POLICY BRIEF

High Oil Prices: Undermining Debt Cancellation and Fueling a New Crisis?

Time for a Clean Energy Revolution

JULY 2006

Introduction

Soaring oil prices are undermining the benefits of debt cancellation and putting serious stress on many of the world's most impoverished countries. On July 7, 2006, the market price of oil hit an all time record high of $75.70 a barrel, up from only $19.70 in December 2001. Adjusted for inflation oil is now more expensive than at any time since 1980, and the rising cost of oil imports is draining far more money out of impoverished countries than debt cancellation is contributing each year. As a result, there is a very real risk that countries will be dragged further into debt.

This is not the first time that volatile oil prices have played a role in exacerbating debt. The oil shocks of 1973-74 and 1979-80 played a central role in triggering the modern debt crisis and clearly exposed the dangers of oil dependence. Unfortunately, the world's industrialized countries chose to respond to the oil shocks of the 1970s by focusing their efforts on increasing oil supplies rather than overcoming their oil addiction. As a result, an entire generation of potential progress was lost and volatile oil prices are once again threatening to undermine impoverished countries.

Today the stakes are higher than ever. Global warming threatens us all, but it is impoverished countries that are most vulnerable to its impacts. A new energy revolution is needed, one that focuses on promoting a just transition away from oil dependence and towards energy efficiency and sustainable alternatives. We need a global strategy that will take oil out of the debt equation once and for all, including more and faster debt cancellation as well as programs that are focused on overcoming energy poverty in a truly sustainable way.

Unfortunately, many governments around the world are once again arguing that the solution to our oil addiction is more oil (that if we increase and protect the supply of oil and gas then prices will fall and all will be well with the world)! This approach, which is in part reflected in the draft *Plan of Action on Global Energy Security* that G-8 leaders are preparing to endorse at the July 2006 St. Petersburg Summit, will not address the role that oil plays in exacerbating the debt crisis nor will it help lift billions of people out of energy poverty. Using public resources to subsidize the expansion of the oil and fossil fuel industry will feed overconsumption in the North, fuel global warming, and increase international tensions without generating long-term alternatives. As outlined in the following brief,

TABLE 1: The Impact of Higher Oil Prices on Select Highly Indebted Countries

Country	Estimated Cost of Oil to Country in 2002 (US$)	Projected Cost of Oil to Country in 2006 (US$)	Increase in Annual Cost of Oil to Country 2002-2006 (US$)	Projected Debt Savings from IMF/WB in 2006 (US$)
Tanzania	189 million	480 million	291 million	140 million
Ethiopia	231 million	589 million	358 million	78 million
Malawi	47 million	119 million	72 million	40 million
Rwanda	51million	131 million	80 million	38 million

These numbers are a sub-set of a broader range of figures compiled by the Center for American Progress. Cost of oil to country in 2002 is calculated using CIA World Factbook figures for estimated 2003 country consumption levels and the average of 2002 weekly crude oil prices provided by the Energy Information Administration of the Department of Energy, or $23.47/bbl in 2002 dollars. Inflation since 2002 is assumed to be negligible. Predicted world price for 2006, $59.76/bbl in 2006 dollars, is the average of 2006 weekly world crude oil prices as of June 1, 2006 as provided by the Energy Information Administration of the Department of Energy.]

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there is an urgent need to challenge G-8 plans to increase support for the oil and fossil fuel industry and to call on governments around the world to focus international efforts on strategies that will simultaneously address energy poverty, crushing debt and global warming.

Lessons Learned? The "Oil Shocks" of the 1970s

There is no single event or cause that can explain the complicated series of factors that came together to generate the modern debt crisis, but the relationship between oil and debt is well established. More than 25 years ago the world was rocked by a series of "oil shocks" that sent the price of oil through the roof and triggered a global recession. The world's most impoverished countries scrambled to find resources to cover the mushrooming cost of oil imports, "petrodollars" flooded the international banking sector, and lenders went on an irresponsible lending binge. There were a lot of other factors at work, including fluctuating interest rates, diminishing terms of trade, and a host of issues related to historical and ongoing injustices in the global economy, but it is clear that the oil shocks of the 1970s played a key role in triggering the modern debt crisis.

In the wake of the second oil shock of 1979-80, one could have reasonably expected the world's leaders to learn the lessons that the 1970s so clearly offered. Volatile oil prices had helped to cripple the world's economy and expose the dangers that oil dependence posed for both over consuming countries of the North and impoverished countries alike. There was an opportunity to chart a new course, one that focused on energy independence based on the sustainable use of renewable energy and dramatic improvements in energy efficiency. This path held out the opportunity of removing oil from the debt equation while simultaneously offering a long-term solution to the many problems associated with oil production. Instead, governments embraced the idea that the solution to the world's oil addiction was `more oil' and, as a result, an entire generation of potential progress was lost. Today another oil shock looms as impoverished countries are faced with rapidly rising oil bills.

Another Oil Shock?

When adjusted for inflation, oil prices are at their highest point since the last oil shock of 1979-80. The price of a barrel of oil is up by more than 350 percent over the past four-and-a-half years, a $55 per barrel increase since December 2001. The International Energy Agency (IEA), the International Monetary Fund (IMF), the United Nations Development Program (UNDP) and the World Bank have all expressed concern that oil price increases would seriously harm the world economy and, in particular, the economies of low-income countries that import all or most of their oil. Studies by these organizations predict that sustained oil price increases of as little as $10 would seriously harm the economies of oil-importing impoverished countries by, among other things, causing a significant decline in Gross Domestic Product (GDP).[1]

In 2005, the IEA predicted that the cost of sub-Saharan Africa's oil imports would roughly double to about $20 billion a year if oil prices stayed above $55 a barrel (oil prices are currently hovering between $70 and $75 a barrel). This would represent an additional $10.5 billion per year in oil payments, which is more than ten times the amount that all 16 African countries combined are expected to receive after the cancellation of their World Bank, IMF and African Development Fund debts in 2006 under the G-8 deal.[2]

Nicaraguan economists have also raised serious concerns about oil price increases. "According to figures from the Nicaraguan Central Bank, the government will spend $717 million on oil imports in 2006 … which is a whopping 66% of income generated by all the country's exports."[3] This means that Nicaragua will spend about $180 million more for oil in 2006 than it did in 2005 (for roughly the same amount of oil). This additional $180 million is more than three times the $49 million that will be freed up

Debt and Oil in Tanzania:

Tanzania is an example of a country that has put resources freed up by debt cancellation to good use. According to the 2005 UK Africa Commission report, Tanzania has increased funding for poverty reduction expenditures by 130% over the last six years. Tanzania focused its savings on increasing education spending and eliminating school fees for elementary school in order to encourage kids to go to school. Almost overnight an estimated 1.6 million children were back in class. By 2003, school enrollment had grown by 3.1 million and universal primary education was within sight. Debt cancellation is working in Tanzania.

Unfortunately, the additional resources at Tanzania's disposal as a result of debt cancellation are being dwarfed by the rising cost of oil imports. According to figures compiled by the Center for American Progress (CAP), the cost of Tanzania's oil imports rose from roughly $190 million in 2002 to about $480 million in 2006, representing an additional $290 million in payments each year for roughly the same amount of oil. Conversely, debt cancellation is expected to free up roughly $140 million in Tanzania in 2006, less than half of the additional amount that the country is paying for oil imports each year. Similar trends on the impact of rising oil prices can be detected in a variety of countries around the world. Research conducted by the Mali Folkecenter estimates that Mali has gone from spending roughly $100 million per year on oil imports in 1998 to almost $400 million in 2005.

by Nicaraguan debt cancellation in 2006. Nicaraguan economists have issued warnings about the impending collapse of the national energy sector and the "imminent economic collapse of several sectors of Nicaraguan industry as well as some sectors of tourism and trade"[4] as a result of historically high oil prices.

High oil prices are undermining the economies of impoverished oil importers in a range of ways, and could force countries to take on more loans to pay for their higher energy bills, thereby creating more debt. They could also stop countries from enjoying much-needed benefits from debt cancellation. Additional resources to fight HIV/AIDS, to provide support for small-scale farmers, and to improve primary education are at risk of disappearing as increasing oil bills continue to eat away at impoverished countries' limited resources.

The G-8 Strategy: Feed the Oil Addiction!

The oil shocks of the 1970s clearly exposed the dangers of oil addiction, but rather than learn from these events and focus on transitioning away from oil dependence, the G-8, Northern governments and international institutions like the World Bank have spent the past 25 years subsidizing the expansion of the international oil industry. They have directly transferred funds to oil corporations through grants, loans and equity infusions and have provided generous tax credits and other fiscal incentives. At a global level the bilateral aid programs and export credit agencies of Northern governments have been used to help international oil companies expand production and feed Northern markets. Similarly, the World Bank Group and other international financial institutions have not only lent billions of dollars to oil companies, they have also used structural adjustment programs to liberalize oil sectors and create an investment climate that is friendly to the interests of international oil companies.

The True Price of Oil

Despite hundreds of billions of dollars in subsidies and untold diplomatic and military support for the activities of oil corporations over the past 25 years, we find ourselves today in the midst of yet another oil shock. The economies of impoverished oil importers are once again under stress and, as the world gradually comes to terms with the true price of oil, the stakes are higher than ever. The true price of oil ultimately goes beyond the increasingly high market cost of fueling cars, running generators and transporting goods to market. It includes the livelihoods of communities in oil producing regions that have lost access to clean water and productive land. It includes authoritarian regimes that use oil revenues to maintain repressive states and the complicity of many countries that choose to remain silent about this repression rather than risk losing access to oil. It includes oil wars and low-intensity conflicts that have cost thousands of lives and billions of dollars. And it includes the mounting costs of global warming and climate chaos.

Unfortunately, G-8 leaders are developing an "energy security" strategy that fails to take into account either the lessons of the past or the dangers that the world is currently facing. Last year, the G-8 focused on mitigating the impacts of climate change and canceling debt. This year in St. Petersburg the G-8 will focus on promoting trillions of dollars of investment in fossil fuels, which will exacerbate climate change and fail to promote long-term alternatives to the role of volatile oil prices in debt creation.

A leaked G-8 draft *Plan of Action on Global Energy Security* reveals that the Saint-Petersburg Summit, scheduled to take place from July 15-17, 2006, will focus first and foremost on feeding the world's oil and fossil fuel addiction. The G-8 draft

Global Warming Hits the Poor Hardest

Global warming, primarily fueled by over-consumption in the North, will have a devastating impact throughout the Global South, claiming hundreds of millions of lives and reversing poverty alleviation gains in many impoverished countries.

- Christian Aid predicts that 185 million people in Sub Saharan Africa alone could die of disease directly attributable to global warming by the end of the century

- Global warming also makes natural disasters worse, causing more droughts in dry areas and more floods in wet tropical areas, and 97% of natural disaster deaths occur in the South. "Poor people are the ones who suffer the most when extreme weather strikes. They may not have access to formal information networks that could alert them that a storm is coming; they tend to live on land that is more susceptible to storms and flooding because they cannot afford to live anywhere else; and they often depend on the land for their livelihoods, land vulnerable to severe weather."

- But there is hope - a turn away from carbon-based energy to renewables would help stop climate change.

Source: Christian Aid, The Climate of Poverty: Facts, Fears and Hopes, May 2006

Plan of Action argues that trillions of dollars of investment will be needed over the next 25 years in order to create a shock-proof system of global energy supply and it outlines the G-8's intention to work together to create "an environment for the effective mobilization of these huge sums." The G-8 is calling for a global effort to reshape regulatory regimes and remove "unjustified administrative barriers". According to the draft Plan of Action, these legal and regulatory changes will help create the conditions for the private sector to:

- find new reserves of oil and gas at a faster rate than the existing reserves are depleted;
- increase oil and gas output by, among other things, more drilling on the continental shelf;
- expand production capacity in oil-refining, petrochemical and gas processing industries; and
- develop new electric power facilities, with an emphasis on nuclear and hydro-power plants.

The draft *Plan of Action* also references the importance of fighting climate change and promoting renewable energy and energy efficiency, but the core proposals revolve around expanding and securing access to fossil fuels. By seeking to both subsidize the expansion of the oil and fossil fuel industry and simultaneously play a role in the struggle against climate change, G-8 programs are ultimately working at cross purposes.

Time for A New, Clean Energy Revolution

The world is standing at an energy crossroads and the decisions that are made over the next few years will either lock us into a self-destructive path for decades to come or send us in the direction of long-term solutions. Now more than ever, we need vision and leadership from our leaders. Energy security and energy poverty are serious issues that deserve and demand the world's attention, but we cannot overcome energy poverty or achieve lasting energy security if we continue on the road that we are on today.

The problems of oil addiction and debt cannot be solved by relying on the same kinds of approaches that helped to create them. The solution to the ongoing oil crisis is not more oil, and increasing supplies will not help highly indebted oil importers overcome their dangerous dependence on foreign oil. Similarly, energy security will not be achieved by using public institutions to subsidize the expansion of the international oil industry or by militarizing oil supplies. Public resources should be focused on supporting truly sustainable energy solutions that will help to minimize our reliance on oil, maximize the potential of renewables, and put an end to the unacceptably high price that the world is currently paying for its addiction to oil.

Alternatives are available. Public resources should be focused on supporting the widespread adoption of new renewables such as wind, solar, small hydro, geothermal and biofuels, as well as urgently addressing wastage and overconsumption in much of the world. History shows that improvements in energy efficiency and the adoption of sustainable alternatives will have a major impact on the rising market price of oil. Supporting alternatives will also accelerate the transition away from oil and help to mitigate the many problems that are associated with its production and consumption.

With this in mind, we are calling on the G-8, Northern governments and international institutions to:

- **End direct and indirect subsidies to the oil industry and other fossil fuels**. Northern governments and international institutions must stop subsidizing fossil fuels under the guise of development assistance. Public support for the expansion of the international oil industry has historically served to promote the interests of international oil corporations while fueling conflict, climate change, and local social and environmental damage.

- **Dramatically increase support for energy efficiency and new renewables**. By focusing limited public resources on new renewables and energy efficiency, governments and international institutions can work to address energy poverty while simultaneously helping to set the stage for a new energy revolution.

- **Cancel all unjust and unfair debts and adhere to responsible financing standards moving forward to avoid a new debt crisis re-emerging**. Cancellation of unfair and unjust debts should begin with an audit of potentially odious and illegitimate loans made for oil extraction. Responsible financing standards could help to avoid the reaccumulation of new, odious debts, and move creditors towards financing for renewables rather than fossil fuels.

Resources for More Information

Center for American Progress, Our Addiction to Oil is Fueling World Poverty, April 6, 2006
www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=1533171

Christian Aid, *The Climate of Poverty: Facts, Fears, and Hope*, May 2006.
www.christianaid.org.uk

Institute for Policy Studies, *The Debt Boomerang: How Americans Would Benefit from Cancellation of Impoverished Country Debts* (see Boomerang 3: Global Warming), March 2006
www.ips-dc.org/boomerang/DB2006.pdf

Institute for Public Policy Research, Oil Change International and Jubilee USA Network, *Drilling Into Debt: An Investigation into the Relationship between Debt and Oil*, June 30, 2005,
www.priceofoil.org

Organizations for More information:

Jubilee USA Network: www.jubileeusa.org
Oil Change International: www.priceofoil.org
Friends of the Earth: www.foe.org
Rainforest Action Network: www.ran.org
Bank Information Center: www.bicusa.org
African Network on Debt and Development (AFRODAD): www.afrodad.org
Jubilee South: www.jubileesouth.org

Endnotes

1 The IEA study estimated impacts on GDP, inflation and Trade Balance (as a percentage of GDP) of a $10 oil price increase, from a base price of $25, after one year. The International Energy Agency (IEA), "Analysis of the Impact of High Oil Prices on the Global Economy," May 2004; United Nations Development Program (UNDP)/ World Bank Energy Sector Management Program (ESMAP), "The Impact of Higher Oil Prices on Low Income Countries and the Poor," March 2005. UNDP and World Bank ESMAP, "The Vulnerability of African Countries to Oil Price Shocks: Major Factors and Policy Options - The Case of Oil Importing Countries," August 2005.

2 It is estimated that the G-8 deal will result in total savings of $1 billion per year over 40 years *by all 21 countries* that will have their debts canceled in 2006, which includes four countries in Latin America. Chris Giles and Kevin Morrison, "Oil Prices Could Undercut Debt Relief for Africa, Agency Says," Business Day (South Africa), July 4 2005, available at www.businessday.co.za/articles/article.aspx?ID=BD4A63882; and HIPC Status of Implementation Reports, International Development Association (IDA) and International Monetary Fund (IMF), August 2005 & April 2006.

3 Hannah Given-Wilson, "Nicaragua News Service," Service of the Nicaragua Network (www.nicanet.org) Volume 14, Number 15, April 18-24, 2006.

4 Ibid

About Jubilee USA Network

Jubilee USA Network is the US arm of the international movement working for impoverished country debt cancellation and right relationships between nations. Jubilee USA is a network of more than 75 religious denominations, diverse faith communities, environmental organizations, community groups, research institutes, and solidarity organizations. Jubilee USA engages in public education and mobilization, research and policy analysis, and advocacy.

About Oil Change International

Oil Change International campaigns to expose the true costs of oil and facilitate the coming transition towards clean energy. We are dedicated to identifying and overcoming political barriers to that transition.

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