How will the Middle East Respond to the Global Carbon Neutral Movement?

Paul Stevens*

What 'carbon neutral' implies is complex. Carbon neutral is not equivalent to net-zero carbon emissions because carbon neutral implies carbon offsets, which simply shifts responsibility to someone else to reduce carbon emissions and some regard this as public relations in disguise i.e. 'greenwashing'. For this brief paper, 'carbon neutral' will be treated as implying falling future global oil demand and considers three questions: 1. Will there be a decline in global oil demand? 2. What impact will this have on MENA producers? 3. What are the policy responses of MENA producers?

1. Will There be a Significant Decline in Global Oil Demand?

The current energy transition from hydrocarbon molecules to electrons has been accelerating and has been grossly under-estimated by the "Energy Establishment" such as the IEA, OPEC, other analysts, and the major international oil companies (IOCs). Their main argument is that energy transitions are slow. Historically this has been true. For example, the switch from wood to coal in the USA (1865-1900) took 35 years. However, more recent transitions, especially when governments have been involved, have been much faster. For example France's switch from oil and coal to nuclear – 10 years and the UK's switch from coal to renewables – 8 years. Furthermore, the COVID pandemic is probably increasing the speed. It has changed politics and the role of government intervention. Thus the "Washington Consensus" of leave it all to market forces is dead. Voters now expect governments to intervene in a crisis and climate change and poor urban air quality, which are driving the transition, is now seen as a crisis. The pandemic has also prompted changes in behaviour to reduce oil demand, notable working practices significantly reducing travel. Oil demand has now peaked and is likely to decline rapidly.

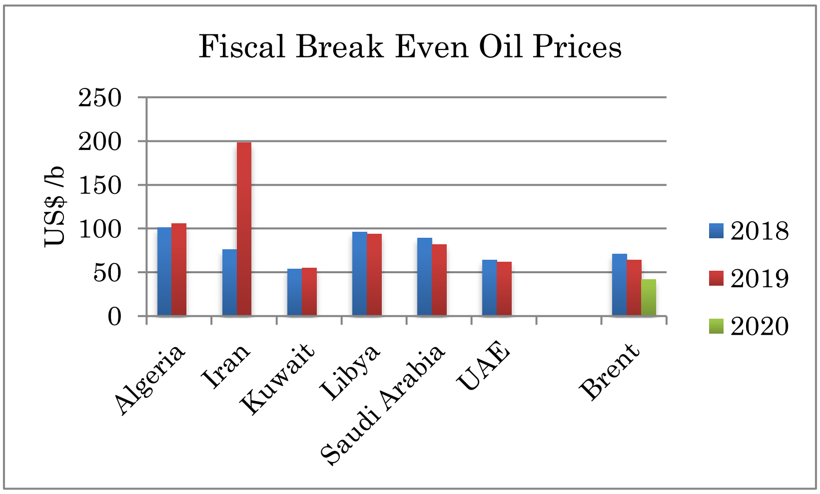
2. What Impact will This Have on MENA Producers?

Obviously, the consequent fall in MENA's oil revenues will create financial difficulties to maintain the 'social contract' to provide subsidies and jobs and defuse domestic opposition to the ruling elites. The figure below illustrates the IMF's estimated fiscal break-even prices and the actual price of Brent and clearly illustrates the problem. There will also be growing competition for market share in a declining market and in an increasingly unpredictable and troubled region; this is

* Associate Fellow, Chatham House UK, Emeritus Professor, University of Dundee / Distinguished Fellow IEEJ

likely to aggravate conflict with Saudi-Iranian relations at the forefront.

Fig. 1 Fiscal Break Even Prices



Sources: Fiscal breakeven https://data.imf.org/regular.aspx?key=60214246.
Brent: EIA Website

3. What are the Policy Responses of MENA Producers?

So far, for the most part, the tendency has been to ignore the problems and deny the energy transition is a threat. However, it is increasingly clear this will no longer work as the transition speeds up. New options are being considered. These include developing renewables, reducing carbon emissions by use of carbon capture and storage, and developing hydrogen production to name but a few. There are two major problems with these approaches. The first is that currently many are unproven and high cost. The second is they lack the 'economic rent', which historically has paid for their 'social contract' obligations. 'Economic rent' in a commodity is the difference betweens the full cost of production including the require return on capital and the market price. This is key. The MENA oil producers have always enjoyed a huge amount of 'economic rent'. This comes from two sources. First, low cost production creates 'producers surplus'. Second, a rigged market, which has characterized oil since 1945, has 'super-normal profit'. There is little 'economic rent' in renewables. There are limited cost differentials thus very little 'producers' surplus' and the market is extremely competitive thus no 'supernormal profit'. Moves away from oil will be unable to maintain the 'social contract' possibly encouraging a repeat of the 'Arab Uprisings' of 2011.

The only effective solution for the MENA countries to manage declining global oil demand is to diversify their economies away from dependence on oil exports. Since the first oil shock of 1973-4 this has been promised regularly but, with few exceptions in MENA, has failed. The reasons for this past failure are complex but revolve around the political economy of a weak private sector arising from an absence of property rights and the rule of law coupled with the stifling behaviour of ruling elites grabbing all the best deals for themselves. The issue goes back to the

Soviet Union at the time of Mikhail Gorbachev. The debate was then: “can you have *‘perestroika’* (economic liberalization) without *‘glasnost’* (political reform)?” Russia said “no” but China said “yes”. For the MENA region, it is clear that political reform will be essential if a vibrant private sector is to lead the way to greater economic diversification. Absent this, the region is likely to face an increasing number of failed states as oil demand and oil revenue fall dramatically undermining the ‘social contract’ that has ensured economic and political stability for so long.

Writer’s Profile

Paul Stevens

Professor Stevens was educated as an economist and as a specialist on the Middle East at Cambridge and SOAS; 1973-1979 teaching at the American University of Beirut in Lebanon; 1979-93 at the University of Surrey. Between 1993 and 2008, he was Professor of Petroleum Policy and Economics at the University of Dundee, Scotland, a chair created by BP. He is an expert in the international petroleum industry, economic development in the Gulf and energy economics.

Contact:report@tky.ieej.or.jp