The Energy Realist

Hit Putin Where It Hurts

Sell the Strategic Petroleum Reserve.

BY PHILIP K. VERLEGER, JR.

Oil prices rose sharply on the Monday morning following Russia's seizure of Crimea. This should not surprise anyone. Oil prices always surge when political uncertainty intensifies. Given that Russia is a petro state that depends on oil and natural gas exports for its survival, that price hike also had the effect of rewarding the aggressor for its aggression.

As the United States contemplates its response, it should realize that it has a tool at its disposal that could impose meaningful consequences on the Russian economy. That tool is the Strategic Petroleum Reserve, which now holds 694 million barrels of crude. The federal government acquired the oil between 1977 and 2009 as a safeguard against a severe disruption of world oil markets. Years ago, the academics and policymakers who worked on the original SPR design (I was one of them) advocated the creation of a billion-barrel reserve to offset any prolonged interruption of America's oil imports during some future conflict.

Today, the United States does not need a billion-barrel strategic reserve, or anywhere close to it. Because we have made a commitment to the International Energy Program to hold reserves equal to ninety days of imports, we can't eliminate the petroleum reserve entirely. But we could easily sell 500,000 to 750,000 barrels a day for up to two years without breaching this obligation. By my calculation, if we were to do so—and all else remained equal (about which more in a moment)—the world price of oil would drop between $10 and $12 a barrel.

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Although that amounts to only about a 10 percent reduction in the current price, it would still be enough to inflict significant pain on the Kremlin. A crude oil price decline of $10 per barrel would cut Russian export income by around $40 billion, which amounts to about 10 percent of the country's 2012 fuel export income as reported to the World Trade Organization. Russia's GDP could fall by as much as 4 percent. This action could also exacerbate the ruble's decline and further increase the country's internal economic difficulties.

Lower oil prices would also offer significant benefits to European consumers, including those in the Ukraine, who depend on natural gas from Russia. That's because Russia links—or tries to link—the price of natural gas it

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Crude oil pipes at the Strategic Petroleum Reserve's Bryan Mound site near Freeport, Texas.

exports to Europe to crude oil prices. Thus by liquidating the surplus SPR oil, the United States would give Europe lower natural gas prices. In the United States, lower crude oil prices would reduce the price of gasoline by as much as twenty-five cents a gallon. And the profit that was generated by any sale of oil from the petroleum reserve—which cost, on average, $28 a barrel—could go to deficit reduction.

There are two big "ifs." The first is that Congress would probably have to authorize any sale of oil from the SPR. Given that body's demonstrated inability to function, this could take weeks or months—far too long given the speed with which events are moving in the Ukraine. On the other hand, Republicans have been urging President Obama to take tough measures in response to Russia's aggressive moves, and this would surely count as one. One could easily see Republicans such as Senators Lindsey Graham (R-SC) and John McCain (R-AZ) leading the charge for quick approval. Using the money for deficit reduction could also make it appealing to Republicans.

The second big "if" is the reaction of the world's other big oil exporter, Saudi Arabia, which would see its own oil revenues affected by the U.S. action. Still, it seems likely that the Saudis would go along. The Kingdom, after all, is locked in a struggle with Russia over Syria and Iran. The Saudis are supporting the insurrection in Syria as Russia supplies President Assad. And they oppose Russia's alliance with Iran, its long-time foe. The Saudi leaders would likely welcome crude oil sales from the reserve as a clear effort to weaken Russia. Most likely they would say and do nothing as long as the United States limited its effort to drive down prices by 10 percent rather than, say, 50 percent.

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Although it would take a month or longer to begin delivering the oil, the mere announcement of such a program would push prices down—and, in effect, begin the economic counterattack.

As the crisis in the Ukraine has worsened, and Russia has taken over the Crimean peninsula, the cries have gone up from all across the political spectrum calling on the president to do something meaningful. At the same time, however, many observers have noted how few decent options the president has. Here, then, is one option that would matter: Sell oil from the Strategic Petroleum Reserve. It would make a difference, if we were only willing to try it. ◆