

Our View: The Oil Capacity Shibboleth

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There is a longstanding shibboleth among those who follow oil: excess oil productive capacity is essential. Thus, the Saudi oil minister has suggested that his country is doing the world a favor and “acting as mature guys” by keeping surplus capacity in reserve.

The minister is wrong. Most economists understand that monopolists maintain surplus capacity and seek to maximize profits by producing until marginal revenues equal marginal costs. This concept is foreign to those who follow oil, even the so-called “oil economists.”

Knowledgeable economists have known for over 100 years that inventories, not surplus capacity, can be and are used to stabilize prices. Strategic oil stocks were built for this purpose. I know because I was involved in creating the US Strategic Petroleum Reserve. President Biden has finally used it as it was designed to be used.

Biden’s actions have infuriated the Saudis. Today, their oil minister told the Future Investment Initiative conference in Riyadh that “people are depleting their emergency stocks as a mechanism to manipulate markets.” Like most in the oil industry, the minister believes strategic stocks should only be used to address shortages, which never occur in a free market. (See, for example, the rise and fall of natural gas prices in Europe over 2022.)

One should understand the Saudi complaint. Saudi Arabia has lost at least \$23 billion in revenue since Biden stepped forward and released US strategic reserves. The Saudis’ total revenue loss now amounts to more than \$48 billion. So sorry.

Today, the International Energy Agency’s executive director stated, “We still have a huge amount of stocks to be released in case we see supply disruptions.” Consuming countries have gotten the message. They have the stocks. They will use them. The monopolist has lost control.

The “mature guys” are the members of the G7.