Our View: The IEA's Trillion Dollar Theft[1]

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Crude oil refiners and marketers received a huge profit windfall from the March 31 announcement of a sizeable strategic oil stock release by the United States and other International Energy Agency member countries. Conversely, crude oil producers across the world suffered. By August 8, the producers had lost $325 billion. If the trend continues through March 2023, a full year, the total will reach almost $1 trillion. Saudi Arabia will lose $100 billion and Russia nearly $90 billion.

To date, refiners have captured most of the losses recorded by producers because of the global capacity shortage. The exception is France, where refiners agreed to substantial price cuts to avoid a windfall tax on profits. Consumers, though, saw little benefit anywhere.

The income transfer is occurring because the tighter financial conditions imposed on the oil industry have broken traditional arbitrage relationships. The refining sector has seized the advantage created by the reduced bank lending and the SPR release announcement's impact on speculative activity to drive a wedge between crude and product prices.

Since President Biden took office, the pundits writing on oil, the leaders of many oil-exporting countries, and oil firm CEOs have belittled him. Their scorn is justified. Often Biden seems as clumsy as President Gerald Ford, who many asserted could not walk and chew gum simultaneously.

The vitriol spawned by President Ford's occasional physical miscues was unfair to the former Michigan All-American football star. The criticism of Biden is equally unjust, although the oil industry's distaste for him is understandable. His actions have cost producers plenty. His decision to release oil from the US Strategic Petroleum Reserve, which prompted other nations to follow, has saddled oil firms with losses that could eventually total $1 trillion.

That number bears repeating. The stock releases will reduce the combined incomes of oil-exporting countries such as Kuwait and Saudi Arabia and oil producers such as Pioneer Natural Resources and Occidental by $1 trillion if the trend that began on March 31 per-sists for a year.

March 31 was the date President Biden announced an SPR release of one hundred eighty million barrels. Other IEA countries followed suit. Initially, however, the United States acted alone. Five months later, the average price received by oil producers is at least $28 per barrel lower than it would have been absent this action. For Saudi Arabia, the country that so publicly dismissed the president's request for increased production, the loss to date is a little less than $36 billion.

Still, the measures have not had the intended effect. Consumers have not seen the crude oil price reductions reflected in gasoline prices. While retail gas prices in the United States have declined from a June 14 peak of $5.02 per gallon to $4.16 , the drop should have been higher given the change in crude

[1] Note: Text excerpted from "The IEA Strategic Stock Release," *Notes at the Margin*, August 8, 2022.

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prices. The average retail price would have been around $3.50 per gallon had refiners not captured the benefit of the SPR sales.

Refiners, not consumers, have been the primary beneficiaries of the SPR "tax" on crude oil production. Integrated firms such as Chevron, ExxonMobil, and Shell, independent refiners such as Marathon, PBF, and Valero, and marketers such as Global Partners LLC and Couche-Tard have profited most.

Global's product margins, a measure of the SPR or Biden tax on producers, rose more than $100 million or fifty-two percent in the second quarter from the second quarter in 2021 despite a seven-percent decline in sales volume. Murphy USA, another retail marketer, reported a forty-two percent increase in profits.

Refiners and marketers have become the "SPR winners" for six reasons. First, global refiners are operating at capacity and, outside of China, cannot boost output. Second, the oil-exporting countries' decision to drive down inventories after the 2020 price collapse has left global crude and product stocks exceedingly low. Third, the US Department of Energy released the wrong type of crude. Fourth, key banks deciding to limit their lending to oil companies have reduced the ability of intermediaries to hedge inventories, leading to greater backwardation in product markets. Fifth, the expansion of the "oil casinos" operated by the CME and ICE increased price volatility, further decreasing the ability to hedge. Finally, the Chinese government's limits on product exports have reduced the sup-ply of critical fuels from the one nation with surplus refining capacity.

In effect, Biden's action resulted in the transfer of money from the producers' pockets to those of refiners and marketers. One way to envision this is to imagine Pioneer Natural Resources CEO Scott Sheffield writing checks for $1.18 billion to PBF CEO Thomas Nimbley and Valero CEO Joseph Gorder.

Again, consumers gained little from the stock release. Gasoline futures prices did not fall, and gasoline markets remained in backwardation. The data reveal that the retail gasoline prices followed the gasoline futures price in most major markets, meaning consumers have not seen any benefit from the strategic stock releases. Indeed, refiners and marketers seem to have captured more than one hundred percent of the benefits from the release in all but the most competitive markets—Houston, for example. There, refiners and marketers may have reaped eight percent of the gain.

The impact of the IEA oil releases, then, has primarily been an income shift from one part of the petroleum sector to another. Given the constrained refining capacity, this result should not be a surprise.

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