Weekly Economic Commentary
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Finding the Will to Refill the Strategic Petroleum Reserve

A drawdown to fight energy inflation has left the SPR at a new low.

By Ryan James Boyle

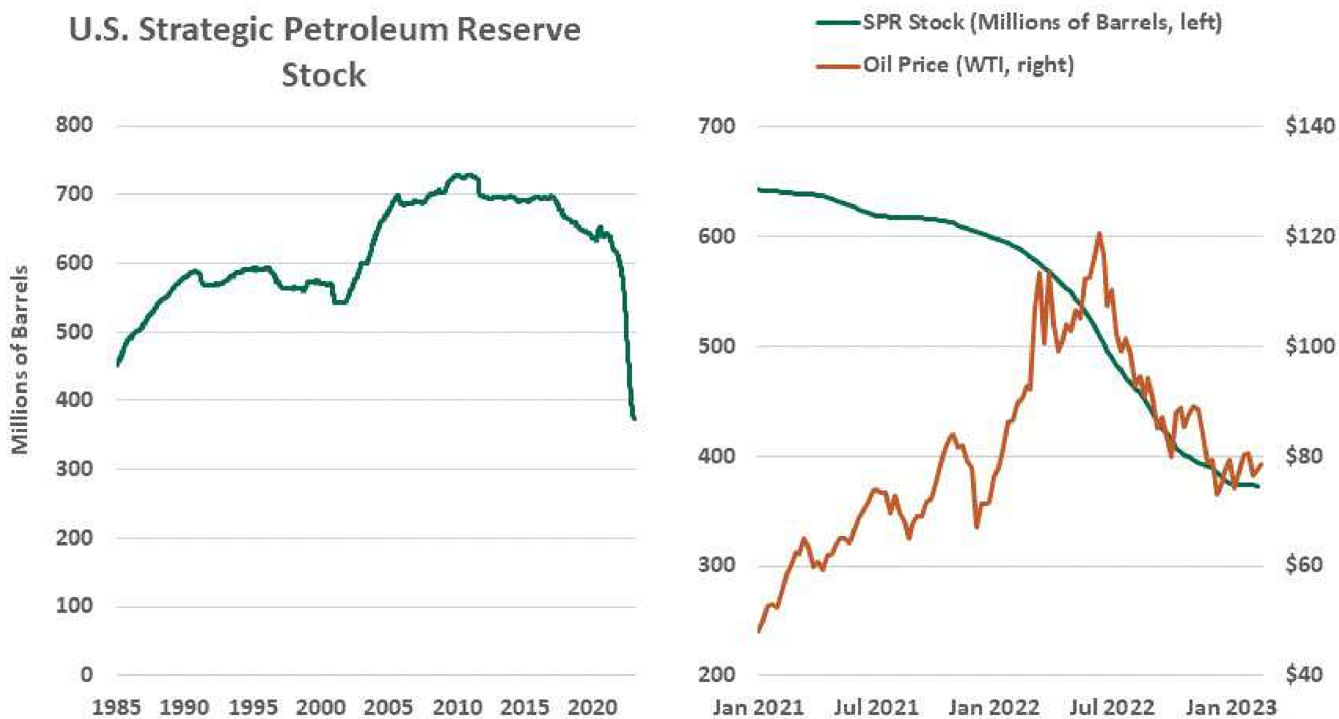
In 1975, President Gerald Ford signed the Energy Policy and Conservation Act. A lasting consequence of the act was the creation of the Strategic Petroleum Reserve (SPR), meant to "reduce the impact of disruptions in supplies of petroleum products." Through most of its history, the SPR has been a comforting afterthought, seeing only minor drawdowns in the wake of natural disasters and regional wars that disrupted crude oil supplies.

Over the past two years, however, the SPR has taken a larger role in energy markets. Sales of SPR oil began by executive order in November 2021, as the reopening following the pandemic pushed up fuel prices. The reduction entered a higher gear in March 2022. Russia's invasion of

Ukraine was a systemic disruption to oil markets, prompting President Biden to order 180 million barrels to be sold from the SPR.

Stock of the Strategic Petroleum Reserve may never return to its pre-COVID high.

In recent weeks, the SPR has leveled off. After declining by 267 million barrels in two years, the reserve stock is being replenished. The U.S. government has committed to purchasing 60 million barrels of domestically produced oil at prices of at least $67 per barrel. In effect, the U.S. government entered a spread trade: during the drawdown, SPR stocks were sold at market prices sometimes exceeding $100 per barrel. Now, the new minimum price is accretive to government finances, but also sets a floor for producers and may help to encourage domestic production.



Sources: EIA, CME, Haver Analytics

But the SPR was never intended to put the government in the business of energy arbitrage. Sanctions against Russia were not a severe supply interruption to the U.S., nor have they proven to be short-term. Drawing down over 40% of the reserve carries risks: In the event of an emergency, the SPR can now only fuel less than three weeks of U.S. oil demand. Additionally, using the SPR to manage consumers' inflation experiences was a stretched rationale with limited effectiveness; energy prices continued their upward march despite the intervention.

Domestic production of oil has stayed low despite high prices last year, and the government's offer of a floor price has not yet brought about a production response. As demand for oil stays high, domestically produced oil available to pump into the SPR may be scarce, and recent legislation has been more focused on renewable energy. But after such a rapid drawdown of an important resource, we hope the dwindling stock of the SPR will be strategically reversed.

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