Rodney's Take

October 17, 2022

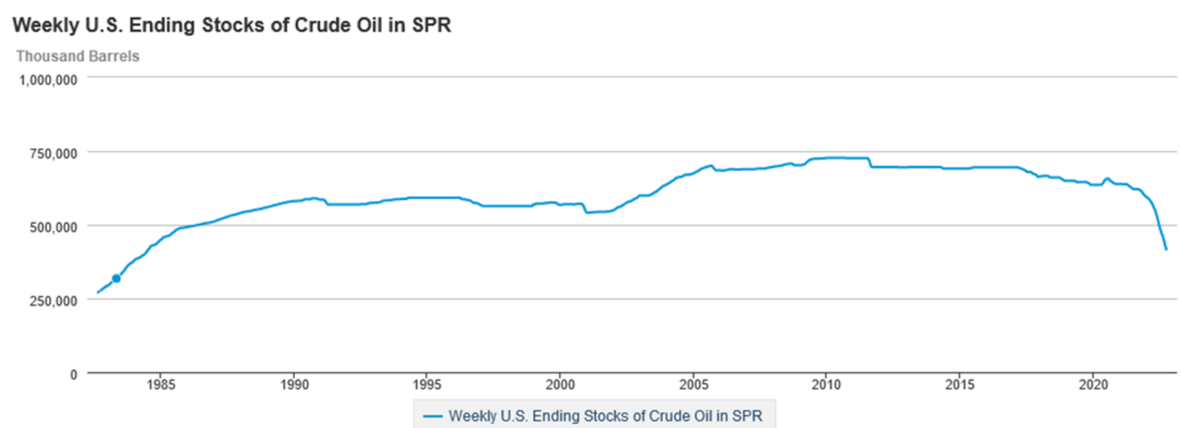
Draining the Strategic Petroleum Reserve

According to an old Russian proverb, when all you have is a hammer, everything looks like a nail. That must be part of the logic driving President Biden's energy advisors, as they consider what to do about OPEC+ not just refusing to raise production to bring down prices, but also cutting production quotas to make sure prices remain elevated. Last spring, the Biden administration announced that it would release 180 million barrels of oil from the Strategic Petroleum Reserve (SPR) over six months in an effort to bring down energy prices. Now that OPEC+ has announced it won't acquiesce to U.S. demands, Biden is considering releasing more oil from the SPR. This might be too much of a bad thing.

Historically, we released oil from the SPR to cover emergency shortfalls caused by hurricanes or ship channel shutdowns. We also sold some oil from the SPR in the mid-1990s to pay down some debt and did so again in recent years to fund certain budget items, which is the same as using SPR reserves to pay down debt. This is the first time we've used large-scale, long-term releases to put a lid on oil prices, and there's every reason to believe it won't work. While adding to global supply for a few months took the edge off of oil prices in the short-term, the only way to bend the curve is to add production or to reduce demand. Releasing stored reserves does neither, and the more we release, the less inventory we have available to use for actual future emergencies.

The chart below shows that we have drained about 160 million barrels out of the SPR so far, taking the inventory to a level last seen in 1984 when we were filling it up.

U.S. Strategic Petroleum Reserve Stock
1984 – October 5, 2022



Source: U.S. Energy Information Administration

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The administration cannot take the SPR stock below 250 million barrels of oil without congressional approval. If we continued to draw down the reserves at the current rate, we'll reach that level just as we reach the summer of 2023 and the beginning of the next hurricane season. There's no indication that President Biden is considering continuing the current program for that long or at the current level, but there's also no plan for replacing the oil that has been released. This leaves us in the uneasy position of having the lowest level of reserves on hand in almost forty years while prices could be driven higher if we try to replenish our inventory as OPEC+ reduces production to match falling demand.

Instead of trying to address the energy crisis by using a finite resource meant to keep our economy rolling during emergencies, we should be addressing the same factors as OPEC+, production and demand. So far, the current administration has shown that it wants domestic companies to produce less energy, not more, which sends prices higher. Interestingly, those higher prices do address the other part of the equation by eroding demand. The more people pay for fossil fuel energy, or anything else, the less they use.

This might sound like it would serve some energy transformation goals, but it comes at a cost. Consumers might use less energy because it costs more, but they won't be happy about it and usually will blame whomever is in office. So far, no politician on either side of the aisle has figured out how to make consumers feel happy about inflation, so they pursue short-term fixes, such as draining the SPR, to address long-term problems, hoping to keep the grumbling to a minimum.

Looking at the current SPR inventory, we can only hope that we don't need the extra reserves to address a real problem or emergency before we get a chance to replenish the stock and that prices don't jump too high as we try to buy back what we sold.

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Got a question or comment? You can contact us at info@hsdent.com.