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Banking on Energy

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This is a guest post by Chris Cook. Chris is Former Director of the International Petroleum Exchange, and is now a Strategic Market Consultant and commentator. The post was written prior to the G20 meeting which started April 2. In this post, ***Chris proposes that international trade be denominated not in dollars, but energy****.*

In the approach to the G20 meeting we saw two distinct threads of global policy emerging: one by the global debtor nations, led by the US, and another by global creditor nations, led by China.

In the US, we see Treasury Secretary Geithner's trillion dollar quantitative easing of the rich, which cannot work for two reasons.

Firstly, the problem is not a shortage of credit, but a shortage of the creditworthy. As asset prices and incomes continue to collapse, only the top few percent are now in a position to borrow, based upon the wealth which has become increasingly concentrated in their hands in the last 20 years of debt-disguised recession. The only solutions for the US are therefore fiscal.

Secondly, this initiative is based upon the premise that the creditors of the US will support these measures by continuing to buy assets denominated in an increasingly debased currency.

China's increasing impatience with the dollar as a global reserve currency is now quite overt and specific. Zhou Xiaochuan – the Chinese Central Bank governor – has published a thoughtful essay proposing that the IMF should take on the role envisaged by Keynes at Bretton Woods in 1944 as the issuer of a global reserve currency, Keynes' “Bancor”.

Russia's proposal for the G20 meeting is set out on the President's website and says, among other things

> “....Introduction of a supra-national reserve currency to be issued by international financial institutions. It seems appropriate to consider the role of IMF in this process and to review the feasibility of and the need for measures to ensure the recognition of SDRs as a "supra-reserve" currency by the whole world community.”

Alongside these proposals for multilateral solutions, energy market observers like myself noted with interest in mid February that China and Russia have already taken bilateral “Peer to Peer” action. This took the form of a 20 year $25 billion loan by China to Russia secured against crude oil supplies of some 15 million tonnes per year. It was not just the cynics who considered that this transaction will almost inevitably be tested to destruction by the dollar's decline relative to energy, and sooner rather than later.

At a high-level conference in Tehran in January I made a proposal in respect of an "Energy Standard" for international trade which was very well received, to the extent that it has been suggested that a presentation be made to the Economic Cooperation Organisation (ECO) states concentrated around the Caspian Sea, but extending to Pakistan and Turkey.

The concept is extremely simple, and it is that international trade should be denominated not in dollars, but in energy. Producers of energy, such as Russia and Iran may then-–in exchange for value received--issue Units redeemable either in electricity, or in "energy vector" fuels such as gasoline, heating oil, fuel oil and above all natural gas, which all have a fixed value denominated in energy.

Global transactions will then take place within the framework of an International Energy Clearing Union subject to the collective guarantees of energy producer and consumer nations generally. Both energy creditor nations – such as Russia, Iran, the GCC and Norway – and energy debtor nations, such as the US, UK and EU would all pay an amount into a global "energy pool" in support of the guarantee. The resulting balances would be deployed in massive investment in new renewable energy infrastructure and energy efficiency savings.

The US, which is the biggest energy debtor by far, could therefore be funded by the Pool in redeploying much of its increasingly baroque military expenditure not just into the "Green New Deal" proposed in the US, but also globally, in partnership with the immense UK and EU intellectual capital at the cutting edge of research and development.

The use of an "energy dollar" or "Petro" energy unit, as it was referred to in Iran, addresses one of the most pressing issues. This is the catastrophic waste of carbon-based energy in those countries blessed or cursed with large oil and gas reserves. Anyone who wishes to see the negative effects of gasoline available at 30 cents per gallon on the environment and on the quality of life, need only travel to Tehran.

President Ahmadinejad recently proposed to massively raise gasoline prices and to compensate the population with cash subsidies, and the Majlis threw out the proposal. The unitisation of gasoline, on the other hand, allows the price of gasoline to be raised to global levels, and for the population to be compensated with Units redeemable for gasoline. While some will continue profligate use of gasoline, most will cut back on gasoline use and exchange their Units for something else of value.

Perhaps the most interesting potential lies in the global market in natural gas, where Iran, Qatar and Russia own two-thirds of global reserves and recently instituted a Gas OPEC based in Doha. The unitisation and clearing of natural gas offers the potential basis for an International Energy Clearing Union, I believe. The massive loans which financed Qatar's LNG infrastructure may be refinanced interest-free simply by selling Units redeemable in natural gas to major consumers such as China, who thereby both lock in a price, and may found a new global energy-based reserve currency.

I believe that it is only through the use of an energy standard – rather than a fiat currency or gold - that the transition from carbon-based fuels to renewable energy may be painlessly made, and in so doing, allow the US, and other nations to repay their energy, and other resource debts.

President Obama, for his part, may dispense with the deficit-based "Cap and Trade" mechanism which, like emissions trading, attempts to monetise by political fiat something with no intrinsic value – which of course brings us back to Treasury Secretary Geithner's proposal also to do just that.

So I will conclude by saying, not for the first time, that *oil is not priced in dollars: dollars are priced in oil*, and recommend that the G20 turn their attention to a sustainable International Energy Clearing Union alternative to our current unsustainable global monetary system.

This story is cross posted at Seeking Alpha.