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Greece's Debt Woes: Deepening their Reliance on Iranian Oil

SUMMARY

- Greece's sovereign debt crisis has led most oil suppliers to decide that they cannot take the risk of trading with Greece. This includes Russia, historically Greece's largest supplier. This crisis has driven Greece both to draw down its oil stocks and to massively increase its reliance on Iran.
- As such, Greece is now the potential weakest link in the European Union's (EU) plans to embargo Iranian oil imports; unless Greece finds alternate suppliers that are willing to trade with it on terms it can afford, it will not be able to comply with the embargo without running out of oil.
- If Greece begins to lobby to water down the EU embargo, it could easily be joined by Iran's other major European customers—Italy and Spain. As such, policymakers may wish to consider how the EU could guarantee Greece's oil payments in order to enable it to access a wider range of suppliers.
- Although the United State has now exempted EU countries, including Greece, from sanctions, this is merely a reward for the EU promise to cease imports by July—a promise that Greece may be unable to honor.

ANALYSIS

Crises with Iran and Greece have surprising link

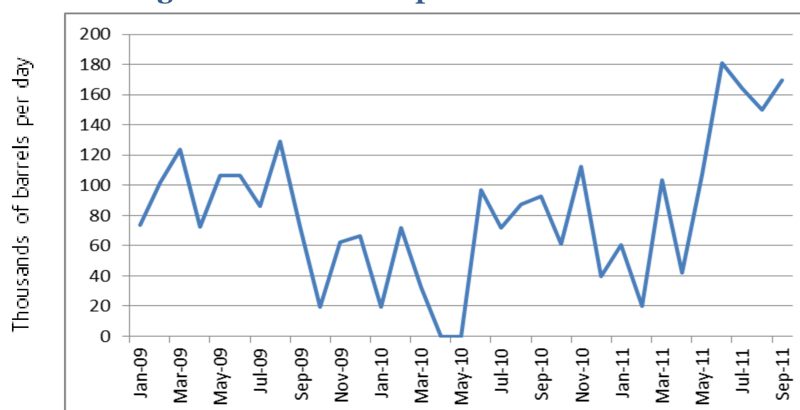
What do the world's most high-profile economic and security problems have in common? More than one might think.

Sanctions on Iran, even before the most recent round, constrained its set of potential trade partners and forced it to be more flexible about payment terms. Meanwhile, Greece's sovereign default on March 9th and possible exit from the Euro means that major oil suppliers, like Russia, which provided 38 percent of Greece's oil imports in 2010, require cash payment in advance to ship oil to Greece, which Greece's majority state-owned Hellenic Petroleum cannot afford. Thus, a perfect match of necessity has led Greece to increase its imports from Iran from 14 percent in 2010 to 53 percent in the third quarter of 2011 and perhaps even higher today. (The most recent data on Greek crude imports from Eurostat, the EU statistical agency,

is from September 2011.) Although Hellenic Petroleum brags that replacing Iranian imports will be "easy", the reality seems to be anything but.

As the chart and table below shows, Greece had managed to reduce its imports from Iran in 2010 as compared to 2009, but they rose dramatically from the summer of 2011, as oil traders began to demand payment in advance from Hellenic Petroleum. By contrast, Iran remained the only major supplier to continue to offer Greece so-called "open credit terms", in which Iran delivered oil and only received payment when the oil was sold in Greece. If a supplier is not willing to offer open credit terms, it will need to find an international bank to provide trade finance. However, oil traders are reporting that no bank is willing to do so when Greece's sovereign credit rating is junk. If Greece were to default, the bank might be left with a huge loss.

Figure 1: Greece's imports of Iranian crude oil



Source: Eurostat

Table 1: Sources of Greece's crude oil imports

	2008	2009	2010	1H2011	3Q2011
Iran	28%	24%	14%	26%	53%
Russia	35%	33%	38%	29%	8%
Saudi Arabia	14%	12%	12%	17%	15%
Iraq	1%	9%	9%	10%	10%
Kazakhstan	6%	7%	10%	6%	4%
Libya	15%	13%	15%	5%	0%

Source: Eurostat

Resorting to Depletion of Strategic Stocks

Greece's difficulty sourcing crude imports is clear. Although Greece's oil demand has fallen for the past two years as its economy has contracted (Figure 2), its oil stocks have also fallen dramatically since June as its debt crisis has intensified (Figure 3).

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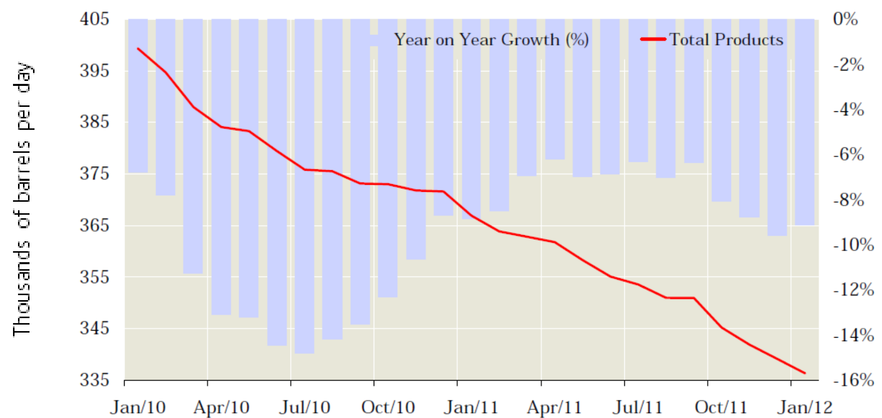
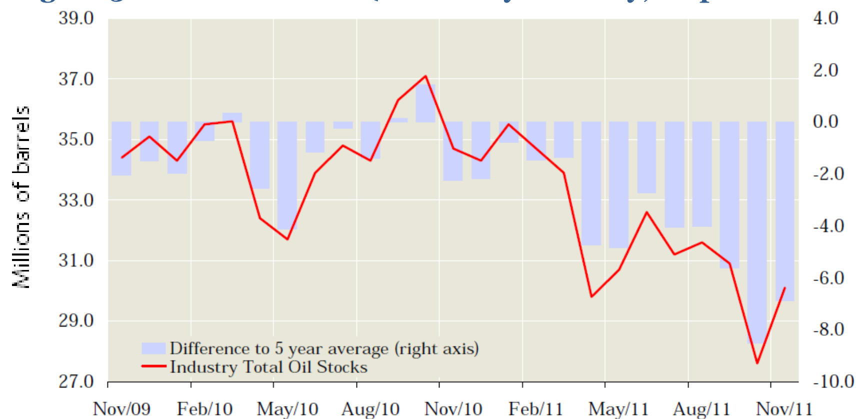
Figure 2: Greek oil demand



Source: IEA

Greek oil stocks have fallen very sharply, recently reaching in a five year absolute low in October 2011 before recovering slightly in November, the latest month for which data is available. This suggests that Greece has been unable to source adequate quantities of crude oil on international markets, despite its increasing imports from Iran, so it has been forced to draw down stock levels.

Figure 3: Greek oil stocks (all held by industry, no public stocks)



Source: IEA

If this trend continued—and we do not know whether it has because the data have not been published—Greece would have breached IEA and EU rules requiring member states to maintain oil stocks equivalent to 90 days of imports or consumption, which are the same in Greece's case as it has no domestic production. The possibility that Greece will, or indeed has already, breached IEA and EU rules shows the seriousness of the problem and the pressure that Greece must feel it is under to secure imports in whatever way it can, even if this requires strengthening its ties with Iran.

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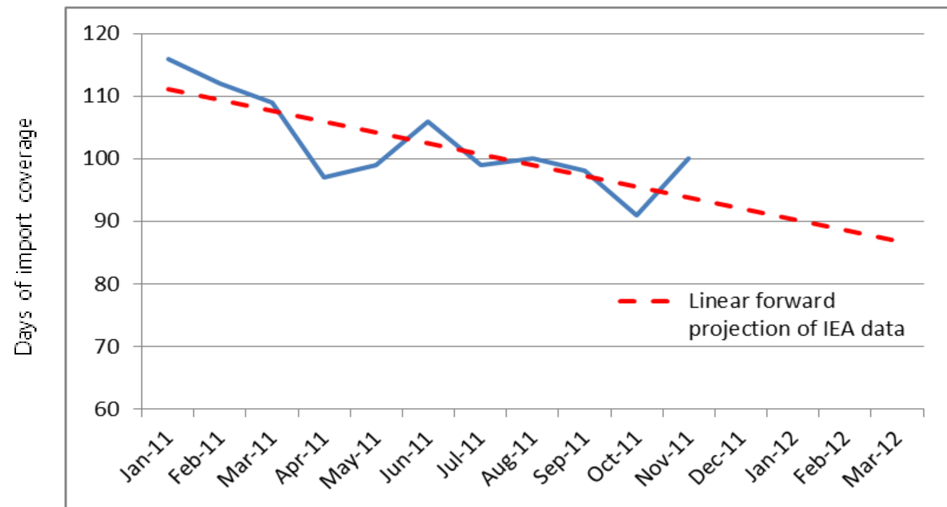
Figure 4: Greek oil stock levels in days of import coverage



Source: IEA

Greece now risks becoming the West's Achilles' heel in its conflict with Iran. Greece's rising dependence of Iranian imports makes it increasingly challenging for Greece to achieve the European Union's target of eliminating imports from Iran by the end of June. Meanwhile, Iran can use Greece as a means to exert pressure on the European Union and, by extension, the United States. Unsurprisingly, Greece has been lobbying hard to water down the EU boycott of Iranian oil.

On February 25th, Iran's Fars news agency reported that Iran had refused to load a Greek oil tanker and sent it home empty. Although Hellenic Petroleum denies this, as do some Iranian industry sources, the move served to highlight Iran's ability to add to the economic havoc in Greece in retribution for Western sanctions on Iran.

Greece is currently looking to a number of sources for alternative supplies, most notably Libya and Saudi Arabia. A number of oil trading firms are also in talks with Hellenic Petroleum. In order for Greece to secure alternative supplies, it will need to convince another supplier to offer open credit terms, find cash to pay for oil imports in advance or convince an international bank to provide trade finance. All of these depend on Greece's credit worthiness improving. Recent progress on Greece's latest EU bailout package makes this marginally more likely, but substantial problems remain. First, the terms of Greece's bailout are very challenging, and many commentators expect that Greece will fail to meet them. Second, even in the best case scenario, Greece's debt will still be unsustainably large (more than 120 percent of GDP) in 2020, raising questions about its credit worthiness. Finally, on March 9th, Greece defaulted on its debt by using collective action clauses to force the holders of its government debt to accept deep reductions in their value, further damaging Greece's creditworthiness.

In a sign of desperation, Greece is now trying to establish some sort of barter arrangement with traders where it would trade refined oil products for crude oil imports. Greece's recession has reduced energy consumption, and increases in energy prices, part of rising global energy prices and the structural reforms that Greece was required to undertake to secure its bailout, have further reduced demand. This fall in demand means that Greece has substantial spare refining capacity, so there may be some genuine scope for barter. Nevertheless, this can only at best be a partial solution, and it will likely put further economic pressure on Greece, as

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Greece is likely to be forced to substantially overpay for oil imports as a condition for receiving them on barter terms.

Implications for the United States

But why does this matter for the United States? Indeed, one could argue that Greece is firmly Europe's problem: banks in Northern Europe lent the Greek government far more than it could repay and now they are suffering the consequences. While this is obviously true at some level, Iran will continue to be able to use its leverage over Greece to attempt to damage trans-Atlantic solidarity over sanctions.

Moreover, Spain and Italy also import substantial quantities of oil from Iran (16 percent and 13 percent of imports, respectively, in Q3 2011). While this does not give Iran the same leverage over them that it has over Greece, it still makes replacing Iranian oil difficult. Indeed as Table 2 shows, because Spain and Italy are much larger countries, in terms of absolute quantities their exports from Iran are actually meaningfully larger than those of Greece. Indeed, Italy's technocrat Prime Minister, Mario Monti, has already expressed worries that phasing out Iranian imports will further damage Italy's already vulnerable economy. As such, a serious campaign by Greece to water down European sanctions against Iran could easily find support from Spain and Italy.

Table 2: Imports from Iran by Greece, Spain and Italy

	Greece	Spain	Italy
Percentage of imports	53%	16%	13%
Thousands of barrels per day	161	174	209

Source: Eurostat

As such, it is in the United States interest to ensure that Greece is able to find alternate oil suppliers and therefore does not seek the flexibility that would undermine European sanctions against Iran. The best way to ensure this is to remove the perceived risk that Hellenic Petroleum will not pay, facilitating either open credit terms with another supplier or export finance from a bank. The simplest way to achieve this would be for another European country or a European Union institution to guarantee oil payments from Hellenic Petroleum. For example, the AAA-rated European Investment Bank, the EU's development finance institution, could guarantee to pay suppliers if Hellenic Petroleum failed to do so. This would certainly be adequate to secure trade finance and might even enable open credit terms with another supplier. U.S. policymakers may wish to discuss the problem of Greece's oil supply—and options such as an EU institution extending its guarantee—with European partners to ensure trans-Atlantic solidarity in sanctions against Iran. Although the State Department announced on March 20th that it would exempt EU countries and Japan from the new sanctions, this appears to be merely a reward for the EU's promise to ban Iranian crude imports starting in July. A solution to Greece's oil problem must be found if the EU is to keep this promise.

Conclusion

Greece's economic crisis has driven it to draw down its oil reserves and rely on Iran for the majority of its oil imports. This allows Iran to use Greece to gain leverage over the EU, and by extension the United States. Two other economically vulnerable southern European countries, Spain and Italy, actually import even more in absolute terms, though not in percentage terms, than Greece. Were Greece to begin a concerted campaign to weaken European sanctions against Iran, it might find tactical support from Spain and Italy. Therefore, it is imperative to enable Greece to find alternative suppliers in order to maintain trans-Atlantic solidarity against Iran. While there may be other options for Greece to access oil, none will offer Greece flexible credit terms, and Greece cannot afford to pay in cash. The United States should thus consider discussing with our European partners how best they might guarantee Greece's payments for oil in order to enable it to access a wider range of suppliers.

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