Third World Network
Submission on the assessment of environmental, social, and economic co-benefits of climate change policies and actions, focusing on economic diversification*

A. Introduction

The Third World Network (TWN) is pleased to provide this submission in response to the call for inputs from the Katowice Committee of Experts on the Impacts of the Implementation of Response Measures (KCI) pursuant to the Message to Parties and Observers dated 14 July 2022[1]. The inputs requested by the KCI are in relation to its workplan activity 11, "Facilitate, exchange and share experience and best practices in the assessment of the environmental, social and economic co-benefits of climate change policies and actions informed by the best available science, including the use of existing tools and methodologies".

TWN is an accredited observer organization to the UNFCCC. It is an independent non-profit international research and advocacy organisation involved in issues relating to development, developing countries and North-South affairs. TWN's objectives are to deepen the understanding of the development dilemmas and challenges facing developing countries and to contribute to policy changes in pursuit of just, equitable and ecologically sustainable development. To achieve these objectives TWN conducts research on economic, social, health and environmental issues pertaining to the South; publishes books and magazines; participates in intergovernmental processes; organises and participates in conferences, seminars and workshops; and provides a platform representing broadly Third World interests and perspectives at international fora such as United Nations agencies especially UNFCCC, CBD, FAO, WHO and WIPO, as well as WTO, the World Bank and IMF.[2]

B. With respect to KCI Call for Inputs Guiding Question No. 1 on what climate change policies and actions were assessed

TWN has recently undertaken a study looking at the economic diversification policies and approaches undertaken by selected developing countries with a high national economic dependency on fossil fuel extraction, production and export.[3] In multilateral policy negotiations such as in the UN Framework Convention on Climate Change (UNFCCC) and the World Trade Organization (WTO), these issues of sustainable development, policy space, and the challenges around implementing a sustainable low carbon, climate resilient development pathway are very sensitive. A big part of the sensitivity among developing countries is that responses to addressing climate change and reducing greenhouse gas emissions on an economy-wide scale could adversely impact their economic and social development. In the last decade, the need to promote sustained economic diversification and transformation in developing countries has been recognized as a proactive way of addressing the economic and social consequences of climate change response measures that may be undertaken by countries as part of their implementation of the UNFCCC and its Paris Agreement. There has been an increasing focus on elaborating the technical work on economic diversification and transformation in the context of sustainable development and the post-2030 development agenda.

The governments of developing countries that are dependent on their oil resources for national revenue are deeply concerned about the adverse economic social effects of downward oil price shocks due to their knock-on effects on political stability. Given that policy and technological shifts can give rise to such oil price shocks, it is not surprising that the governments of these countries have been taking an active interest in shaping multilateral climate policy formulation and response processes such as the UNFCCC and Paris

*

[1] UNFCCC, Message to Parties and Observers: Call for inputs by the Katowice Committee of Experts on the Impacts of the Implementation of Response Measures (14 July 2022), at https://unfccc.int/sites/default/files/resource/kci_7_call_for_inputs.pdf. Inputs to be submitted to KCI@unfccc.int, copying klata@unfccc.int, by Friday, 30 September 2022

[2] For more information about TWN, see http://www.twn.my

[3] Vicente Paolo Yu, Economic Diversification from Oil Dependency: Practice and Lessons from Persian Gulf Oil-Dependent Developing Countries (TWN Climate Change Series No. 6, forthcoming 2022)

Agreement. In this context, active engagement in the UNFCCC discussions in relation to response measures and economic diversification has been one of the key elements of this approach.

The UNFCCC stipulates that those measures to address climate change should not present adverse economic and social consequences for developing countries. Such an occurrence would create undue burden for developing countries who are already particularly affected by the impacts of a warming planet.[4] In the Paris Agreement, economic diversification is explicitly referred to in Article 4.7 in relation to mitigation and in Article 7.9(e) in relation to adaptation:

> "7. Mitigation co-benefits resulting from Parties' adaptation actions and/or economic diversification plans can contribute to mitigation outcomes under this Article."[5]

> "9. Each Party shall, as appropriate, engage in adaptation planning processes and the implementation of actions, including the development or enhancement of relevant plans, policies and/or contributions, which may include: … (e) Building the resilience of socioeconomic and ecological systems, including through economic diversification and sustainable management of natural resources."[6]

The mitigation co-benefits of adaptation and economic diversification would be the GHG emission reductions that are the result of the implementation of adaptation-related and economic diversification actions, as stated above in PA Article 4.7. However, this wording does not make clear how co-benefits of adaptation are to be integrated and recognized under the PA, as they are not mentioned under accounting (Art. 4.13), market mechanisms (Art. 6) or transparency (Art. 13). Nevertheless, Art. 4.7 provides a good anchor even if its operationalization remains unclear.

Beyond "classical" adaptation, actions supporting economic diversification can also have co-benefits relating to adaptation and mitigation, as defined in Decision 24/CP.18 of COP 18 in Doha 2012. The central tenets of adaptation under the Paris Agreement are laid out in Article 7 of the PA, with the overarching goal of "enhancing adaptive capacity, strengthening resilience and reducing vulnerability to climate change" (PA Art. 7.1). Article 7.4 recognizes the link between the mitigation ambition level and the adaptation needs but shies away from quantifying adaptation. Art. 7 stresses the country-driven nature of adaptation approaches and specifies (Art. 7.10) that each country prepares an adaptation communication defining its priorities, its implementation and support needs and projects and measures.[7]

A quick review of various reports submitted by Parties under the UNFCCC, including their national communications (NCs), national inventory reports (NIRs), biennial reports (BRs) and biennial update reports (BURs), however, indicates that very limited information has been reported on economic diversification. Only two Parties included in Annex I to the Convention (Annex I Parties) included information related to economic diversification in their NIRs and a number of non-Annex I developing country Parties included information on economic diversification as part of their intended nationally determined contributions (INDCs).[8] From the current set of NDCs, economic diversification features prominently in the NDCs of developing countries whose economies show a great dependency on oil production, such as Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, the UAE.[9]

In addition to enhancing the ability to respond to and address the economic and social impacts of climate change response measures taken by other Parties pursuant to their UNFCCC and Paris Agreement commitments and NDCs, pursuing economic diversification can enhance the ability of oil-dependent developing countries to pursue their sustainable development objectives in the light of what is increasingly a policy-driven decrease in demand for fossil fuels.

---

[4] See e.g. the latest IPCC AR6 WG2 report - https://www.ipcc.ch/report/ar6/wg2/
[5] Paris Agreement, Art. 4.7
[6] Paris Agreement, Art. 7.9(e)
[7] Axel Michaelowa et al., Mitigation co-benefits of adaptation actions and economic diversification (2018), p. 2.
[8] UNFCCC, The concept of economic diversification in the context of response measures – Technical Paper (2018), at https://unfccc.int/sites/default/files/resource/Technical%20paper_Economic%20diversification.pdf.
[9] See UNFCCC, NDC Registry, at https://www4.unfccc.int/sites/NDCStaging/Pages/All.aspx

To address both technology and policy-driven future declines in the demand for fossil fuels, especially oil, many developing country governments whose economies are dependent on these fossil fuels are scaling up their economic diversification planning and efforts. The idea is that decreasing global demand for oil is leading policymakers in these countries to promote economic diversification into alternate economic sectors over the medium and long term, and to protect and enhance the competitiveness of their oil industries over the short and medium term. [10]

The consideration of economic diversification in the context of the multilateral climate change policy regime should be viewed from the perspective that the decisions on what and how to undertake economic diversification and any implied structural transformations are the purview of the national government(s) and their citizens in the context of the right to development and Agenda 2030. This is because it is a matter of sustainable industrial and economic planning, access to resources, including technology, training, and transition adjustment relief policies. Measures taken to address climate change stimulated by the unilateral action of one party, or under multilateral agreement, can either present obstacles to planned, or, in process programmes of economic diversification or accelerate such processes.

Economic diversification is both a goal and a multi-purpose, multi-dimensional process, depending on the starting point. For developing countries this can range from countries that seek to diversify outputs to those that are more focused on diversifying their export basket, both in terms of its composition, volume, and direction of trade. Some may seek diversification through global value change processes, others by a variety of other means. Some countries have more options and degrees of freedom in terms of policy space and finance while others have limited diversification options. It entails a broad societal process, which transforms a country from a single source of income, in this case oil or gas, to a society where multiple sources of income are generated across the primary, secondary and tertiary sectors, and where large sections of the population participate, including the private sector.[11]

Economic diversification should ideally result in developing a more robust range of sectors that can provide a more diverse range of goods and services for both domestic consumption and for international trade; enhance the performance of non-agriculture sectors such as manufacturing, services, construction, infrastructure, tourism, information and communication technology, finance, etc.; and significantly contributes to sustaining long term economic growth and development of the countries and the maintenance or creation of international competitiveness in the world economy. [12] In the context of, for example, oil-dependent developing countries in the Middle East, economic diversification would be the key towards transitioning away from oil dependency and creating more resilient economies, under which revenues from oil and gas production would be used to create infrastructure, production facilities, education, health, housing and "soft infrastructure" in terms of efficient administrative and legal institutions that promotes global competitiveness of the countries.[13]

Additionally, promoting economic diversification hinges on the equitable and fair resolution of other issues within the multilateral climate change, trade, and other regimes such as the transfer and development of environmental sound technologies, the provision of intellectual property rights flexibilities with respect to the needed technologies, the reflection of the principles of common but differentiated responsibilities (CBDR) and of Special and Differential Treatment (SDT) for developing countries, the provision of new, additional and adequate finance for mitigation, adaptation, economic diversification, and loss and damage.

---

[10] See e.g. J Krane, Climate Strategy for Producer Countries: The Case of Saudi Arabia, in G. Luciani, T. Moerenhout (eds), When Can Oil Economies Be Deemed Sustainable? (The Political Economy of the Middle East Series, 2021), p. 301, at https://doi.org/10.1007/978-981-15-5728-6_5

[11] M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), p. 10.

[12] See e.g. M A Malik and T Massood, An Analysis of Economic Diversification of Middle Eastern Countries (Saudi Journal of Economics and Finance, 29 February 2020), p. 72.

[13] M A Malik and T Massood, An Analysis of Economic Diversification of Middle Eastern Countries (Saudi Journal of Economics and Finance, 29 February 2020), p. 72.

C. In relation to KCI Call for Inputs Guiding Question No. 2 on how the assessment was conducted

The TWN study undertook a case study approach with respect to trade policy measures and fossil fuel subsidy reform. Furthermore, focusing on Persian Gulf oil-dependent Arab countries' economic diversification policies that were analyzed, the study used national case studies in terms of mapping out key national economic diversification policies and strategies announced by the governments of these countries. These include the developing countries Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

The lessons learned from the assessment of the economic diversification policies and approaches of the countries studied are highlighted as follows:

1. Recognizing the need for transformative change

The national visions[14] of various Gulf countries highlight economic diversification as the pathway towards long-term economic sustainability and prosperity. As they implemented economic diversification policies over the last two decades, there has been an overall decline in the share of oil and gas in GDP and increased spending on industrial infrastructure across the region, a rising share in GDP of the services and financial sectors, major investments in education, healthcare, water, communications, transportation, tourism, and other non-hydrocarbon sectors, and investments in renewable and alternative energy sources such as solar, carbon capture and storage, and clean technology.[15]

The underlying strategy is to move their economies away from rent-seeking reliance on oil or gas coupled with an allocative approach to welfare distribution, towards developing economies in which incomes are generated through the production of non-oil/gas goods and services. This will require a transformative type of economic diversification that will fundamentally change the underlying conditions for economic activity and political legitimacy in these countries.

2. Addressing external climate and geopolitical shocks, economic uncertainty, the global energy transition, and structural barriers

There are structural and political barriers that need to be addressed, such as highly volatile global economic conditions, intra-Gulf economic duplication and competition, and domestic political challenges.[16] For example, previous low oil prices in the mid- and late 2010s led to budgetary deficits and consequent fiscal consolidation in the Gulf oil-exporting countries, making it difficult for their governments to invest more in their economic diversification and domestic industrialization efforts.[17] The impact of the COVID-19 pandemic caused a global collapse in oil demand and a consequent global oil price shock that adversely

[14] These include Saudi Arabia's Vision 2030, the UAE's Vision 2021, Kuwait's New Kuwait 2035, Bahrain's Vision 2030; Oman's Vision 2020 and Oman 2040; and Qatar's National Vision 2030. See e.g. S Krones, How Gulf Cooperation Council Countries (GCC) Are Dealing with Falling Oil Prices (COFACE, 29 September 2015), at https://www.cofacecentraleurope.com/News-Publications/News/How-Gulf-Cooperation-Council-countries-GCC-are-dealing-with-falling-oil-prices

[15] A Mishrif and YA Al Balushi, Economic Diversification: Challenges and Opportunities in the GCC (GRCC, 2015); see also N Alsharif et al., Economic Diversification in Resource Rich Countries: Uncovering the State of Knowledge (CSAE Working Paper WPS/2016-28, 13 October 2016), pp. 17-19, for a discussion on the economic diversification experience of oil and other commodity exporters in the Middle East, former USSR, high-income countries, sub-Saharan Africa, South East Asia, and Latin America.

[16] M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), pp. 39-42.

[17] B Hussein, Energy Sector Diversification: Meeting Demographic Challenges in the MENA Region (Atlantic Council Global Energy Center, January 2020), pp. 12-13.

impacted the fiscal position of oil-exporting developing countries.[18] However, by late 2021, demand for and prices of fossil fuels, particularly for oil, has rebounded although significant volatility remains.[19]

There is a growing recognition that the pace of oil demand growth is likely to slow over time, eventually plateauing or declining, as efficiency improvements, technological advances, climate change and environmental policies and changing social preferences lead to substitution away from oil in its traditional sectors (such as transportation), which have historically driven oil demand growth[20] -- this is the global energy transition. This recognition of the global energy transition is permeating these countries' policymaking, leading them in various ways to undertake various strategies intended to place their economies on a pathway for transition away from oil and gas dependency. [21]

The possible impacts, for example, of multilateral and national climate change-related mitigation-focused response measures on oil, gas, and coal demand[22] will likely play a significant role in long-term economic diversification strategies. These impacts will include not only technological, production, and consumer shifts away from fossil fuel energy-consuming production and consumption but also in terms of the direction of financial investments.

However, the speed of the energy transition globally is highly uncertain[23], and neither will such transition be uniform across countries or world regions. What this means is that any economic diversification strategy

---

[18] OECD (2020), The impact of coronavirus (COVID-19) and the global oil price shock on the fiscal position of oil-exporting developing countries (OECD, 30 September 2020), at https://www.oecd.org/coronavirus/policy-responses/the-impact-of-coronavirus-covid-19-and-the-global-oil-price-shock-on-the-fiscal-position-of-oil-exporting-developing-countries-8bafbd95/.
There are other challenges that the Gulf region faces in terms of the ability of their non-oil industries to absorb pandemic-related shocks and enhance economic diversification, such as heavy dependence on few or single trading partners, falls in tourism into the region due to travel restrictions and a reduction in fiscal space to continue paying for expensive, long-term megaprojects. See e.g. Kingdom of Bahrain Supreme Council for Environment, Kingdom of Bahrain: The Human Capital Advantage (2016), at https://unfccc.int/files/cooperation_support/response_measures/application/pdf/20160902_edrm_bahrain.pdf; Bahrain Transparency Society, Implementation of the 2030 Agenda of Sustainable Development and Sustainable Development Goals: Bahrain National Report (Social Watch, 27 October 2020), at https://www.socialwatch.org/node/18504

[19] See e.g. IEA (2022), Oil Market Report – February 2022, at https://www.iea.org/reports/oil-market-report-february-2022. The Ukraine-Russia conflict and the sanctions and countermeasures imposed by the West on Russia and vice-versa have pushed up oil prices but might only be temporary. See eg. C Hendrix (2022), Higher oil prices stemming from Russia-Ukraine war may be temporary (PIIE, 3 March 2022), at https://www.piie.com/blogs/realtime-economic-issues-watch/higher-oil-prices-stemming-russia-ukraine-war-may-be-temporary

[20] B Fattouh and A Sen, Economic Diversification in Arab Oil-Exporting Countries in the Context of Peak Oil and the Energy Transition, in G. Luciani, T. Moerenhout (eds), When Can Oil Economies Be Deemed Sustainable? (The Political Economy of the Middle East Series, 2021), p. 74, at https://doi.org/10.1007/978-981-15-5728-6_5

[21] See e.g. J Krane, Climate Strategy for Producer Countries: The Case of Saudi Arabia, in G. Luciani, T. Moerenhout (eds), When Can Oil Economies Be Deemed Sustainable? (The Political Economy of the Middle East Series, 2021), p. 302, at https://doi.org/10.1007/978-981-15-5728-6_5. One strategy is to prepare, through economic diversification, the economic landscape for a day when oil rents no longer dominate the state's fiscal revenue, whether from a plateauing of global oil demand or any other reason. Another strategy seeks to insulate flows of oil and gas rents against the more direct challenges emanating from climate policy, such as increasing involvement in importing markets and in bolstering oil-consuming technology; investment into refining and other infrastructure ties with developing states where expectations for growth in oil demand are high; research investment into low-emission and non-combustion uses for crude oil, which are consistent with a transitioning energy system; increasing cooperation with the global climate regime, pursuing a commitment to energy efficiency which does double duty in domestic oil demand management; and engaging in international climate negotiations to lessen the focus on mitigation and increase the focus on adaptation and the impacts of response measures.

[22] For example, governments at the 26th session of the UN climate change convention in November 2021 in Glasgow recognized that limiting global warming to 1.5C requires rapid, deep and sustained reductions in global greenhouse gas emissions, including reducing global carbon dioxide emissions by 45 per cent by 2030 relative to the 2010 level and to net zero around mid-century, as well as deep reductions in other greenhouse gases, and that this requires accelerated action in this critical decade, on the basis of the best available scientific knowledge and equity, reflecting common but differentiated responsibilities and respective capabilities, in the light of different national circumstances and in the context of sustainable development and efforts to eradicate poverty. In this context, governments were called upon to "accelerate the development, deployment and dissemination of technologies, and the adoption of policies, to transition towards low-emission energy systems, including by rapidly scaling up the deployment of clean power generation and energy efficiency measures, including accelerating efforts towards the phasedown of unabated coal power and phase-out of inefficient fossil fuel subsidies, while providing targeted support to the poorest and most vulnerable in line with national circumstances and recognizing the need for support towards a just transition." See COP26, Glasgow Climate Pact, para. 17-18, 20, at https://unfccc.int/sites/default/files/resource/cop26_auv_2f_cover_decision.pdf; and CMA3, Glasgow Climate Pact, para. 22-23, 36, at https://unfccc.int/sites/default/files/resource/cma3_auv_2_cover%20decision.pdf .

[23] A possible key driver for a slower global energy transition is the fact that governments are collectively projecting an increase in global oil and gas production and only a modest decrease in coal production over the next two decades, leading to future fossil fuel

adopted by the Gulf oil production- or export-dependent countries will be conditioned by the speed of the energy transition, during which the oil sector will continue to play a key role in these economies, including in their diversification efforts. These countries will then need to be more strategic in developing their energy sector, including renewables, and diversifying their economies. Their success or failure in doing so and the speed at which they transition to more diversified and more resilient economies will also shape the global energy transition.[24]

This means that the economic diversification efforts in these Gulf countries are not linearly progressive – i.e. they will also be sensitive to changes in external and internal circumstances that may make economic diversification more or less of a national policy priority. [25] For example, in the late 2000s and early 2010s, high oil prices brought in high levels of governmental revenue that in effect disincentivized economic diversification efforts, while a sharp fall in oil prices in the mid-2010s coupled with other economic and political shocks (such as geopolitical tensions and conflict in the Gulf area) highlighted economic vulnerability and triggered a renewed effort for economic diversification. [26]

What these imply is that when it comes to adopting and implementing economic diversification strategies particularly among oil dependent Gulf countries, policymakers will need to consider significant levels of uncertainty about the progress of key trends such as how fast and uniformly a global energy transition will take place, whether there will be a sudden and sharp discontinuation in oil demand as a result, or whether oil will continue to be used for energy and non-energy purposes.

Additionally, unforeseen geopolitical factors may also play a role in market demand for these countries' fossil fuel exports. For example, the ongoing Ukraine-Russia war that has instigated the US and Europe to turn to the Gulf states to secure alternative energy supplies through various agreements.[27]

3. Enhancing the role of a developmental State for planned economic diversification

Economic diversification in oil production or export-dependent developing countries, as can be seen in the Gulf, would generally be through a planned and policy-driven economic transition driven by the government in which the public sector develops an increasing share of the private sector rather than through purely market-driven approaches.[28] The diversification process is often conditioned on a planned transition with the possible continued role of the oil sector in their economies as a source of material inputs into other non-energy uses of oil (such as petrochemicals and plastics) to generate revenue. [29]

---

production levels that would be far above those consistent with limiting warming to 1.5 or 2C. See SEI, IID, ODI, E3G, nd UNEP (2021), The Production Gap Report (2021), at https://productiongap.org/wp-content/uploads/2021/11/PGR2021_web_rev.pdf

[24] B Fattouh and A Sen, Economic Diversification by Arab Oil Exporters in the Context of the Peak Oil and the Energy Transition (118 Oxford Institute for Energy Studies Journal, June 2019), p. 22.

[25] See e.g. M McIntosh, How 2020's Oil Prices Will Challenge Saudi Arabian Economic Diversification (IAH, 20 April 2020), at https://www.internationalaffairshouse.org/how-2020s-oil-prices-will-stall-saudi-arabian-economic-diversification/; Buchholz, K., OPEC Countries Further Diversify Exports (Statista, 10 September 2020), at https://www.statista.com/chart/18310/petroleum-and-other-export-from-opec-countries/

[26] International Strategic Analysis, The Lack of Economic Diversification in the Middle East (ISA, 31 August 2016), at https://www.isa-world.com/news/?tx_ttnews[backPid]=1&tx_ttnews[tt_news]=239&cHash=22cd713f95255577b3fb174bb555d037; HH Tuama, Economic Diversification and Oil Revenues in the Arab Gulf Countries – The Case of Saudi Arabia (6:4 Journal of Economics and Development Studies, December 2018), p. 2, at https://doi.org/15.15640/jeds.v6n4a15; M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), p. 2.

[27] See e.g. https://www.aljazeera.com/news/2022/7/16/us-saudi-arabia-pledge-moves-to-stabilise-global-energy-markets ; https://markets.businessinsider.com/news/commodities/europe-energy-crisis-germany-natural-gas-deals-qatar-uae-russia-2022-9; https://www.aljazeera.com/news/2022/9/24/french-oil-giant-signs-new-natural-gas-deal-with-qatar; https://dohanews.co/qatars-amir-tamim-taps-into-energy-with-uks-pm-truss-as-london-scrambles-for-gas/

[28] Gulf countries generally take a state-led approach to their economic diversification policies and strategies, in which "the state, through direct ownership of productive assets and large governmental budgets, is an active player in the market, creating both a supply of goods and services and, not least, a demand for them." See M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), p. 37; see also A Movchan et al., Managing the Resource Curse Strategies of Oil-Dependent Economies in the Modern Era (Carnegie Moscow Center, 2019), p. 1.

[29] See e.g. B Fattouh and A Sen, Economic Diversification in Arab Oil-Exporting Countries in the Context of Peak Oil and the Energy Transition, in G. Luciani, T. Moerenhout (eds), When Can Oil Economies Be Deemed Sustainable? (The Political Economy of the Middle East Series, 2021), pp. 94-95, at https://doi.org/10.1007/978-981-15-5728-6_5; Opportunities abound as the GCC

This will require, among other things, sufficient policy and fiscal space at the international and domestic level for national policymakers to be able to design and implement the appropriate mix of policy, fiscal, investment and other instruments that would be needed to make sure that economic diversification is undertaken in a managed manner so as to avoid or mitigated adverse economic and social consequences.

Furthermore, given the heterogeneity among individual Gulf countries and their different economic, population, and land and natural resource endowments, economic diversification policies would need to be tailed according to each country's specific national circumstances (there is no "one size fits all").[30] In the context of the Gulf countries, economic diversification means reducing their heavy dependence on the oil sector by developing a non-oil economy, non-oil exports and non-oil revenue sources and, by implication, reducing the leading role of the public sector in these countries by promoting the growth of the private sector.

The Gulf countries tend to incorporate their economic diversification strategy within a broader national planning document that outlines the aims and aspirations of the rulers for their countries. These plans vary in scope, level of detail and in quality, often highlighting broader targets which are to be implemented through detailed plans and spending budgets.

4. Using an integrated and cross-sectoral industrialization and diversification strategy

To achieve economic diversification, Gulf countries generally seek to invest their current oil and gas revenues in economic assets such as infrastructure, production facilities, housing, education, health, and "soft infrastructure" such as administrative and legal practices etc., to develop international competitiveness and generate a future income.

The economic diversification plans that they have put forward generally take a three-step approach:[31]

(1) Diversification within their oil and gas sector by using crude oil or gas output to produce downstream products, such as petrochemicals, fertilizer and chemicals, or as cheap fuel in energy-intensive industries, such as aluminium or steel;
(2) Further diversification within already successful activities or sectors within their respective economies. These include banking or processing raw aluminium in Bahrain; logistics, the seaports and trade sector in Dubai; the trade sector in Kuwait; and the LPG industry and steel mills in Oman;
(3) Introduction of new sectors, industries or activities which hold high growth potential within a globalized economy, such as aviation (airports, airlines, and air transport servicing and logistics), tourism and hospitality (such as conference and experiential tourism), real estate, logistics and business services or, within manufacturing, high technology-content products like smart technologies or green technologies.

More specifically, the approaches undertaken by Gulf countries to achieve economic diversification (and development in general) featured the following: [32]

- The development of the physical and social infrastructure, including investments in public infrastructure, education and health care as essential foundations for non-oil economy growth;

economies diversify (Grant Thornton LLC, 20 Jne 2017), at https://www.grantthornton.global/en/insights/growthiq/opportunities-abound-as-the-gcc-economies-diversify/

[30] MA Malik and T Massood., An Analysis of Economic Diversification of Middle Eastern Countries (Saudi Journal of Economics and Finance, 29 February 2020), p. 76; M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), p. 12.

[31] M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), pp. 35-36.

[32] See e.g. M Hvidt, Economic Diversification in GCC Countries: Past Record and Future Trends (LSEKP Research Paper 27, January 2013), p. 12.

- The development of capital-intensive industries that utilize the country's oil and gas resources for the production, for example, of steel, aluminium, fertilizer and petrochemicals (i.e. chemical components derived from oil which serve as building blocks for products such as detergents, adhesives, plastics, fibres, lubricants and gels);[33]
- The development of other manufacturing industries such as cement, construction materials (plaster, cladding, rebar, window frames etc.), electrical products, textiles, clothing, furniture and household items;
- The development of other productive sectors and services such as agriculture (animal production, poultry, dairy products), trade, banking, financial services and, since the early 2000s, aviation, real estate, tourism, and investments in overseas assets (e.g. hotel chains, harbours, real estate) to be managed from the Gulf;
- The reduction of the direct role of the public sector as an agent of economic growth by privatizing publicly owned companies and utilities and reducing domestic subsidies for water, electricity, housing, and food;
- The implementation of demand-side measures to reduce domestic fossil fuel energy use and the integration of renewable energy into their domestic energy mix given their great potential for renewable energy (especially solar and wind) to supply rising domestic energy demand and complement and eventually supplant domestic oil or gas use as well as provide a new energy export revenue stream.[34]

Additionally, other studies looking at the diversification experience of oil-dependent countries, including those outside of the Gulf, point out that such countries also need to ensure that the following are reflected:[35]

- Fiscal and monetary discipline to help avoid having public sector investments from crowding out private sector investment, achieve long-term price stability, and mitigate macroeconomic volatility
- Investment in human capital and public physical infrastructure to improve labour productivity and lower production costs
- Improve the business environment through regulatory, tax, and administrative reforms to make it easier for the private sector to operate
- Political good governance, including ensuring accountability, political stability, regulatory quality, and voice and participation in governance by citizens and other stakeholders[36]

---

[33] See also B Fattouh and A Sen, Economic Diversification by Arab Oil Exporters in the Context of the Peak Oil and the Energy Transition (118 Oxford Institute for Energy Studies Journal, June 2019), pp. 24-25, 86-87, explaining the strategic role of the oil sector in Gulf countries in fostering and supporting the energy transition. This study suggests that as low-cost producers with some of the largest oil and gas reserves, they may be expected to fill the energy supply–demand gap and that, therefore, even when oil demand growth slows, oil will continue to play a role in these economies for the foreseeable future. As leaders develop new visions to transform their countries, the energy sector will be under increasing pressure to show that it can contribute to diversification, by generating rents that could be used to create new industries, extending the value chain and creating new industries by fostering backward and forward linkages such as more complex petrochemical products and finished products manufactured in industrial parks that attract private-sector and foreign direct investment, and extending their national energy models to integrate renewables into their domestic energy mix given their great potential for renewable energy (solar and wind) to supply rising domestic energy demand. See also B Hussein, Energy Sector Diversification: Meeting Demographic Challenges in the MENA Region (Atlantic Council Global Energy Center, January 2020), p. 13; T Gould and A Al-Saffar, Economic diversification for oil and gas exporters doesn't mean leaving energy behind (IEA, 25 October 2018), at https://www.iea.org/commentaries/economic-diversification-for-oil-and-gas-exporters-doesnt-mean-leaving-energy-behind

[34] B Fattouh and A Sen, Economic Diversification by Arab Oil Exporters in the Context of the Peak Oil and the Energy Transition (118 Oxford Institute for Energy Studies Journal, June 2019), pp. 24-25, 89-90; Arezki, R., Oil Producing Countries in the Middle East and Africa Must Focus on How to Transform Their Economies (118 Oxford Institute for Energy Studies Journal, June 2019), p. 27; B Hussein, Energy Sector Diversification: Meeting Demographic Challenges in the MENA Region (Atlantic Council Global Energy Center, January 2020), p. 14; C Nakhle, Clean Energy and Fossil Fuels in the Middle East: A Virtuous Cycle? (Natural Resources Governance Institute, 29 June 2020), at https://resourcegovernance.org/blog/clean-energy-fossil-fuels-middle-east-virtuous-cycle

[35] See e.g. M Ross, What Do We Know About Economic Diversification in Oil-Producing Countries? (EEG State of Knowledge Paper No. 5.2, 19 December 2017), p. 9; IMF Staff, Economic Diversification in Oil-Exporting Arab Countries (IMF, April 2016); T Callen et al., Economic Diversification in the GCC: Past, Present, and Future (IMF Staff Discussion Note SDN/14/12, December 2014)

[36] See e.g. M. Raquibiz Zaman, A Comparative Analysis of Economic Policies and Performance of the OPEC and Non-OPEC Countries of the Middle East Region since the 1980's (1:1 Afro Eurasian Studies, Spring 2012), p. 86; S Matallah and A Matallah,

D. Conclusion

The lessons coming from the economic diversification experience of Gulf countries highlight the integrated and complex nature of the sustainable development challenge facing oil production and export-dependent developing countries. This challenge is made particularly more acute considering global economic volatility, the gathering pace of the global energy transition, the adverse effects of climate change and other environmental degradation processes, and imposition of climate change policy response measures by other countries.

It should be recalled that Article 4.10 of the UNFCCC calls on Parties to "take into consideration in the implementation of the commitments of the Convention the situation of Parties, particularly developing country Parties, with economies that are vulnerable to the adverse effects of the implementation of measures to respond to climate change. This applies notably to Parties with economies that are highly dependent on income generated from the production, processing and export, and/or consumption of fossil fuels and associated energy-intensive products and/or the use of fossil fuels for which such Parties have serious difficulties in switching to alternatives."[37]

To implement Art. 4.10, governments should ensure that the design and implementation of climate change response measures are equitable and do not adversely affect developing countries that are dependent on fossil fuel production, production, and export. This would include, for example, supporting their economic diversification efforts through finance, technology transfer, and the provision of appropriate policy space and flexibility to experiment with different national economic policies to find the policy mix that is best and most appropriate for their national context. Because of the economic nature of the systemic and structural changes that are needed to rapidly undertake effective economic diversification in the context of sustainable development and poverty eradication, national and multilateral climate change policy response measures need to be robust but at the same time equitable and flexible. Doing so would be consistent with the principle of CBDR embedded in the UNFCCC and its Paris Agreement.

In this context, the developed countries, considering their historical responsibility, current capabilities, and continued high per-person emissions, must continue to take the lead in reducing global greenhouse gas emissions through domestic emissions reductions and in providing climate finance and technology transfer to developing countries.

Developing countries also will have to ensure that their long-term sustainable development prospects are climate-proofed and made more climate-resilient by putting in place needed adaptation and economic diversification policies and strategies, in a manner that is socially and economically equitable. This would imply looking at, inter alia:

- The energy access and energy infrastructure transformation to clean/renewable energy possibilities for developing countries, in light of their sustainable development objectives;
- The technological and financing (including investment) needs for such transformation and ensuring that a just transition takes place, particularly in developing countries concerning their workforce and their marginalized and vulnerable populations and ensuring that social and economic conditions for their populations remain stable or are improved and that national development objectives will be achieved;
- Identification of the economic diversification and transition sectors that could be developed in the economies of those developing countries that are likely to be adversely affected by emission reduction-focused response measures of other countries, particularly in light of current economic contexts and existing sectoral dependencies and avoiding non-solutions (such as bio-energy carbon capture and storage, carbon trade markets, and geoengineering), or by initiatives to halt further expansion of fossil fuel production;

Oil rents and economic growth in oil-abundant MENA countries: Governance is the trump card to escape the resource trap (18:2 Topics in Middle Eastern and African Countries, September 2016), pp. 87, 110.

[37] UNFCCC, Art. 4.10.

- Identification of key equity considerations from a developing country context in terms of the extent of diversification, financing requirements, technology requirements, social impacts, economic impacts, and transition costs, and other considerations associated with ensuring that there is a just transition in countries from today's fossil fuel-dependent economies (whether in terms of export or import dependence or energy dependence) to ones that are more climate-resilient and adapted;
- Identification of international cooperation arrangements under the UNFCCC and its Paris Agreement that need to be enhanced or scaled up to better address equity, economic diversification, just transition for the workforce and other marginalized sectors, and the impact of response measures (including in climate finance, technology transfer, adaptation financing, and loss and damage financing).

This is particularly important for those developing countries whose economies rely on fossil fuels, whether in terms of imports for energy, exports as commodities, or for domestic energy use (e.g., for industry, transportation, aviation, heating/cooling, residential power, or desalination). For such countries, the key question that needs to be answered is how the economic needs that are currently filled by fossil fuels can be met – e.g., providing cheap usable energy to fuel the economy and, for exporters, obtaining income from fossil fuel production and exports that is often used to provide income support to their populations and thereby maintaining internal civil stability.

Therefore, proactive engagement by fossil fuel-dependent developing countries on issues relating to economic diversification and just transition is very important as part of these processes, particularly to define the policy, economic, and support measures that need to be undertaken to achieve effective economic diversification and just transition.

Indeed, an essential part of response measures to climate change is the fundamental question of energy as the critical enabler of development and good health. Shifting from dirty to clean energy is a vital step towards integrating health, energy, climate, and other priorities. In this context, the model of energy provision is key. Decentralized, demand-driven, clean, and renewable energy can power rural and peri-urban economic activities, health facilities, and systems for sanitation and hygiene, and enable effective irrigation and farming everywhere. Better access to clean energy makes communities more resilient to health and other shocks and is essential for economic development and the process of economic diversification.

In the context of the oil-dependent Gulf developing countries, while considering their different national circumstances and noting their economic diversification approaches, a sustainable and strategic economic diversification approach could prioritize, inter alia:

(1) Diversification into and within existing non-fossil fuel sector activities or sectors within their respective economies. These include banking in Bahrain; logistics, the seaports and trade sector in Dubai; the trade sector in Kuwait; and fisheries in Oman.

(2) Introduction of new sectors, industries, or activities with high growth potential such as aviation (airports, airlines, and air transport servicing and logistics), education, tourism and hospitality (such as conference and experiential tourism), finance, real estate, logistics and business services or, within manufacturing, high technology-content products produced using low or no-emissions production methods.

(3) Scaling up investment in: (a) the development of public physical and social infrastructure, including education, health care, and basic social protection, as essential foundations for non-oil economy growth, improving labour productivity and lowering production costs; and (b) domestic product and market research into and development of products and services that require low or no emissions.

(4) The implementation of demand-side measures to reduce domestic fossil fuel energy use and the integration of renewable energy (especially solar and wind) into their domestic energy mix to supply rising domestic energy demand and complement and eventually supplant domestic oil or gas use as well as provide a new energy export revenue stream.

To improve the design and implementation of economic diversification strategies, particularly for oil-dependent developing countries, modelling tools are needed that explore sectoral impacts as well as macroeconomic impacts and distributional impacts on workers, individuals and households, micro and small business, medium-sized and large businesses.[38] These tools should help governments identify response to the following questions in terms of designing and implementing their economic diversification strategies.

Finally, addressing the twin development and climate change challenge requires an integrated approach to, inter alia, trade policy, economic diversification, the development of productive capacity, environmental policy, investment policy, intellectual property policy, among others. This approach should ensure that the overall development approach is "climate-friendly", alleviate poverty, achieves development, and improves standards of living while adapting to and mitigating climate change.

At the international level, governments should pursue international cooperation and support as essential elements to ensure that the national development and economic diversification efforts of developing countries not undermined or undone. In this regard, there are three key elements for international cooperation and support include:[39]

- Ensuring that at the multilateral level, developing countries' development policy space is not constrained or limited by multilateral rules, particularly in the international trade, investment, finance, and taxation arenas
- Ensuring transfer of environmentally-sound and climate change-related technologies to developing countries
- Ensuring adequate financial support to developing countries for climate change actions, sustainable development, and economic diversification.

[38] See e.g. C Freire, Economic Diversification: Explaining the pattern of diversification in the global economy and its implications for fostering diversification in poorer countries (UNDESA Working Paper No. 150, August 2017); G Peszko, D van der Mensbrugghe, and A Golub, Diversification and Cooperation Strategies in a Decarbonizing World (World Bank Policy Research Working Paper 9315, July 2020); UNFCCC Secretariat, Enhancing the capacity and understanding of Parties, through collaboration and input from stakeholders, on the assessment and analysis of the impacts of the implementation of response measures to facilitate the undertaking of economic diversification and transformation and just transition (UNFCCC, 4 October 2021); A Lashitew, M Ross, and E Werker, What Drives Successful Economic Diversification in Resource-Rich Countries? (World Bank Research Observer, 2020), at https://academic.oup.com/wbro/advance-article/doi/10.1093/wbro/lkaa001/5813434

[39] See M Khor, MF Montes, M Williams and VP Yu III, Promoting Sustainable Development by Addressing the Impacts of Response Measures on Developing Countries, South Centre Research Paper 81, November 2017, pp. 42-48.