Our View: European Refiners Face Extinction

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A *Financial Times* article by Ed Crooks posted online yesterday[1] suggests European refiners are being harmed because US refiners are benefiting from low-cost crude. He is wrong. European refiners, like the dinosaurs, face extinction because they failed to adapt to changing circumstances. The mistakes in the Crooks article vitiate its conclusion that US refiners are in a battle to protect their interests. These refiners will do better than ever in the future, in part because four million barrels of European capacity will soon close.

The article's first mistake is to characterize the refining business as being "all about grubbing for pennies in the street." Crooks uses Shell as an example in this respect, saying "the keys to [refining] success are not courage and creativity, but careful management of price differentials and diligent cost control." In reality, large integrated companies like Shell starved their refiners by artificially inflating crude prices. The low returns tied to these high costs led to underinvestment.

In contrast, US independent refiners have not paid inflated crude prices or been forced to run their parent companies' oil for decades. As a result, they have earned higher returns and reinvested the profits in upgrades and additional capacity.

The US refining sector is now the most efficient and complex in the world, in large part because the integrated companies exited the business. Our East and Gulf Coast refineries are mostly state of the art and independent.

European refiners, on the other hand, have not benefited from such investment in general. They also failed to adjust to shifting conditions. As their governments forced a switch from gasoline to diesel, these refiners, particularly the integrated companies, complained rather than making the investments needed to accommodate the change. (Complaining was less expensive.) Today, they must export large volumes of gasoline produced at their out-of-date facilities or close. No European market exists for their product.

For years, European refiners could send gasoline to the US East Coast. This outlet has disappeared, however, as falling demand and investments made in independent refineries there—facilities owned by entrepreneurs rather than integrated firms—closed that opportunity. Today, East Coast refiners also benefit from natural gas prices at $1.50 per thousand cubic feet ($18 per barrel). They do not benefit from low-cost crude. They pay Brent-based prices and still earn profits.

European refiners have now turned to Africa to sell their gasoline, but the more efficient and competitive US refiners will soon squeeze them out of that market as well.

Crooks asserts that "the greatest threat to these halcyon days for US refiners is the prospect of an end to the crude export ban." The debate over US crude exports is a sideshow. Required investments were not made in European refining. Refiners there face a situation similar to an airline flying prop-driven DC-3s attempting to compete with Lufthansa's A380. One third and perhaps even half of the refining capacity in Europe must close. US refiners will reap the reward.

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[1] See Ed Crooks, "US Oil Refiners Face Battle to Prolong Halcyon Days," *Financial Times*, August 17, 2014.