

Our View: China May Be Able to Shut Down the Permian and Make US Refiners Rich

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The trade war between China and the United States could soon claim a new group of victims—US independent oil producers—while strengthening US refiners. Economic theory buttressed by strong historical evidence predicts that retaliatory actions by China could soon slow or shut drilling in the Bakken, the Eagle Ford, Niobrara, and the Permian Basin by driving US domestic crude prices down sharply while perhaps allowing US refiners to double their margins.

In 1936, the English economics journal *Economica* published a now-classic paper by economist Abba P. Lerner, who was then a graduate student.¹ In it, Lerner offered a “symmetry theorem” that showed that an ad valorem (value-added) import tariff would have the same impact as an ad valorem tax on exports.

In the current trade war with China, US soybean farmers have already felt the financial sting of this effect as the price they receive for their crop has dropped from around \$10.80 per bushel before China implemented its tariff in June to \$8.60 afterward.

US oil producers could be the next to feel the impact of Lerner’s “scribblings.” China has indicated it will impose duties of twenty to twenty-five percent on its imports of crude oil from the United States. The tariffs will create significant problems for US crude producers, just as Chinese tariffs on soybeans have created problems for US soybean farmers. For example, prices for WTI Midland might drop from around \$57 per barrel to under \$43 if China imposes a twenty-five percent tariff on its imports of oil from the United States. This price is less than what many firms developing oil in the Permian Basin require to maintain their operations.

Meanwhile, the Chinese tariffs on that country’s US crude oil imports could send returns and cracks for US refiners to record levels. Refiners will gain because the tariffs will depress their cost of crude as they continue to receive the world price for their petroleum products.

For more information on the possible impact of Chinese tariffs on US oil producers and refiners, please contact us at info@pkverlegerllc.com. Thanks!

¹ A.P. Lerner, “The Symmetry between Import and Export Taxes,” *Economica* 3, No. 11 (August 1936), pp. 306-313.