DRILLING INTO DEBT

An Investigation into the Relationship Between Debt and Oil

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Executive Summary

Prime Minister Tony Blair is planning to discuss climate and development in Africa at the G8 Summit in Scotland. The external debt of developing countries is already very much on the table. In addition the G8 Finance Ministers have also indicated that they want to talk about oil, specifically oil prices. If the G8 nations, and the world, want to seriously tackle climate change, poverty, and debt, its time to look deeply at the common thread between all of them: oil.

This investigation focuses on debt and oil, and exposes the very real relationship between them. In short, this research documents an energy strategy for the G8 which is fundamentally at odds with a development strategy for the rest of the world.

In their June 11 communiqué, the G8 Finance Ministers not only announced debt relief for 18 countries, they also stressed their commitment to the "elimination of impediments to private investment" in Africa. Oil and minerals are traditionally at least 60% of foreign direct investment in Africa – and much higher in certain countries. West Africa is widely regarded as one of the priority areas for investment by the oil industry, and oil production from the region is universally projected to rise. As this paper shows, the G8 commitment to growth via private investment, and specifically the oil industry, is cause for concern.

Drilling into Debt is the first study to rigorously examine the relationship in between oil and debt. To do so, we have collected data on 161 countries for the period 1991-2002, and collected further data on 88 developing countries for the period 1970-2000 for use in a statistical model of debt burdens. We have supplemented that analytical exercise with additional research, in order to shed light on the policies that led to the current situation.

Our key findings are

1. **Increasing oil production leads to increasing debt.** There is a strong and positive relationship between oil production and debt burdens. The more oil a country produces, regardless of oil's share of the country's total economy, the more debt it tends to generate.
2. **Increasing oil exports leads to increasing debt.** There is a strong and positive relationship between oil export dependence and debt burdens. The more dependent on oil exports a country is, the deeper in debt it tends to be.
3. **Increasing oil exports improves the ability of developing countries to service their debts.** There is a strong and positive relationship between oil exports and debt service. The global oil economy improves the ability of countries to make debt payments, while at the same time increasing their total debt.
4. **Increases in oil production predict increases in debt size.** Doubling a country's annual production of crude oil is predicted to increase the size of its total external debt as a share of GDP by 43.2 per cent. Likewise, the same change is predicted to increase a country's debt service burden by 31per cent. For example, the Nigerian government currently plans to increase oil production by 160% by 2010. Past trends indicate that Nigeria's debt can thus be expected to increase by 69%, or $21 billion over the next six years.
5. **World Bank programs designed to increase Northern private investment in Southern oil production have instead drastically increased debt.** Northern multilateral and bilateral "aid" for oil exporting projects in the South has exacerbated, rather than alleviated debt. Specifically, an examination of those countries where the World Bank Group conducted "Petroleum Exploration Promotion Programs" (PEPPs) reveals debt levels (debt-GDP ratios) in those countries that are 19% higher than those countries that did not undergo this form of structural adjustment.
6. **The relationship between debt & oil is most likely caused by the interplay in between three factors:**
    a. Structural incentives for and direct investments in the oil industry by multilateral and bilateral institutions, such as the World Bank Group and export credit agencies.
    b. Oil fueled fiscal folly – both in the North by creditors over eager to lend to nations perceived as oil rich, and in the South by unwise fiscal policies.
    c. The volatility of the oil market.

A previous report, published in 2004 by the Institute for Policy Studies[1], demonstrates how multilateral support for oil is consistent with an agenda to diversify oil supplies for Northern consumption, and open Southern reserves to Northern corporate investment. It also noted that 82 percent of all oil extractive projects funded by the World Bank Group since 1992 are export-oriented, and primarily serve the energy needs of the North, not the South.

Countries that produce oil tend to be poorer and less productive economically than they should be, given their supposed blessings. This has been well documented over the last decade. Further research has confirmed that oil export-dependent states tend to suffer from unusually high rates of corruption, authoritarian government, government ineffectiveness, military spending, and civil war.[2]

Coupling these previous efforts with our key findings we see a disturbing picture of a global oil economy that primarily serves the interests of Northern consumers, creditors, and governments, while running counter to the interests of poverty alleviation, development, and a stable climate in the rest of the world.

We incorporate these analyses into our own, and make the following recommendations:

1. **End Oil Aid.** OECD countries should end Northern governmental subsidies for new oil projects in the South. Such projects have not historically provided energy for the poor, and are proven to be associated with increases in poverty, conflict, and debt, and to increase the risk to the poorest from climate change. They cannot be considered aid.
2. **Reserves, revenues, and contracts transparency.** We applaud the G8 Ministers for calling for the establishment of a "global framework for the reporting of oil reserves". This mechanism should be mandatory, uniform, and fully transparent, as should similar mechanisms for oil revenues and contracts transparency.
3. **Support for renewable energy and efficiency should be dramatically increased.** These technologies will provide energy for those who need it, while tackling poverty, debt, and climate change.
4. **The G8 should immediately cancel 100% of the remaining multilateral and bilateral debt** without requiring that countries join the HIPC (Heavily Indebted Poor Country) initiative, or imposing any additional harmful economic conditions.
5. **Development aid to oil exporting countries should concentrate on economic diversification** in order to minimize debt burdens from excessive oil export dependence.
6. **G8 Ministers should commit by their next meeting to a global harmonization of energy and development strategies in light of global warming, debt, poverty, and peak oil.** The issues should henceforth be viewed as inextricably woven together.

Some will undoubtedly read this research as further evidence of the urgent need for revenue transparency and anti-corruption measures regarding the extractive industries in the developing world. While this research certainly supports those claims, we are highly skeptical of the ability of the current, non-mandatory, version of the Extractive Industries Transparency Initiative (EITI) to deliver on much, except to make oil companies and governments look good.

More fundamentally, we ask, at what point do we recognize that oil has not, and is unlikely to, work as a path to prosperity? Our global continued dependence on oil is clearly changing the climate, and placing the poorest – particularly in Africa - at the front lines of global warming. If Tony Blair and other G8 leaders are serious about tackling global warming and development problems in Africa, they need to be willing to look at the common factor that causes both – oil.

Each country has a right to its share of the global commons, just as each country has the right to choose its own development path. Implementing the recommendations above would go a long way towards ending ongoing economic coercion and opening up new choices for people and our planet.