change or Saudi Arabia's Middle East Green Initiative would stimulate exchange, cross-border learning and build momentum for action.[6,7,8]

It is critical to build awareness across all sectors and audiences of both the upsides of low carbon transition and social justice, as well as the economic, social, and physical risks associated with inaction.

While awareness of the risks is growing, articulating the opportunities is less clear, especially in fossil-fuel dependent countries.[9] Businesses and households recognise the threats and expect policymakers to create the conditions for positive change.[10]

It is recommended that governments **support awareness campaigns linked with practical implementation measures** that seek out and quantify the opportunities afforded by climate action and social inclusion.

REGIONAL

FINANCIAL MECHANISMS

Develop a regional carbon market

Carbon pricing is widely acknowledged to play a fundamental role in transitioning to a low carbon economy.[11] Compared to other instruments like carbon taxes, feed-in tariffs, subsidies and other regulatory instruments, market mechanisms like cap-and-trade systems and voluntary carbon markets have been shown to reduce the overall cost of emission reductions and can be more responsive to changes in economic conditions.[12,13] Large carbon markets have more low-cost abatement opportunities than small ones, allowing regional markets to be more cost-effective than smaller national ones. The absence of established national carbon markets in the countries studied represents an opportunity for regional alignment from the outset.

It is recommended that **a regional carbon market be established**, potentially building on the methodologies and framework of Qatar's Global Carbon Council,[14] the carbon trading platform being explored by the Dubai Carbon Centre of Excellence,[15] or the proposed Riyadh Voluntary Exchange Platform initiative being undertaken by the Saudi Tadawul Group and Public Investment Fund.[16]

Leverage sovereign wealth funds for transition finance

The region is home to some of the world's largest sovereign wealth funds (SWF).[17] They are especially exposed to fossil fuel investments.[18] The SWFs of Abu Dhabi, Kuwait, Saudi Arabia, and Qatar are founding members of the One Planet Sovereign Wealth Funds Initiative, which aims to integrate climate change risk into investing, and Dubai's Mubadala and the Sovereign Wealth Fund of Egypt joined the initiative in 2020 and 2021 respectively.[19] And yet, all state-owned investors in the region score below average on the 2021 SWF Governance, Sustainability & Resilience scorecard, which assesses the world's 100 largest state-owned funds.[20] Six of the region's 14 funds score in the bottom 15. Only four state-owned investors have a dedicated team for responsible investing, and none produce a publicly available annual ESG report.

It is recommended that **SWFs go beyond their current plans to establish ESG frameworks, and orient their huge resources towards nationally critical transition finance**, scaling up investments in strategic low carbon industries while managing exposure to fossil fuel investments that may be at risk in the context of a global low carbon transition.

BAHRAIN

ENABLING ENVIRONMENT

Translate national visions into a bankable pipeline of sustainability projects

Bahrain's Vision 2030 embeds sustainability as one of three guiding principles in the country's comprehensive economic vision.[21] To support this, Bahrain released a detailed National Renewable Energy Action Plan and a National Energy Efficiency Action Plan and maintains a thorough inventory of progress towards its Sustainable Development Goals. [22,23,24]

It is recommended that **Bahrain develop a financing strategy that turns these energy, efficiency, and sustainability goals** into specific, costed project opportunities linked to the most viable financing tools.

FINANCIAL MECHANISM

Develop a framework for green sukuk, green bonds and transition bonds

Bahrain has the

Highest national debt of the countries studied at 129% of GDP[25]

Third-largest Islamic finance sector in the world

First country to include Islamic Finance in its Open Banking Framework[26]

Bahrain has a sophisticated financial market and extensive engagement with sustainable finance initiatives, both through the Bahrain Associates of Banks and the Bahrain Stock Exchange, but Bahrain has not yet issued green bonds or green sukuk.[27,28]

It is recommended that **Bahrain develop a green bond, transition bond and/or green sukuk framework** to issue sovereign and commercial green bonds (potentially at a discounted repo rate to promote green investments).[29]

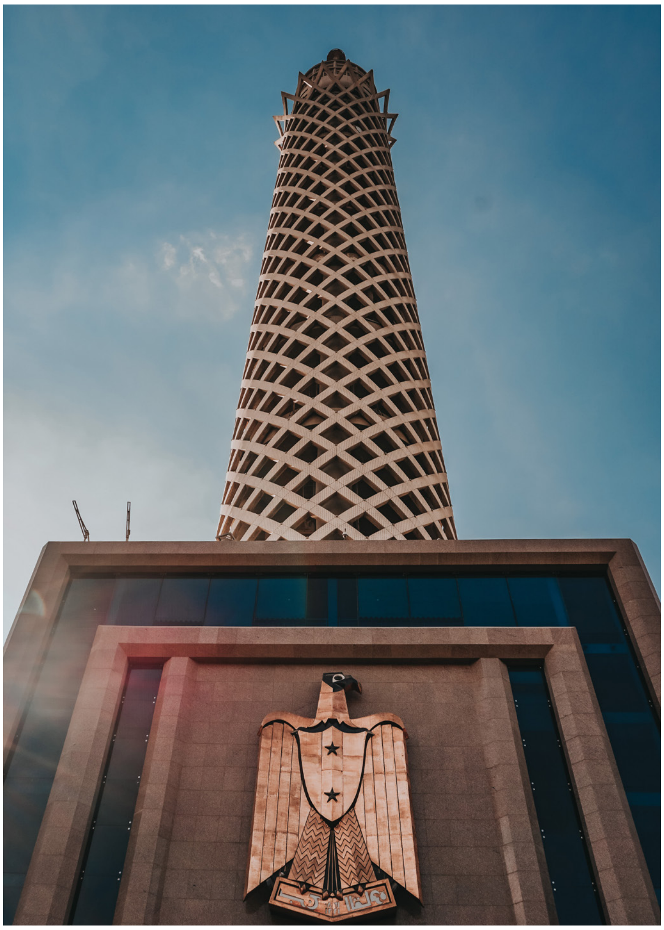
EGYPT

ENABLING ENVIRONMENT

Establish a Super ESCO

Among the countries studied, Egypt has the strongest energy efficiency potential across the commercial and residential sectors and strong potential in the industrial sector.[30] It also has the second-highest electricity prices.[31] These strong fundamentals support Energy Service Companies (ESCOs), yet Egypt's ESCO market is embryonic.

It is recommended that a Super ESCO be **established to overcome financial and non-financial barriers** to ESCOs and **support development and growth** of the ESCO market.



FINANCIAL MECHANISM

Expand debt-for-environment swaps

Egypt has the second-highest national debt of the countries studied at 93% of GDP.[32] It is a leading candidate to participate in the United Nations Economic and Social Commission for Western Asia's Climate-SDG Debt Swap Initiative, which was launched in 2020.[33]

It is recommended that Egypt leverage its experience with debt-for-development swaps, undertaken with Germany and Italy, and **leverage the UN ESCWA initiative to finance climate and sustainable development initiatives** using debt-for-nature and debt-for-climate swaps.

Utilise state-owned enterprises

Egypt's SOEs are present in nearly every sector in the economy.

With over
300 SOEs

and

645 joint ventures and partnerships
involving the state

SOEs account for

16%
of the economy

25%
of capital investment

6%
of employment.[34]

It is recommended that SOEs reflect Egypt's National Strategy for Adaptation to Climate Change and Disaster Risk Reduction and **integrate green policies and actions into their day-to-day operations**, including leveraging public-private collaborations to **strengthen the private sector's role in greening the economy.**

IRAQ

ENABLING ENVIRONMENT

Develop a financing strategy

Iraq's recovery from COVID-19 and its progress towards sustainable development focuses on four areas:

- **Social development and solidarity**
- **Youth engagement**
- **Strengthening institutions**
- **Ensuring political stability and security**[35]

Financing these goals, as well as environmental objectives, requires a financing strategy that maps out priority projects and matches them with the most appropriate funding sources and financial instruments to de-risk investments.

It is recommended that a financing strategy for a **green and fair recovery** be developed in concert with existing technology needs assessments and **action plans like the Green Climate Fund's Readiness Proposal** that was approved in 2020.[36]

FINANCIAL MECHANISM

Seek out more international climate finance

Iraq is eligible for international climate finance.

It has already been granted, as follows:

$17 M
across nine national projects from the Global Environment Facility[37]

$10 M
from the Adaptation Fund[38]

$4.6 M
for four readiness activities from the Green Climate Fund, for which it established a Green Climate Fund National Designated Authority in 2018.[40,41]

$6 M
from UNDP (alongside much larger stabilisation funding)[39]

Compared to countries of similar size and standing, these international climate finance investments are small.

It is recommended that international climate finance resources be **leveraged more, and targeted at mitigation and adaptation measures** that also achieve social development and resilience objectives.

IRAQ

FINANCIAL MECHANISM

Secure guarantees and risk insurance

Iraq's national budget fell by
41% in 2020.

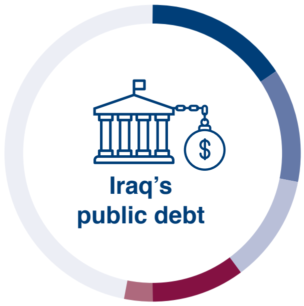
The government is currently in talks with the IMF to secure an Extended Fund Facility to manage a tenuous macroeconomic situation.[42]

The World Bank's Country Partnership Framework aims to increase private sector participation in the economy, but the private sector is cautious about investing due to political and financial instability.

It is recommended that guarantees and risk insurance be sought from **multilateral development organisations to encourage private sector activity and investment** in the country.

Explore debt-for-nature & debt-for-climate swaps

Just over half of Iraq's public debt is foreign-owned, with the largest debtors being:



14% the World Bank

13% Japan

13% the US

10% IMF

8% Eurobonds[43]

Iraq may benefit from the United Nations and Social Commission for Western Asia's Climate-SDG Debt Swap Initiative, which was launched in 2020.[44]

It is recommended that **debt swaps be explored,** especially to **strengthen water security and mitigate desertification.**

KUWAIT

ENABLING ENVIRONMENT

Establish a Green Investment Bank

Kuwait aims to be a regional leader in financial services[45] and would benefit from a dedicated institution **focused on financial innovation** that supports its sustainable development goals.

It is recommended that Kuwait **establish a Green Investment Bank** to mobilise private sector capital into strategic sectors facing financial barriers.

Leverage the power of the central bank

The Central Bank of Kuwait (CBK) took an active role in response to COVID-19 but it is not a member of the Central Banks and Supervisors Network for Greening the Financial System and has not yet leveraged tools specifically directed at enhancing financial flows towards climate-positive investments.[46,47]

It is recommended that the CBK **broaden its focus** to include both measures that **reduce risks and offset banks' exposure to the oil sector** as well as measures that **encourage investment in low carbon projects and enhance lending** to underserved groups.

KUWAIT

FINANCIAL MECHANISM

Utilise state-owned enterprises

Partially and fully owned SOEs have played a key role across many sectors of Kuwait's economy throughout its development.[48]

Kuwait's power and petrochemicals sector are either fully or partially state-owned[49], and are responsible for

42% of greenhouse gas emissions from the **power sector**

26% of greenhouse gas emissions from the **petrochemicals sector**

They will need to play a leading role in Kuwait's low carbon transition.

It is recommended that Kuwait's SOEs focus on **building a resilient core business, exploring diversification into adjacent low carbon growth industries**, and start to **shift their business strategy and capital allocations** in the context of the energy transition.

Develop a green bond / sukuk framework

Banks and corporations in Kuwait have regularly issued sukuk since 2005 and the partially state-owned bank, Kuwait Finance House, issued an historically large 750M sukuk in June 2021.[50,51]

But sukuk in Kuwait only represented **4% of the total value raised in the GCC** in the first half of 2021,

compared to

38% for Saudi Arabia

34% for UAE

10% for Oman[52]

It is recommended that Kuwait leverage its experience developing a governance and monitoring framework for vanilla sukuk to **build out a similar green sukuk or green bond framework, to capitalise on the growing investor appetite** for such instruments.

OMAN

ENABLING ENVIRONMENT

Support companies to disclose sustainability-related financial information

Oman has the **highest** inward FDI as a percent of **GDP at 4.48% worth $3.4 billion** in 2019.[53]

It wants to retain uninterrupted access to investors facing sustainability disclosure requirements such as the EU's Sustainable Finance Disclosure Regulation, which require them to account for and disclose sustainability related risks.[54]

It is therefore recommended that an initiative be developed to **help Omani organisations join disclosure frameworks** like the Taskforce for Climate-related Financial Disclosures (TCFD) and the Taskforce for Nature-related Financial Disclosures (TNFD).

FINANCIAL MECHANISM

Facilitate green sukuk

Oman received huge demand for its **$1.75 billion issuance of sukuk** in June 2021.[55]

The governance, monitoring and verification frameworks required to ensure sharia compliance of sukuk can be extended to include green criteria.

It is recommended that Oman **develops a standard green bond / green sukuk framework** and offer support to corporates to adopt the framework and raise capital through green sukuk.

Develop innovative energy efficiency subsidy programmes

Oman has the biggest industrial energy efficiency opportunity of the countries studied but the third-lowest electricity prices, which challenges the economic viability of efficiency improvements.[56,57] Oman's Nama Group (the Electricity Holding Company) is establishing a new National Energy Efficiency Centre.[58]

It is recommended that the National Energy Efficiency Centre **develop and potentially administer an innovative energy efficiency subsidy model** to strengthen the economic viability of energy efficiency.

QATAR

ENABLING ENVIRONMENT

Activate the central bank

Qatar Central Bank (QCB) took some measures to boost liquidity and stimulate general investment in response to COVID-19 but these measures were not directed at stimulating green investments or transition-related activities.[59] QCB is also not a member of the Central Banks and Supervisors Network for Greening the Financial System.[60]

It is recommended that QCB **utilise the full suite of available tools to facilitate diversification** away from oil and gas and encourage investments in projects congruent with a low carbon future.

FINANCIAL MECHANISM

Establish an innovative energy efficiency subsidy programme

Qatar is an energy-exporting country with subsidised energy and rapidly growing domestic energy demand that is satisfied by the state-owned transmission and distribution utilities.[61] Reducing domestic energy consumption through efficiency measures therefore delivers a triple financial return to the government by enabling increased exports, reduced subsidy costs, and slower demand growth.

It is recommended that an **innovative energy efficiency subsidy programme be developed to improve its economic viability.** Kahramaa's Tarsheed, the National Campaign for the Conservation and Efficient Use of Water and Electricity in Qatar, may be a natural administrator of this programme.

Direct state-owned enterprises to invest in the energy transition

Qatar's largest state-owned enterprises are emissions intensive: Qatar Petroleum, QAPCO, Qatar's state-owned utilities and Qatar Airways account for

CO_2 **27% of the country's emissions.**

The government has significant control over their activities as they are not required to follow OECD Guidelines on Corporate Governance.[62] While they are already investing in water and energy efficiency measures, carbon capture and storage, renewable energy and sustainable aviation fuels, deeper and broader diversification and decarbonisation are required for Qatar to achieve the balance of economic growth and environmental sustainability outlined in its Vision 2030.[63,64]

It is recommended that Qatar's state-owned enterprises **work together to redirect capital** away from oil and gas development and new gas-fired power generation, and **towards innovative alternatives like clean hydrogen, sustainable aviation fuels and renewable energy.**

SAUDI ARABIA

ENABLING ENVIRONMENT

Augment the Financial Sector Development Programme to include a Green Investment Bank workstream

Saudi Arabia's Financial Sector Development Program (FSDP), one of its Vision 2030 Realisation Programs, aims to:

- **Enable financial institutions to help grow the private sector**
- **Develop an advanced capital market**
- **Encourage SME lending**
- **Boost financial planning**[65]

It is recommended that FSDP be augmented to include a **workstream focused on activities that are characteristic of a Green Investment Bank**, such as developing innovative financial products for low carbon investments or structuring co-financing to unlock private sector investments in sustainability-related priorities.

Leverage the newly expanded remit of the central bank

The Saudi Central Bank, formerly the Saudi Arabian Monetary Authority, was given an **expanded mandate that covers**

monetary stability

- **promoting confidence** in the financial sector
- **supporting economic growth**[66]

It is recommended that the rebranded entity **join the Central Banks and Supervisors Network for Greening the Financial System,**[67] **issue regulatory guidance** on how to institutionalise Environment, Social and Governance (ESG) considerations in investment policy, **develop climate stress tests** to maintain stability in the face of climate shocks, **consider adjusting credit weightings** to reflect climate impacts, and **implement other macroprudential policies** outlined in this report that support future-oriented, low carbon industries.

UNITED ARAB EMIRATES

ENABLING ENVIRONMENT

Translate the net zero target into a financing strategy and project pipeline

The UAE has one of the most advanced sustainable finance frameworks, green financial instruments, and green finance capacity building programmes in the countries studied.[68] These capacities and revenue-raising capabilities should be matched with a defined pipeline of green projects.

It is recommended that a **green project pipeline and finance strategy be developed that defines a common green taxonomy, identifies eligible projects,** and matches projects with the least-cost financing instruments, whilst providing targeted incentives for where market failures emerge.

Support companies to disclose sustainability-related financial information

The UAE has the highest inward FDI among the studied countries worth

$13.8 billion in 2019, or 3.3% of GDP.[69]

Only 5 organisations headquartered in the UAE currently support TCFD.[70]

Companies want to retain uninterrupted access to investors facing sustainability disclosure requirements such as the EU's Sustainable Finance Disclosure Regulation, which requires them to account for and disclose sustainability related risks.[71]

It is recommended that an **initiative be developed to help organisations operating in the Emirates join disclosure frameworks** like TCFD and TNFD, potentially through the Dubai Financial Market, Dubai Financial Services Authority, or an Abu Dhabi Global Market working group or academy.

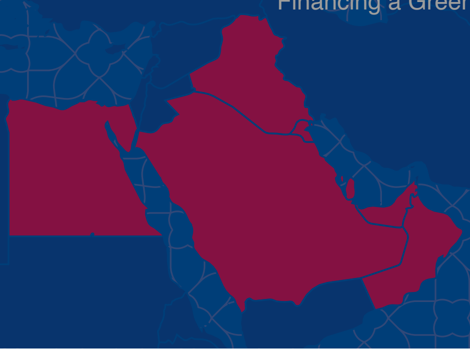
FINANCIAL MECHANISM

Establish an innovative energy efficiency subsidy programme linked to Energy Service Companies (ESCOs)

The UAE is an energy-exporting country with subsidised energy and an electricity demand forecast to grow by 6% annually to 2026.[72]

Reducing domestic energy use through efficiency measures therefore delivers a triple financial return to the government, and is a key plank of the country's National Water and Energy Demand Management Programme, and its Energy Strategy 2050.[73] The country has an active ESCO market and a Super ESCO (Etihad ESCO) but low energy prices limit the depth of economically viable retrofits.

It is recommended that an **innovative energy efficiency subsidy programme be developed** that links to the realised energy savings achieved by ESCOs, **to promote deep retrofits, improve the economic viability of efficiency, and strengthen the ESCO market.**



Summary table of recommendations

Category	Recommendation	Bahrain	Egypt	Iraq	Kuwait	Oman	Qatar	KSA	UAE
ENABLING ENVIRONMENT	Awareness	Regional Opportunities							
	Financing strategies	★	—	★	—	—	—	—	★
	Taxonomies	Regional Opportunities							
	Disclosures	—	—	—	—	★	—	—	★
	Market facilitators (Super ESCOs and Green Investment Banks)	—	★	—	★	—	—	★	✓
	Central banks	—	✓	—	★	—	★	★	—
FINANCIAL TOOLS	Subsidies and inclusive loans	—	✓	—	—	★	★	—	★
	Guarantees & risk insurance	—	✓	★	—	—	—	—	—
	International climate finance	✗	✓	★	✗	—	✗	✗	✗
	Green bonds / sukuk	★	✓	—	★	★	✓	✓	✓
	Carbon pricing	Regional Opportunities							
	Swaps	✗	★	★	✗	✗	✗	✗	✗
	Sovereign Wealth Funds	—	—	✗	Regional Opportunities				
	State-owned enterprises	—	★	—	★	✓	★	✓	✓

Regional Opportunities

★ Opportunities

✓ Already happening

✗ Not appropriate

— Not a top priotity

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