The Street

U.S. May Be Selling Oil at Worst Possible Time

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The goal of investing is to buy low and sell high. The U.S. government apparently never got that memo.

The recent budget agreement between the White House and Congress calls for the U.S. government to sell about 8% of its strategic petroleum reserve to help offset some $66 billion in new spending.

The only problem is, selling now could result in a $1.5 billion loss.

With oil prices down sharply because of a supply glut, the government's timing is probably not the best.

"There have certainly been more opportune moments for the government to start selling petroleum," Thomas Finlon, an analyst at Energy Analytics Group, said in an interview. "While China and India are using the depressed prices to boost their own reserves, we're buying high and selling low."

Although sales won't begin until 2018, the outlook for oil prices is not very favorable right now. That's why the government is likely to lose money. Most of the oil was bought when prices were nearly double what they are now.

Oil traders estimate the government paid about $60 to $80 a barrel. One study by research firm ClearView Energy Partners puts the average price at $74 after adjusting for inflation and other factors.

"There's not a barrel of oil in there that they paid $43 a barrel for," Finlon said.

With U.S. crude now selling for about $46 a barrel, the government could lose up to $1.54 billion, or $28 a barrel, based on the $74 average purchase price estimate. The strategic reserve currently holds about 695 million barrels.

The U.S. Department of Energy disagrees with this assessment, saying it paid only $29.70 a barrel on average. But oil prices haven't been that low since 2004.

Whatever the price, the sales will just put more pressure on oil prices. If you include Iran's oil sales once U.S.-led sanctions are lifted, a further slowing of China's economy, an obstinate Organization of Petroleum Exporting Countries and booming production in the U.S. shale, the prediction of $20 oil doesn't sound so far-fetched.

Not everyone thinks the government's idea is so bad. Proponents of privatization and small government say it's about time the U.S. did away with its outdated reserve system, regardless of any losses.

"It should absolutely be liquidated," Steve Hanke, applied economist at Johns Hopkins University and a senior fellow at the libertarian Cato Institute in Washington, said in an interview. "The whole thing is a hokey white elephant boondoggle."

Hanke and others draw attention to the cost of building and maintaining the infrastructure of the reserve, as well as the capability of private markets and supply chains to keep up with commodity demands even during times of crisis.

"It's not like we're constantly running out of stuff because we don't have a government backup somewhere," Hanke said. "The implications for national security are minimal."

Another theoretical function of the reserve, which critics call out for rarely being used, is to suppress volatility in the markets by introducing more supply at moments of peaking prices.