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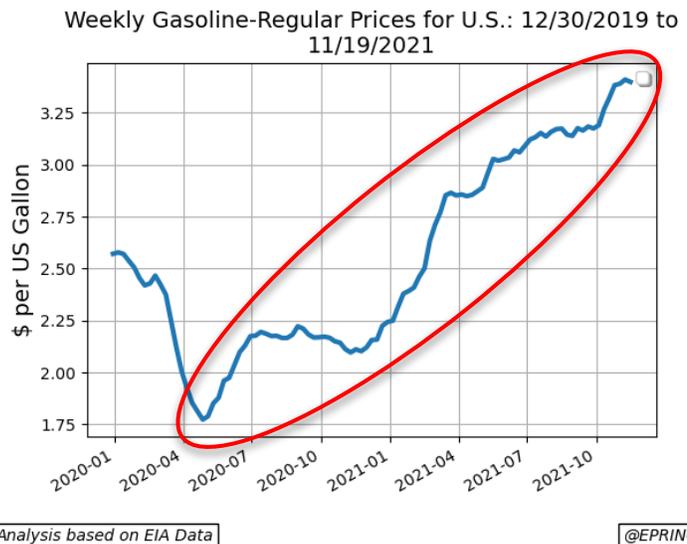
The Use and Misuse of the Strategic Petroleum Reserve

Overview

Over the course of 2021, U.S. transportation fuel prices have climbed steeply and rapidly, rising to levels not seen in almost a decade. From the beginning of 2020 through the most recent period, the increase at the national level has been about 40% (see Figure 1).

In an attempt to lower gasoline prices, the Biden administration announced on November 23, 2021 the release of 50 million barrels (MBs) from the U.S. Strategic Petroleum Reserve (SPR). This is the equivalent of three to four days of U.S. consumption. Concurrently, the administration requested the FTC to investigate oil companies to determine whether "illegal conduct is costing families at the pump."

Figure 1



These actions were taken after the administration requested both U.S. producers and OPEC+ members to increase crude oil production in order to lower its price given that it is the main feedstock in the production of gasoline and other transportation fuels. In addition to requesting more production from oil producers, the Administration pursued a coordinated release of strategic oil stocks from China, India, Japan, and Korea. Stock releases are traditionally undertaken under the auspices of the International Energy Agency (IEA). The Administration has been criticized over these initiatives as they have pursued a range of policies that are likely to constrain U.S. oil and gas production, among the more important are decisions earlier in the year to halt construction of the Keystone XL Pipeline and suspension of the oil and gas lease sale program on federal lands..

The U.S. Strategic Petroleum Reserve (SPR) was established in the 1970s in reaction to oil supply shortages brought on by political instability in producing countries in the Middle East. Any potential SPR releases would be coordinated by the IEA on behalf of OECD member countries, which includes the U.S.

The anticipated scenarios for any sort of SPR release were oil supply disruptions brought on by events such as extreme weather, military conflicts, geopolitically motivated embargos, and major oil supply infrastructure accidents. Furthermore, given the integrated nature of the world oil market, a release by one country is generally undertaken in conjunction with other OECD countries, all with oversight from the IEA (see Figure 2).

The Biden administration's recent announced SPR release policy, 50 MBs, is directed at reducing gasoline prices not related to a major oil supply emergency (see Figure 3). In June 2011, the Obama administration authorized a release of 30.7 MB in response to supply interruptions from the Libyan Civil War, the highest previous release.

While there have been instances by previous Presidents of using the SPR for price relief, this is the first explicit case of a release without a concurrent supply disruption threat or occurrence.

Key Causes of Higher Prices

EPRINC's research indicates that rising prices are attributable to four sets of factors – inadequate investment in exploration and production (E&P), rising refining feedstock costs, renewable energy mandates, and rising wholesale and retail distribution costs – all adding to rising costs across the entire petroleum product supply chain.

Upstream investment has been curtailed and has flattened considerably in recent years. New discoveries have only replaced about a third of demand at current levels of consumption.

Capital availability for E&P companies has become constrained for a host of reasons: private equity has become the primary source while public equity markets have lapsed. In addition, financing interests have become more selective in choosing underwriting candidates, seeking better returns on investment.

Figure 2

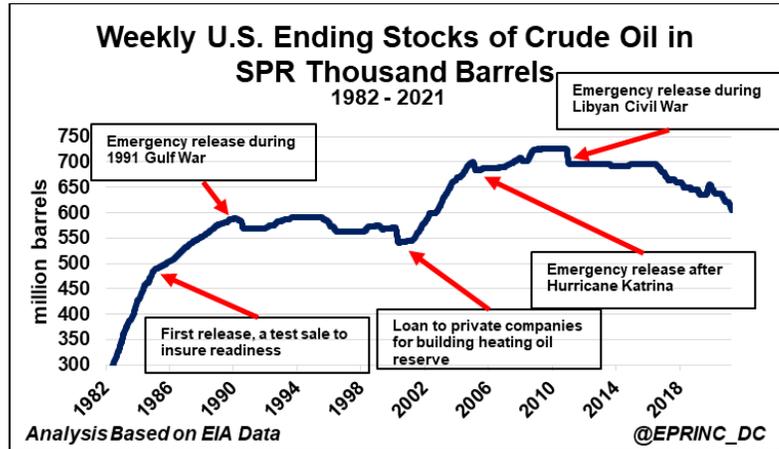
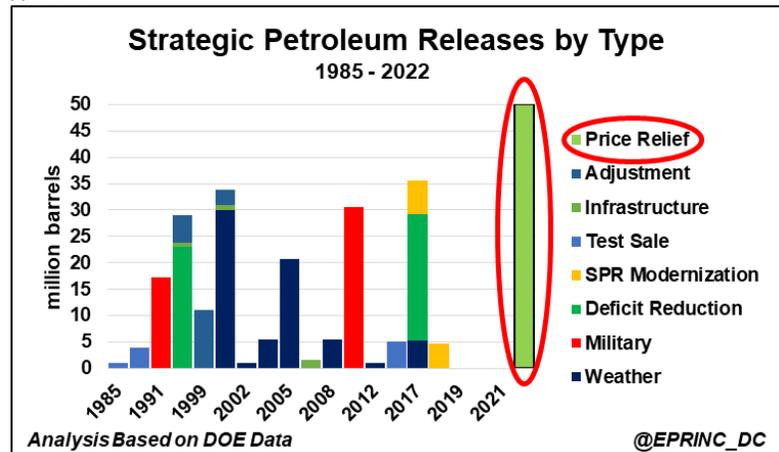


Figure 3



Refiners and fuel blenders use considerable amounts of corn-based ethanol. Current high corn prices are passed through to ethanol prices that, in turn, are passed on to consumers. In addition, high renewable energy mandates in the face of constrained demand have led to high prices for renewable energy credits.¹

Although reducing feedstock costs can provide some relief to consumers, supply chain constraints are also contributing to rising processing, distribution, and marketing costs in retail markets, i.e., refining, terminals, and gasoline stations. Contrary to conventional wisdom, gasoline stations are not owned by oil companies but rather for the most part by individuals or specialized distribution companies. These businesses are seeing a shortage in station employees and truck drivers; and continuing increases in operating costs such as insurance, rent, equipment maintenance, and credit card fees. With fewer truck drivers, truckload gasoline deliveries to filling stations are occurring more frequently and are leading to run-outs at filling stations.

Conclusions and Policy Recommendations

Political pressure to provide price relief to American consumers is understandable. American consumers often do not pay a lot of attention to energy policy, but will respond quickly to rising gasoline prices, often taking out their frustration in the nearest election. The SPR is a strategic asset, and its primary purpose is to provide relief in the rare occasion of a genuine supply disruption, either from war or acts of God. It was never intended to act as a routine regulator for ups and downs in the petroleum market and given the dynamics and potential of OPEC to adjust their production decisions, it is also likely to be of limited use in that role.

The U.S. contains sufficient petroleum reserves to provide considerable supply and price stability to both the U.S. and world oil market. U.S. policy makers should place their efforts on providing the conditions to sustain the productive capacity of the North American production platform until the date arrives when the energy transition is well underway.

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