

Our View: Send in the Clowns

Zero Sum Economics: OPEC vs. the Traders

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“Send in the Clowns” is one of Stephen Sondheim’s greatest songs. The lyrics from the fourth stanza almost perfectly explain the oil market situation today:

Don't you love farce?
My fault, I fear
I thought that you'd want what I want
Sorry, my dear!
But where are the clowns
Send in the clowns
Don't bother, they're here

We leave it to the reader to decide whether the OPEC+ meetings are farcical. However, the third and fourth lines above summarize the problems confronting oil producers:

I thought that you'd want what I want
Sorry, my dear!

The ministers from the various oil-exporting countries evidently believe that traders and refiners want what they want: higher prices. **The ministers are wrong.**

Traders and refiners today have two desires: strong demand and fat margins. The business economics for independent refiners and trading companies depend primarily on the levels of consumption and margins.

The consumption level depends on product prices.

The margin depends on the difference between the product’s cost and the cost of crude.

Full success requires lower product prices, which will boost sales and slow the transition from fossil fuels to renewables.

Stronger margins require crude oil prices to fall by greater amounts than product prices.

The increasing need of refiners and traders for low crude prices dates from the early part of this century. Historically, large multinational oil companies were interested in the profitability of fully integrated operations. Even after OPEC nations nationalized their oil production facilities almost fifty years ago, companies such as BP, Chevron, ExxonMobil, and Shell focused on the entire margin.

The divestiture of refining assets changed the situation. The sale of these assets created a group of firms that profited not from the absolute price but from the margin.

Initially, the change did not matter. However, the power has shifted as a greater share of refining capacity has moved to firms having no assets, including reserves.

Most recently three trading firms—Glencore, Trafigura, and Vitol—acquired significant positions in refining. These firms want low product prices because they boost sales and volatility. They also seek large margins.

All oil producers are losers from this development. The trading firms will use every technique possible to drive down crude prices. (Note: at noon today, crude prices were down almost \$3 per barrel.) The integrated oil companies that sold refineries to the traders literally put the fox in the hen house.

This trend has already resulted in much larger refining margins. My analysis shows that from 2018 to 2022, margins rose by \$2.30 per barrel from the 1997 to 2017 average. They then jumped another \$16 in 2022. The increase has declined since.

Overall, trading companies and independent refiners have gained \$10 per barrel from the period before refining divestitures were so common.

Following the OPEC meeting, Amrita Sen of Energy Aspects told Reuters that the ministers' agreement “keeps OPEC+ in charge of the market.” Sen is **dead wrong**. Traders and refiners now have control, not the oil-exporting nations.

Send in the clowns? No, don't bother, they're here.