Alternative Eurozone Bailout

Why the world's energy exporters should be coming to the rescue.

BY PHILIP K. VERLEGER, JR.

Countries that rely on hydrocarbons for part of their export earnings—such as OPEC members, Russia, Australia, and Canada—earned more than $1.5 trillion from such sales in 2011. These incomes may be halved in 2012 and 2013. In fact, exporting nations could earn less than $500 billion collectively in 2012. The threat to their short-term income comes from Europe's dire financial situation. Energy-exporting countries have greater financial exposure to this than any other nation. The exporters could, however, work together to help prevent the region's economic collapse. What's more, they could probably pull off this *deus ex machina* with relatively little risk to themselves.

Europe's economic problems have been well chronicled, especially during the last months of 2011. Every leading economist has written on the issue. Many have become regular commentators. The general consensus is that most EU members are solvent. However, Greece's severe problems have undermined confidence in European banks. The banks, in turn, have become increasingly reluctant to lend to many Economic and Monetary Union members except at usurious rates. At the same time, several northern EMU members, led by Germany, have demanded that all EU members (or at least the EMU) institute aggressive austerity packages. The consequence of such belt-tightening plus the weakened banks can only be a serious recession for Europe, one that far exceeds the relatively benign end-of-year economic forecasts.

Europe's problems could be partially alleviated by lending from an outside source. A purchase of bonds issued by solvent EU members (all but Greece as of this writing) that totaled €500 billion to €1 trillion during 2012 would go a long way to moderate the crisis. Such buying would drive down the borrowing costs of the EU members most seriously affected by recent events (Spain, Italy, and Ireland, for example). In turn, the lower rates would boost confidence, facilitate additional government expenditures, and possibly even prevent severe recession.

The nations that would benefit most from such an outcome are the energy exporters and, believe it or not, possibly Germany. Energy-exporting countries have more at risk than any other participant in the world economy. Global economic growth will slow if the euro crisis plunges Europe into deep recession. Oil and natural gas prices will surely plummet if this occurs. The incomes of energy-exporting nations will fall off a cliff as they did in 2009. Germany will suffer as well because its export-oriented economy earns more from oil-exporting nations than from China.

Philip K. Verleger, Jr. is President of PKVerleger LLC.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

The price collapse impacts that followed Lehman Brothers' failure are instructive. Between June and December 2008, crude oil prices dropped from $144 to $34 per barrel. Between 2008 and 2009, EU natural gas prices fell 30 percent because they were linked to oil prices. The price falloff, combined with declining sales, reduced energy exporter incomes. OPEC member revenue went from almost $1 trillion to less than $600 billion between 2008 and 2009, according to the U.S. Department of Energy. Russia suffered as well as its export revenues nosedived 35 percent between 2008 and 2009.

These losses, as bad as they were, could have been worse. OPEC members could have seen their 2009 incomes fall to $400 billion or $300 billion had consuming nation governments not engaged in a massive relief effort. For example, the United States' American Recovery and Reinvestment Act of 2009, the U.S. Treasury's Troubled Asset Relief Program, and the Federal Reserve's quantitative easing combined to moderate and shorten the global economic downturn. Oil and gas prices quickly recovered from their lows as use picked up and traders took advantage of very low interest rates to build inventories. The recovery raised demand for OPEC exports by 2.5 million barrels per day, while the inventory accumulation financed by the Federal Reserve easing boosted those exports another two million barrels. OPEC revenues recovered as the call for its oil rose.

A European economic collapse in 2012 would be very different. Global oil and gas use would drop as economic activity slowed. World consumption would remain depressed, perhaps even dropping by significant amounts, through 2012, 2013, and possibly 2014 due to the absence of stimulus programs similar to the U.S. recovery act. Instead, European countries, and possibly the United States, would try to outdo each other's austerity programs. Worse still, global inventories would likely fall as banks cut credit lines to trading firms that usually hold such stocks.

In short, a serious European recession that became a global "contagion" would be very bad for energy-exporting nations. It could be even worse for countries confronting the second year of the Arab Spring.

Fortunately, energy exporters can help stave off a European-based contagion. They can use their liquid financial assets to buy debt issued by various EU countries. For instance, OPEC members, Russia, Australia, and Canada own $441 billion in U.S. Treasury assets (€340 billion). They also no doubt hold other assets that may be redeployed. These assets could be sold and the funds used to purchase EU nation bonds. If energy exporters acted quickly, they could buy roughly half the EU debt scheduled for issue in 2012.

Chinese officials may believe they have much to gain from Europe's troubles.

Germany has more at risk than one might think.

Selling such assets to purchase European government debt would not be an act of altruism on the part of energy exporters, but rather one of pure self-interest. These nations have more to gain than any other country or group of countries, especially China. Indeed, China might actually welcome a European recession if an oil price collapse accompanies the slowdown. Low oil prices would benefit China in three ways: first, they would reduce China's oil import cost; second, they would create resource investment opportunities for China in the nations weakened by low prices; and third, they would give China a chance to negotiate favorable natural gas purchase contracts with Russia.

China's reluctance to participate in various assistance proposals for Europe may stem from its calculation of potential recession "spillover" effects on energy and commodity markets. Indeed, Chinese officials may believe they have much to gain from Europe's troubles.

Germany, on the other hand, has more at risk than one might think. In recent years, its export manufacturers have turned increasingly to energy-exporting countries to replace falling demand from other EU members. The energy producers have been a prime target for German exports, accounting for a larger share of its exports than China. An oil price collapse would quickly suffocate this source of growth.

One final reason for energy-exporting countries to consider a "bailout" for Europe is this: they might profit from selling dollar-based financial assets and investing in the debt of certain EU countries. The replacement assets would pay higher interest rates than U.S. Treasury instruments. In addition, markets would likely respond favorably to such an action, boosting the euro relative to the dollar. The interest rate differential and a strengthening euro would provide energy exporters a benefit on top of what they would gain from avoiding losses from an EU-associated energy price collapse.

The case is clear. Energy exporters should take the lead in helping Europe. They would be the greatest beneficiaries from their "altruism." ◆