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RETHINKING EMERGENCY ENERGY POLICY

Since the mid-1970s, U.S. policy for responding to severe disruptions of the world supply of oil has relied on a government-owned stock of crude oil, known as the Strategic Petroleum Reserve (SPR), and the multilateral programs of the International Energy Agency. To date, the United States has spent about \$4 billion to construct five underground storage sites for the SPR and \$17 billion to partially fill the reserve with 592 million barrels of crude oil—enough oil to replace the nation's net imports of oil for nearly 75 days. This study examines issues and options relating to the government's decisions about when and how to use the Strategic Petroleum Reserve to best protect the economy from losses.

The study points out that policies guiding the use of the SPR may no longer be as effective as the Congress originally envisioned. Many analysts feel that the threat posed by disruptions of oil supplies has declined over time and that the potential benefits from releasing SPR oil are smaller today than in the past. Changes in oil markets (such as the decontrol of oil prices) and in the broader economy (such as the falling contribution of oil to economic output) have weakened the impact of oil price shocks on the economy.

During the Persian Gulf crisis in 1990 and 1991, the United States had its first opportunity to activate its emergency energy policy in response to the threat the crisis posed to the world oil supply. That experience pointed up two main problems. First, both the process for deciding to release SPR oil and the mechanism for selling it may have added to market uncertainty at the time in ways that lessened the benefits from the release. Second, the emergency programs of the International Energy Agency did little to mitigate the crisis. IEA members lacked a common interest in curtailing their use of oil during the crisis, which undermined the consensus for any meaningful action.

Nonetheless, a release of SPR oil may still convey economic benefits by helping to lower oil prices and total oil imports. But the impact of a release on prices and imports—and, hence, on benefits—is more complicated than the government currently assumes. For example, total oil imports can drop by less than the amount of the SPR release if the rate of withdrawal from private stocks falls in response to increased uncertainty surrounding current prices. In that case, the economic benefits from using the SPR would be lower than they otherwise would be. To be most effective, an emergency policy should consider how the decision to release SPR oil and the sales mechanism for releasing it affect market uncertainty.

Under the current sales mechanism, the government sets the volume of SPR oil to release and sells that oil to the highest bidder. The resulting addition to world supply can help to limit future increases in prices—and therefore reduce uncertainty about prices—by freeing up other sources of oil to offset further disruptions in supply. But the public's confusion about whether the government will actually sell the full volume it offers can undermine that reduction in uncertainty. Under alternative sales mechanisms, the government could instead set the price for the oil it plans to sell and let the market decide when and how much to take. A sale using such mechanisms may help to reduce uncertainty not only by freeing up additional supplies but also by removing ambiguity about how much the supply of oil will grow and by making the world supply more responsive to changes in price.

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