THE WALL STREET JOURNAL. | OPINION

How to Hit Putin Where It Hurts

Russia needs a $117 per barrel price of oil to balance its budget. Let's aim for $60.

By R. James Woolsey And Anne Korin
May 14, 2014 7:23 p.m. ET

As Russia's Ukrainian incursion sends a chill through the Baltic states, diplomatic fecklessness and the lack of adequate collective defense capabilities on the ground seems to leave the U.S. and Europe with economic sanctions as the only lever against Vladimir Putin's imperialism. Yet asset freezes and travel bans on Putin buddies garner yawns in the Kremlin and almost no public support among NATO or European Union members.

There is, however, another approach that would undermine Russia's (and like-minded oil autocracies') efforts at regional domination while strengthening Western economies.

Russia's geopolitical influence in Europe derives in part from its hand on the natural-gas tap, but its Achilles' heel is the price of oil. A successful effort to drive the price of oil down to, say, $60 a barrel—far below the $117 per barrel that Russia requires to balance its national budget—would benefit the West, as well as China and India. Neither of the latter two countries, on the other hand, is likely to cooperate with sanctioning major energy exporters.

How can we reduce prices when the bulk of the world's low-marginal-cost oil supplies are held by the OPEC cartel, which has not increased production in 40 years? By opening the door to arbitrage among different energy commodities in the market for transportation fuel.

Two thirds of the oil consumed in the U.S., and the bulk of the growth in oil consumed in the developing world, is for transportation. Conversely, more than 95% of transportation fuel is petroleum-based. Due to its high price, in every sector where oil has faced competition from other energy sources it has lost market share. Consider that only 1% of U.S. electricity is now generated from oil, compared with 17% in 1973; and only 1% of U.S. oil demand is attributable to electricity generation, compared with 8.5% in 1973.

Opening cars to competitive fuel sources—so consumers can make an at-the-pump choice among different fuels by comparing cost per mile—would open the door to transportation fuel arbitrage. If investors expect new cars will be open to fuel competition (and that used cars can be easily and cheaply converted), they will expand production capacity for the particular non-petroleum fuels they expect will be profitable. And with a sufficient expansion of supply this competition would serve to lower oil's importance and its price.

Thanks to low U.S. natural gas prices, methanol, an alcohol fuel made from natural gas, is one of the most economically attractive competitors for gasoline. Flexible fuel vehicles that can run on a variety of alcohol fuels made from natural gas, biomass, coal or even recycled carbon dioxide, as well as on gasoline, cost auto makers less than $100—half the cost of a seat belt—extra to make, as compared with gasoline-only cars, according to the MIT Sloan Automotive Lab's research.

These fuels require no subsidies and neither do the vehicles. The U.S. Energy Security Council has proposed no-subsidy, no-mandate regulatory reform that would serve to speed the way to fuel competition. A key recommendation would allow auto makers the option of meeting part of their existing fuel-economy obligations by ensuring that most of the new cars they produce in a given model year allow fuel competition of some sort.

Vehicle fleet turnover takes time, so fuel competition would not have an immediate impact on Russia, or on other oil exporters. But neither would sanctions. The construction of terminals needed to facilitate exports of U.S. liquefied natural gas, or LNG, to Europe will take a long time and an exporter with a choice of markets—in the absence of inducements such as long-term contracts—may find it more lucrative to sell LNG to Asia, where prices are higher. But transportation fuel competition would be politically and economically welcome because consumers world-wide would see a drop in the cost of driving.

Oil would slowly but relentlessly lose its place in the global balance of power, and the countries that rely upon high oil prices as the centerpiece of their national budgets would need to restructure fundamentally their geopolitical ambitions toward the rest of the world.

Mr. Woolsey, a former CIA director, is co-founder of the U.S. Energy Security Council and chairman of the board of the Foundation for Defense of Democracies. Ms. Korin is co-director of the Institute for the Analysis of Global Security and senior adviser to the U.S. Energy Security Council.

http://online.wsj.com/news/articles/SB10001424052702304101504579546181450642264