



Rodney's Take

July 11, 2022

Of Course We Sold Oil to the Chinese

Last week, Reuters reported that more than five million barrels of oil from the U.S. Strategic Petroleum Reserve (SPR) were shipped to destinations in Europe and Asia in June. Other sources tracked some of the oil to destinations in China. News pundits were furious that strategic oil reserves meant to fuel the U.S. during market disruptions were sent to our economic rival. At the same time, President Biden called out refiners in a tweet in which he demanded that they lower the price they charge for gasoline. Both situations show that many people, even some who are in charge, still don't understand the energy markets. When you commit to be part of a global market, local supply and demand are affected by international events.

The U.S. created the SPR during the 1970s in the wake of the 1973 oil embargo. The goal was to have enough oil on hand to fuel critical needs in the event of a supply disruption. It worked. In the decades since, presidents have ordered releases from the SPR after hurricanes disrupted oil shipments from overseas and oil production in the Gulf of Mexico. Draining oil from the SPR kept refineries operating and supported gasoline deliveries. This time is different. The current SPR release isn't about supplying oil when no other source exists, it's about reducing the price of oil in an effort to reduce gasoline prices. The problem is that oil prices and, to a lesser extent, gasoline prices are set on the world market. Even if President Biden instructed that oil from the SPR be sold only to domestic users, it still wouldn't matter. Within grades such as light sweet and heavy sour, oil is fungible.

U.S. refiners can handle about 18 million barrels per day and are running at more than 97% of capacity, which essentially is flat out. U.S. oil companies produce about 12 million barrels per day, and the U.S. uses about 20 million barrels per day. Not only do we import eight million barrels of oil per day on average, we also import two million barrels of oil worth of gasoline. There is no way for the U.S. to supply all the oil we use or to refine all the gasoline we use from domestic sources. We have used more oil than we could produce for almost a century, although our refining capacity just fell behind our gasoline use in the last few decades.

We are part of and partly beholden to the global markets, where roughly 101 million barrels of oil are used every day. By releasing one million barrels per day from the SPR, the Biden administration is adding a proverbial drop to the global oil bucket. It's not nothing, but it's not a game changer, either. The SPR release roughly matches the decline in Russian oil production since that country invaded Ukraine. Whether the oil released from the SPR is sold to domestic refiners, European refiners, or even Chinese refiners doesn't matter. The oil still flows into a global bucket from which all refiners, including those in the U.S., draw their supply.

The administration could have demanded that the SPR oil be sold only to domestic refiners, but that would just lead those producers to buy less oil from foreign sources, who then would sell to refiners elsewhere at the same price. The SPR could sell oil below the market price and only to domestic producers (if such a thing was practical, given transportation issues), but because the release is just one million barrels per day, or 5% of U.S. consumption, even at a price of zero, it would mean an average cost reduction of 5%.

To control the price of oil and gas domestically, we would need to increase our oil production by millions of barrels per day, match all of our refining capacity to the types of oil we produce, and increase our refining capacity by at least two million barrels per day. None of that seems likely. As I discussed in Rodney's Take on June 29, our refining capacity is going the other direction; there's no reason to think it will increase in the years to come.

As long as we're part of a global market for an easily substitutable commodity, controlling the flow will be difficult and largely fruitless, and releasing oil from the SPR won't do much, other than reduce what we have on hand for the next supply shock. With the height of hurricane season just around the corner, we could be facing a real supply shock sooner than we think.

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