Insight

Goolsbee Plays Petroleum Politics

CATRINA RORKE, DOUGLAS HOLTZ-EAKIN | APRIL 18, 2012

Looking to avoid the political perils of $4 gasoline, the White House is searching high and low for a chance to claim leadership on energy prices. That's why one of their top allies in economics, Austan Goolsbee, took to the editorial pages last week to launch a clever — but too cute — argument to justify a politically motivated oil sale from the Strategic Petroleum Reserve.

The politics are simple: Craft an argument that we have too much oil in the SPR and use it to justify a sale for strategic purposes, then convince the electorate you're working to lower gas prices.

What about the substance? Remember that the SPR was created in response to the Arab oil embargoes as a domestic crude oil reserve to counter a severe supply disruption. Its original authority provided up to 1 billion barrels in petroleum reserves; current capacity hovers around 727 million barrels, of which 697 million barrels are filled.

Goolsbee argues that the SPR is an "insurance policy" that should be sized to the potential loss. He suggests that we insure against "potentially strategically vulnerable sources" outside North America, and that we have an SPR equal to about 75-80 days' worth of these imports.

Because the U.S. is currently benefiting from increased domestic and Canadian production of unconventional oil resources, imports are down. And since our imports from the strategically vulnerable sources are down, we need less insurance.

To Goolsbee, it's time to sell.

But hold on. Why 75-80 days of non-North American oil? He offers no justification except to point out that it is about what we had until 2008. Unfortunately, the canonical insurable event – the original Arab oil embargo – lasted 149 painful days. Perhaps the likelihood of a similar embargo is lower today, but how much lower?

And embargoes are not the only threat. How should we think about disruptions from natural disasters and national security threats? Putting some hard numbers on these exposures seems like a sensible prerequisite to downsizing the nation's insurance protection.

And why is the focus on imports? Goolsbee asserts, "If you produce all the low-cost energy you need domestically, you don't need a reserve."

But the SPR is not just as an insurance policy for oil imports. It's an insurance policy for oil use. And we use a lot. If North American supply is disrupted by a natural disaster or terrorist strike, the exposure is identical to that if jihadists successfully destroy a Saudi facility.

Worse, if this happened, imports would increase. The Goolsbee rule would lead the U.S. to bulk up the SPR, buying oil for the strategic reserve at the same time that the price is increasing on the world market and domestic wealth is declining in the face of an intensified trade imbalance.

It makes little economic sense to sell low and buy high — considering that the SPR was designed to insulate our economy from the price swings associated with severe supply disruptions.

His final argument is that cutting back to 75-80 days of imports would allow the release of 185 million barrels of oil that could raise $20 billion for the Treasury.

Nobody should be in favor of expensive over-insuring. But it is a mistake to look at a strategic national and economic security investment as a potential revenue raiser.

Goolsbee's argument is a clever way to help the White House justify an SPR release. I bet you'll see it echoed by the White House soon.

Don’t be fooled. And don’t sell the SPR.

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