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Prospects for Energy Transition in the Mediterranean after COVID-19

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ABSTRACT

Strongly exposed to global warming effects and commodity price volatility, the Mediterranean basin needs cleaner energy supply for both environmental and long-term economic reasons. Blessed with great renewable energy potential, the region has attracted growing attention from both public and private players, although several obstacles still hamper the energy transition in the region, with considerable differences between the northern shore and the southern shore (where RES potential is largely untapped). The ongoing COVID-19 pandemic, the related economic crisis and the shock in oil and gas prices, which affect the whole basin, have important implications for energy transition prospects. In the months to come the crisis could serve as a catalyst for transformative changes that could revitalise the Mediterranean economies along with meeting stronger decarbonisation goals.

keywords

Mediterranean | Energy | Renewables | Oil | Natural gas | Coronavirus

Prospects for Energy Transition in the Mediterranean after COVID-19

by Margherita Bianchi*

Introduction

The Mediterranean region displays unique opportunities for the energy transition, which is (slowly) gaining momentum despite mixed results and speeds. The penetration of renewable energy is still limited compared to its potential, and the region requires substantial investments and forward-looking vision to undergo a stronger – yet gradual and orderly – energy transition.

Fossil fuels remain a socio-economic and political pillar in (and bridge between) countries of the Mediterranean, which is a hub for global energy flows. The interrelated and mutually reinforcing dynamics that the world is undergoing – the COVID-19 pandemic, the resulting economic crisis and the strong stress on oil and gas prices – certainly impact the area and its energy landscape.

At the time of writing, the effects of these crises on the energy landscape in the Mediterranean basin cannot be captured entirely. The uncertainty around the intensity and duration of the crisis, the impact of which varies across the basin, leaves doubts over the longer-term economic scenario, the potential slump in investment spending and its consequences for the prospects of energy transition.

The type and scope of responses put in place in the next months provide an interesting prism to assess whether a stronger sustainability in the area is pushed or discouraged. The vision and plans for the recovery phase might open or close windows into more sustainable development paths on both shores of the Mediterranean, thereby affecting the future energy mix, infrastructure, jobs and cooperation patterns.

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1. State of play in the region

From an energy perspective, the Mediterranean region is markedly diverse,[1] as it encompasses importing, exporting and transit countries, all displaying specific underlying socio-economic trends that result in different energy demand, energy mixes, and energy and carbon intensity.

One common feature is the strong dependence on fossil fuel use (77 per cent of the regional mix[2]). The environmental and health externalities associated with the consumption of hydrocarbons are exacerbated by booming electricity consumption and further amplified by subsidies still widely adopted on the Southern shore of the region. As the Mediterranean will be more subject to global warming compared to the global average,[3] there is a special incentive for the Mediterranean to see a successful global energy transition and to contribute to it. A stronger penetration of renewable energy sources (RES) may also be a way to reduce the importers' energy bill while diversifying sources of energy; and for current fossil fuel exporters in the Mediterranean it may represent a solution to respond to the growth in internal energy demand.

The Mediterranean basin holds massive RES potential,[4] particularly owing to high levels of solar irradiation throughout the region, as well as wind. In addition, it holds a strategic position near main energy markets and is in itself a large market. Even if these conditions *per se* would not allow Mediterranean countries to become self-sufficient through RES, they certainly provide unique prospects to promote greater RES penetration and electricity interchange, which would lead to greater decarbonisation of the area. This is a promising prospect especially for EU member states, which have politically committed to achieving climate neutrality by 2050.

Until recently, RES production and consumption have however been limited, the regional average being negatively affected by weak penetration in the southern

[1] A common definition of the area includes 25 countries belonging to the EU, the Balkans, North Africa and the Middle East, covering an area of 9 million km2 and a population of around 540 million in 2017. Source: Confindustria Energia, *Infrastrutture energetiche per l'Italia e per il Mediterraneo*, March 2020, https://www.confindustriaenergia.org/wp-content/uploads/2020/04/CE_Infrastrutture-energetiche-per-lItalia-e-per-il-Mediterraneo_compressed.pdf; Observatoire Mèditerranèe de l'Energie (OME), *Mediterranean Energy Perspectives 2018*, Paris, OME, 2018.

[2] Albeit with marked differences between the northern shore (66 per cent) and the southern one (93 per cent). Data refer to 2017. Source: Confindustria Energia, *Infrastrutture energetiche per l'Italia e per il Mediterraneo*, cit., p. 45.

[3] A number of scientific studies confirm that the area has a faster warming trend (ranging from 20 to 25 per cent higher compared to the global average). See for example: Mediterranean Experts on Climate and Environmental Change (MedECC), *Risk Associated to Climate and Environmental Changes in the Mediterranean Region. A Preliminary Assessment by the MedECC Network Science-Policy Interface*, 2019, https://www.medecc.org/?p=1807; Wolfgang Cramer et al., "Climate Change and Interconnected Risks to Sustainable Development in the Mediterranean", in *Nature Climate Change*, Vol. 8, No. 11 (November 2018), p. 972-980, https://doi.org/10.1038/s41558-018-0299-2.

[4] Observatoire Mèditerranèe de l'Energie, *Mediterranean Energy Perspectives 2018*, cit.

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shore. In the wider region, RES have been mainly provided through traditional technologies (hydro and biomass). Wind and solar photovoltaic (PV) accounted for a minority share of the overall Mediterranean energy mix until the early 2000s, but their deployment has strongly risen since 2010 (+40 per cent) mostly due to their wider adoption in Southern European countries (northern shore of the Mediterranean). RES installed capacity in 2017 amounted to 244 gigawatt and forecasts project a substantial increase in RES installed capacity in the next decade.[5]

While the EU pushes ahead with the deployment of RES – although with different results – in the Middle East and North Africa (MENA) area, despite a ten-fold increase in solar and wind capacities in the past decade thanks to a mix of market-based mechanisms, an increasing number of *ad hoc* institutions dealing with RES and dedicated energy development zones, the penetration of RES is far below potential. Even if MENA countries have generally all recognised the need to include a wider share of RES in their mix, RES only account for modest shares of power production (5 per cent on average), with Morocco being a noteworthy outlier (32 per cent). The Western Balkans also have low RES penetration (except for hydro), and they still cover around 50 per cent of their electricity consumption with coal. Similarly, coal supplies around 33 per cent of electricity in Turkey.

A number of regulatory barriers, insufficient and unstable political backing and difficult or expensive access to capital are all responsible for the unsatisfactory RES penetration in the southern shore so far. There is evidence in particular pointing to fossil fuel subsidies being a big impediment to RES (wind and solar in particular) achieving relative cost advantage.[6]

Insufficient physical integration is an additional obstacle to electrification and RES. Again, this is true not only for the MENA but also the Western Balkans, despite recent and important developments.[7] Between-shores electricity trade has not thrived (except between Morocco and Spain), although a number of projects are now underway, including a submarine cable between Tunisia and Sicily.

An increasing number of actors are however working to promote a wider integration of the Mediterranean to boost sustainability. Cooperation in the basin has found new impetus at the institutional, public and private levels, with several prospects for a deeper engagement.[8] The financial and technical investments needed to exploit its massive regional clean potential are also one important

[5] Both reference and proactive scenarios in the study of Confindustria Energia, *Infrastrutture energetiche per l'Italia e per il Mediterraneo*, cit.

[6] Rahmatallah Poudineh, Anupama Sen and Bassam Fattouh, "Advancing Renewable Energy in Resource-Rich Economies of the MENA", in *OIES Papers*, No. MEP 15 (September 2016), https://doi.org/10.26889/9781784670696.

[7] Terna, interconnection with Montenegro, for example.

[8] Margherita Bianchi et al., "Assessing European Energy and Industrial Policies and Investments in the Southern Mediterranean Region from a Bottom-up Perspective", in *MEDRESET Working Papers*, No. 34 (December 2018), https://www.iai.it/en/node/9862.

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area of EU support through Horizon 2020, Connecting Europe Facility funds and European Investment Bank loans.

An important input comes from regional intergovernmental organisations (i.e., Union for the Mediterranean), specific platforms (i.e., Regional Electricity Markets) and associations (i.e., Mediterranean Energy Regulators; Observatoire Méditerranéen de l'Energie; the Mediterranean Transmission System Operators; Renewable Energy Solutions for Mediterranean – RES4Med, part of RES4Africa). Initiatives to promote efficiency – fundamental to ensure that efforts in RES are not outpaced by rising demand – are the object of several projects, which in many cases require stronger policy and funding.[9] Private players also provide an essential input, although investments in RES are currently considered insufficient,[10] with the risk of forgoing evident environmental benefits and industrial opportunities.

In the recent past, Italy has actively supported a number of projects in the region, from the 2008 European Recovery Plan, to the recent Connecting Europe Facility, the EU External Investment Plan programmes or the "Strategy for Africa". Italy has a particular interest in promoting a wider RES development, technological diversification and stronger integration of the area,[11] with gains for the security of its own energy supply and for the growth of its industrial sector, which includes a leading player already working on a number of important projects in the area, Enel.[12]

2. What does COVID-19 mean so far for energy in the Med region?

Now, questions arise with respect to the impact that COVID-19 has on such dynamics. In general, the crisis has sent shockwaves through the global economy and energy system.

The first direct impact is the economic one. According to International Monetary Fund estimates, the world economy is expected to experience the worst recession since the Great Depression.[13] Even if each economy is more or less vulnerable to these circumstances, there is a general risk that governments divert (the already insufficient) political capital and financial resources dedicated to decarbonisation

[9] S. Duygu Sever, "Accelerating the Energy Transition in the Southern Mediterranean", in *Édito Énergie*, 16 September 2019, https://www.ifri.org/en/node/16304.

[10] In both scenarios drawn by Confindustria Energia, *Infrastrutture energetiche per l'Italia e per il Mediterraneo*, cit.

[11] Luca Franza, Margherita Bianchi and Luca Bergamaschi, "Geopolitics and Italian Foreign Policy in the Age of Renewable Energy", in *IAI Papers*, No. 20|13 (June 2020), https://www.iai.it/en/node/11696.

[12] Morocco, Greece and Spain, to cite a few. See Nicolò Sartori and Margherita Bianchi, "Energia nel Mediterraneo e il ruolo del settore privato", in *IAI Papers*, No. 19|21 (November 2019), https://www.iai.it/en/node/10976.

[13] Gita Gopinath, "The Great Lockdown: Worst Economic Downturn Since the Great Depression", in *IMF Blog*, 14 April 2020, https://blogs.imf.org/?p=28948.

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towards more pressing needs. Multilateral and cooperative action, crucial for energy and climate policies but already weak in pre-COVID days, might face even stronger resistance. At the same time, the huge financial response to recover from the crisis represents an opportunity to fast-forward the transition towards a green economy.

The second direct impact is the shock on energy prices. The temporary drop in energy demand and consumption of fossil fuels[14] has contributed to oil and gas prices dipping to unprecedented lows. Signs of a recovery are there, even though it will probably be very gradual, affected by structural oversupply. In the short term, where policies do not explicitly mandate RES, power generation from fossil fuels might likely look more attractive, especially in the most price-sensitive and fossil fuel producing countries. In general, however, the crisis exposed the fact that fossil fuel markets are volatile and vulnerable to shocks. Investors in hydrocarbons might for example seek to diversify risk, and see the returns on lower-carbon options as more attractive.

A third element, indirectly related to (and a consequence of) the first two, regards the effects of the economic contraction on cleaner energy options. Negative effects on the otherwise growing RES capacity have already been forecast for 2020 and a further drop has been anticipated for 2021 as well,[15] depending on the duration of the crisis. The more globally interconnected the chains are (as is the case for solar PV), the more likely they are to suffer from disruptions, even though for the time being this contraction has been quite limited. Delays in supply of components or construction might put companies at risk of missing deadlines/financial incentives, a number of which are set to expire at the end of 2020. Utilities might also tighten their budgets and defer building new plants.[16] In the longer term, countries, including in the EU, might be tempted to rely on shorter and diversified supply chains, potentially increasing the chains' reliability but also seeing a rise in the costs of RES.[17] The shortening of value chains is not to be ascribed to COVID-19 alone, as it is entrenched in a growing trend of neo-protectionism, or more precisely turbulence in the institutional infrastructure and policies of international trade. In spite of a foreseen decline in RES capacity installation in 2020 compared to 2019, RES have nonetheless shown impressive resilience so far compared to hydrocarbons. Since they are more cost-effective than ever, prioritising them in

[14] The drop in energy demand at the moment had a less important impact on RES, both because demand for electricity (supplied by greater shares of RES) has been less affected than that for transportation (primarily supplied by oil) and because of the merit order of the electricity market, which in EU countries, for example, has less of an impact on RES.

[15] Cameron Hepburn et al., "Will COVID-19 Fiscal Recovery Packages Accelerate or Retard Progress on Climate Change?", in *Oxford Review of Economic Policy*, 8 May 2020, https://doi.org/10.1093/oxrep/graa015.

[16] Heymi Bahar, "The Coronavirus Pandemic Could Derail Renewable Energy's Progress. Governments Can Help", in *IEA Commentaries*, 4 April 2020, https://www.iea.org/commentaries/the-coronavirus-pandemic-could-derail-renewable-energy-s-progress-governments-can-help.

[17] Luca Franza, "Is Coronavirus Good for Our Sick Planet?", in *IAI Commentaries*, No. 20|13 (March 2020), https://www.iai.it/en/node/11432.

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economic recovery packages actually constitutes a crucial opportunity to push the world closer to the Paris Agreement goals.

These global dynamics have *per se* an impact on the Mediterranean as part of the global energy market; but a number of risks and opportunities specific to the northern and the southern shores of the Mediterranean can also be identified.

2.1 Risks and opportunities on the southern shore

Most of the area's oil and gas producers are about to go through a period of decline in their revenues. The combination of low prices and low trade volumes will be more dramatic for countries that were already experiencing economic and political troubles before the pandemic. Stagnating economic activity is already a major concern in many countries – such as in Algeria, whose economy is now forecast to contract by 5.2 per cent.[18] Among producing countries there are some – such as Libya – whose already precarious security and political conditions are further deteriorating.[19] Oil and gas producing countries in the wider MENA area are in general all exposed to these effects.[20] Limited fiscal buffers, high fiscal breakeven and rigid expenditure structures do not help, and are worsened by uncertain energy scenarios – doubts over future demand, oversupply, international dynamics (i.e., the possibility that China will soon buy more oil and gas from the US). For the area's importing countries, such as Morocco, Lebanon or Jordan, the drop in oil and gas prices is creating pressures related to dependence on the economies of fossil fuel producing countries in terms of foreign direct investment and tourism – and is only slightly reducing their energy bill.[21]

The collapse of crude prices might in a number of ways catalyse a faster energy transition, giving a push to transformative trends in the sub-region that might fast-forward a future of structural decline for fossil fuels for both exporters and importers.

First, the volatility of fossil fuels and their vulnerability to shocks might encourage exporters to diversify away from them – making policy-makers more aware of the fragility of the system and pushing RES as a viable solution. Already in the past decade MENA exporters have witnessed a rapidly rising domestic demand, and consequently growing shares of production were diverted away from exports. With demand and price shocks, the rationale to diversify becomes more evident and some countries may be pushed to meet domestic energy demand by using more

[18] International Monetary Fund (IMF), *Regional Economic Outlook: Middle East and Central Asia*, April 2020, https://www.imf.org/en/Publications/REO/MECA/Issues/2020/04/15/regional-economic-outlook-middle-east-central-asia-report.

[19] Ibid.

[20] Luca Franza, "Power Shifts and the Risk of a 'Crisis Within the Crisis': COVID, Oil and the MENA Region", in *IAI Commentaries*, No. 20|36 (May 2020), https://www.iai.it/en/node/11631.

[21] Ibid.

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RES, although the extent to which this is realistically achievable depends on several other factors.[22] Considering the declining costs of major renewable technologies, and the many fast environmental and health benefits RES could bring, the case for the transition gets even stronger. Compared to price shocks in the past, today countries and players are forced to think about the decline in oil and gas revenues in structural terms – which may facilitate acceleration in RES investment.

Secondly, fossil fuel subsidies are still a burden for the budget, reaching around 10 per cent of GDP in a number of countries, including Algeria (9.5 per cent) and Egypt (11 per cent).[23] Despite the potential economic and environmental gains, energy price reform is a politically sensitive topic in resource-rich countries and reforms are usually difficult to undertake. However, periods of low oil and gas prices constitute the right time to pursue a gradual lifting of oil and gas subsidies as the negative effect of market price adoption will be felt less. The opportunity to redirect financial resources from subsidisation to more essential and cleaner options in the area might in this sense find momentum in the crisis.

2.2 Risks and opportunities on the northern shore

In 2020 the EU economy will experience a strong recession.[24] The pandemic has hit all member states (with southern EU countries hit faster and harder). While before the outburst of COVID-19 2020 had been announced as a crucial year for the EU climate action, recently some member states have already called for the ambitious EU climate measures to be scrapped – notably some Eastern European countries. It is thus evident that the Commission might likely have less leeway to shape climate trajectories of member states or might also experience a weakened geopolitical grip on multilateral climate action and talks.

Understandably, responding to the broad financial distress has constituted the utmost priority for governments and institutions since the outbreak of the pandemic. Slight delays along the Green Deal roadmap were announced, because a number of measures and targets cannot be assessed and adopted before the full implications of the crisis are known. Much more interesting than the short-term responses (rescue plans) are the prospects for the re-launch phase (recovery plans), which may bring an economic modernisation along decarbonisation priorities,

[22] RES potential is not spread equally in the region and some countries might more efficiently generate certain types of clean energy than others. Countries might face a "buy or make" decision, a choice between cheaper imports from areas with more favourable conditions (and lower costs) and greater security of supply guaranteed by domestic production (albeit potentially less cost-efficient). Specialisation in certain aspects of RES where a country has a comparative advantage based on endowment, technology, costs and transport options, is more likely. For a wider analysis on this please see: Luca Franza, Margherita Bianchi and Luca Bergamaschi, "Geopolitics and Italian Foreign Policy in the Age of Renewable Energy", cit.

[23] S. Duygu Sever, "Accelerating the Energy Transition in the Southern Mediterranean", cit.; IEA, *Fossil Fuels Database*, 2019, https://www.iea.org/data-and-statistics.

[24] European Commission, *Spring 2020 Economic Forecast: A Deep and Uneven Recession, an Uncertain Recovery*, 6 May 2020, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_799.

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both internally and in the EU's cooperation engagement.

The pandemic coincides with member states having to agree on the EU 2021–27 budget, the negotiation over which has become more difficult due to stronger polarisation over the size and nature of recovery plans. From what has emerged from the Commission's proposals at the end of May,[25] the green and digital dimensions – crucial for the energy transition – are given centre stage. It remains to be seen if a strong focus and major money flows to recover the EU would mean less attention and financing being directed towards the wider Mediterranean area, but at the moment the Commission recognises the need to strongly sustain the transformation of the overall region.

Despite the economic scale of the COVID-19-caused crisis is set to be greater than that of the 2008–09 Great Recession, many look at how EU climate resources were impacted more than one decade ago, when too little attention was given to rebuilding a greener economy. There are however a number of differences. A lot has changed since then in the world of energy (i.e., the drop in the cost of RES has accelerated) and there is better awareness on the economic benefits of cleaner technologies and energies. Shaping the global recovery from the pandemic in a way that it tackles climate change is also strongly backed by leading experts.[26] With the Green Deal launched as an economic modernisation strategy and EU discourse progressively including the securitisation of climate change, there are better "green" premises for the upcoming recovery choices of the EU. The proposed recovery instrument – Next Generation EU – alongside a reinforced budget seems to have green strings attached, although clarity will only come once the full EU legislative process is over.

The drop in hydrocarbon prices impacts the northern shore as well. Northern countries of the Mediterranean show a much higher fossil fuel import dependency rate than those in the south (61 per cent compared to 17 per cent in 2017).[27] The contraction in crude oil prices might in the short run have a positive impact for economies like Italy and increase the appeal of fossil fuel consumption in the recovery phase. However, the vulnerability to disruptions and volatility are growing security concerns for importing countries as well, ultimately strengthening the case for stronger diversification. On the northern shore the possible elimination of fossil fuel subsidies – around 100 billion euro per year in Europe[28] – might also further increase RES penetration.

[25] European Commission website: *Recovery Plan for Europe*, https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/recovery-plan-europe_en.

[26] Cameron Hepburn et al., "Will COVID-19 Fiscal Recovery Packages Accelerate or Retard Progress on Climate Change?", cit.

[27] Confindustria Energia, *Infrastrutture energetiche per l'Italia e per il Mediterraneo*, cit., p. 46.

[28] Carlo Papa and Nicolò Sartori, "L'Europa e il Recovery Fund, ripartire da un settore elettrico sostenibile e resiliente", in *Euractiv*, June 2020, https://euractiv.it/?p=5703.

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Conclusion

Going "back to normal", e.g., the pre-COVID-19 energy environment – provided this is possible – is not the best solution for a region such as the Mediterranean basin, which is particularly affected by climate change and commodity price volatility. Responses to the various crises that have resulted from COVID-19 might either create incentives to kill two birds with one stone – pursuing sustainability and prosperity at the same time – or further lock the region in an unsustainable development pathway. The COVID-19 crisis offers opportunities for transformative policies on both the northern and the southern shore of the Mediterranean, including those unlocked by green recovery packages and stronger external cooperation promoted by the EU, the incentive for countries to diversify from volatile commodities and the possibility to promote a reform of fossil fuel subsidies.

Due to both its geographical and industrial potential, Italy remains a key player in plans to promote a Euro-Med energy transition. Its commitment to maintaining a high level of ambition for EU energy and climate policies in the neighbourhood while also promoting an orderly transition on the southern shore should remain a priority. As part of the EU, and having longstanding relationships with many countries on the southern shore, Italy is well placed to promote changes. Italy also has an advantaged standpoint to lead international climate action in the upcoming months as in 2021 it will host the preliminary meeting of the Conference of the Parties to the UN Framework Convention on Climate Change (COP26) as well as the G20 summit, both critical for defining the global response to the many challenges created by the COVID-19 pandemic.

While massive clean investments in the region are needed and welcome, the rising involvement of non-EU countries in energy investment in the area does not always focus on sustainable solutions. China's investments in coal (i.e., in Morocco and in the Western Balkans) or Russia's investments in nuclear energy (i.e., in Egypt and Turkey), might have effects – starting from coal lock-ins or nuclear proliferation – that are not in the interest of Italy, Europe and the Mediterranean region as a whole. The growing engagement of third countries is also a warning that Italy and the EU should not be taking for granted their strategic importance in the region, including in the area of clean energy. With vision and ambition, Italy can expand its comparative advantage in RES, also creating opportunities for Italian RES players throughout the Mediterranean region and new bonds of positive interdependence with countries of the southern shore.[29]

Updated 20 July 2020

[29] See wider analysis on Italy and its foreign policy in the age of renewables in Luca Franza, Margherita Bianchi and Luca Bergamaschi, "Geopolitics and Italian Foreign Policy in the Age of Renewable Energy", cit.

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