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One Way to Punish Russia

By Todd Wood

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The Obama administration’s decision to release 5 million barrels of crude oil from the U.S. Strategic Petroleum Reserve on March 12 signaled to Russia and the rest of the world how the West intends to respond to the Kremlin’s actions in Crimea. It is a harbinger of things to come.

One of the weaknesses that the West has chosen to exploit is Russia’s dependence on energy exports. No matter what you think of the situation in Ukraine, the new global energy realities need to be understood.

The U.S. Strategic Petroleum Reserve was set up after the Arab oil embargo of the 1970s and holds about 727 million barrels of crude oil, making it the largest reserve in the world.

The White House described the March 12 release as a “test release.” However, the timing was not coincidental. It was a shot across the bow of Russia’s petroleum based economy.

The global tension caused by events in Ukraine have actually added to the Russian coffers as the price of crude oil has risen while the ruble has been devalued. By releasing oil from its strategic reserve, the U.S. is telling the world that it has the power to influence the world oil market if it so chooses, and the timing indicates that it considering this course of action in response to events in Crimea.

The Strategic Petroleum Reserve is not the only arrow in Obama's quiver. For example, he could use his executive authority to waive the 1970 ban on U.S. crude oil exports — the same act of Congress that began stockpiling crude oil. In this way, the U.S. could instantly drop millions of barrels of oil on to the international market. In fact, U.S. refineries cannot handle any more of the light sweet crude being produced in shale regions than they are already processing.

U.S. refineries are geared toward the more heavy oil imported from Venezuela and elsewhere. So, by exporting surplus crude to European refineries, the U.S. could reduce European reliance on Russian crude.

Finally, the U.S. can hit Russia through the natural gas market. The hydraulic fracturing revolution is turning the U.S. in to a net exporter of natural gas. Over the next few years, the U.S. and Europe are expected to expand their liquified natural gas infrastructure, further reducing the European market for Russian gas. In less than five years, the threat of a Russian gas cutoff could ring hollow.

Sure, Russia has the largest reserves of hydrocarbons in the world, but it does not possess the technology to harvest them on its own.

It needs Western support and extraction technology to efficiently develop Russian hydraulic fracturing capability in the north. The West could embargo this technology to slow the growth of this capability.

Additionally, a number of European nations have already started to break away from the global warming craze and develop their own hydraulic fracturing sector. This will further reduce demand for Russian gas.

How would these measures effect Russia?

The hydrocarbon windfalls of the last decade have not led to a modernization of the Russian economy, which would have reduced its dependency on energy exports.

Russian government revenues and consumption remain highly dependent on the oil prices. If the U.S. floods the market with crude, the global price of oil will fall and negatively affect the Russian economy. This might push the economy into a recession and the federal budget into a deficit spending situation.

Meanwhile, Russian borrowing costs on the capital markets have been rising. Russia does have a large foreign currency reserve to cushion the blow, but it will not last forever. These reserves must also be used to defend the ruble against its almost certain devaluation.

The discovery of vast hydrocarbon reserves in the U.S. and elsewhere in the last decade has dramatically altered the geopolitical chessboard and the balance of power in the global energy market.

The recent release of oil from the U.S. Strategic Petroleum Reserves is the first of many validations of this new world order. Russia should take heed of these new realities.

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The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.