Gasoline prices and the “free market”: Refiners profit after reducing capacity

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The recent sharp rise in US gasoline prices and the accompanying hardship for millions of people underscore once again the consequences of an energy market dominated by a few giant corporations. The price increase has been attributed to limited refining capacity, which has generated a sharp rise in refinery profits while facilitating market manipulation.

Gas prices in the US rose to record highs just in time for the Memorial Day weekend at the end of May, traditionally a time when many families drive long distances. Average gasoline prices reached $3.22 last week, approaching the record inflation-adjusted high of $3.29, set in 1981. In some parts of the country, prices rose considerably above that, with gasoline reaching as high as $3.69 a gallon in California.

The main beneficiaries of the surge in prices have been American refiners, which import crude oil and process it into gasoline and other products. Some of the major oil corporations, such as ExxonMobil and Chevron, are vertically integrated, combining oil extraction and refining operations. These companies have seen profitability of the refining portion of their business soar.

A *Wall Street Journal* article May 18 noted that refiners are pulling in more than $30 in profit before taxes and other expenses for every barrel of oil that they process, the most per barrel since the immediate aftermath of Hurricane Katrina in 2005. On the West Coast, where gasoline prices are higher than the national average, refinery profits are at $39 a barrel, more than double the average of $17 over the past five years, according to a March 9 report in the *San Francisco Chronicle*.

The large differential between the oil refinery revenues from the sale of gasoline and costs from the purchase of crude has been explained by shortages in refining capacity, which has reduced gasoline reserves as demand increases—leading to a rise in gas prices. All of the extra profit to the major refineries is coming directly out of the pockets of American consumers.

Bloomberg news service quoted Tom Betz, an oil broker with BNP Paribos Inc., as noting, “Probably stocks, based on demand, have never been lower in our history.” Demand is “very strong and is still rising as we head into driving season,” meaning that gasoline prices will stay high throughout the summer.

The rise in prices is hurting working class and lower-income families the most, as they have less disposable income to shift to transportation costs. This means that the high prices are cutting into other necessary spending, including food, prices for which are also rising throughout the country. An AP poll released May 25 found that 46 percent of the population said that high gasoline prices are causing severe financial problems.

The shortage of refining capacity is generally attributed in the media to a number of planned and unplanned refinery outages. However, refinery capacity has been deliberately decreased over the course of the past two decades, for the explicit purpose of boosting profit margins.

The *Journal* article notes, “For decades, there was too much refining capacity in the US, margins were crummy and many companies were closing or selling off refineries. In 1986, refiners made little more than $2 for every barrel they processed.” The newspaper quotes Fadel Gheit, a senior energy analyst of Oppenheimer & Co. and a former employee at Mobil, now part of ExxonMobil, as saying, “We used to commission studies to get rid of refineries. We wanted to give them away.”

In the first quarter of the year, refining profits of $1.91 billion at Exxon and $1.62 billion at Chevron have helped generate massive profits for the companies as a whole. Corporations that engage only in refining have done even better.

In the long-term, the high gasoline prices are a product of the conscious policy of the giant oil companies, who, through a series of mergers and acquisitions over the same period, have concentrated the market in the hands of a small number of firms. Inflation-adjusted prices for gasoline in the US were below $2.00 a gallon for most of the late 1980s and 1990s. They only surged above $2.00 in 2004, and have pushed past $3.00 for periods of time in 2005, 2006 and again in 2007.

The ability of energy companies to increase profits simply by raising prices is aided by the fact that demand for gasoline, particularly in the United States, is highly inelastic—i.e., demand does not fluctuate much with changing prices. This is due to the fact that there are few alternatives to automobile transportation, given the absence of viable public transportation systems in many areas. In major metropolitan areas such as Los Angeles or Detroit workers have no choice but to drive the often long distances separating homes from work. According to the Census Bureau, only 4.7 percent of the US commuting population takes mass transit to work each day.

A University of California study this year found that gasoline demand is significantly less elastic now than it was 30 years ago. As a consequence, when prices rise, the main consequence is that consumers must pay more, rather than that demand will fall.

With refining capacity at a historically low point, it is relatively easy for refiners to manipulate prices in the short term as well. It is only necessary for a few refineries to be shut down—attributed to necessary maintenance or mechanical failures—to drive inventories down and prices up.

A March 2007 study by the Energy Information Administration, part of the US Department of Energy ("Refinery Outages: Description and Potential Impact on Petroleum Prices"), found that refineries operated with excess capacity up until the mid-1990s. By then, refineries had cut capacity substantially. As demand has continued to grow, refining capacity has had a much stronger impact on gasoline prices. "With little spare refinery capacity available during peak demand times, unexpected refinery outages can result in local supply disruptions that result in temporary price surges," the report found.

The *Chronicle* quoted Severin Borenstein, director of the University of California Energy Institute, noting, "It comes down to this: There's a scarcity, and the question is whether it's a real scarcity or if it's being constructed," i.e., if companies are manipulating supply. "If somebody told them, 'Use your market power,' this is how they'd do it," by deliberately shutting down refineries.

A *Denver Post* article of May 19 noted that, at the beginning of the year, "refiners were stating that the heavy maintenance schedule was to enable full production prior to summer demand," but these full production schedules have failed to materialize. Refinery utilization rates have been at a relatively low ebb for months. The *Post* quotes petroleum analyst Bryant Giland of Fort Lupton-based Gray Oil Co: "Yet it seems [refiners] have learned running at reduced rates is very good for profit margins. That's nice work if you can get it."

What is clear is that the rise in prices cannot be explained by a corresponding rise in crude, since crude prices have remained largely flat over the period that gasoline prices have soared.

Several commentators, including the WSWS, noted the coincidence last year between a sharp decline in the gasoline prices and the run-up to the 2006 mid-term elections. According to polls conducted at the time, 42 percent of the American population held the opinion that the price drop was part of a deliberate attempt to manipulate the elections by temporarily decreasing economic insecurity. This was seen as a potential boost to Republican candidates. (See "US gasoline prices; the 'free market' and the November elections")

With the soaring gas prices, the energy companies are now getting back every penny, with interest, that they lost while prices were relatively low in September, October and November.

Even if one were to suppose that there was no element of deliberate manipulation, the situation stands as an indictment of the anarchistic character of the capitalist market, particularly evident in the fluctuations in the prices of basic necessities such as gasoline. An energy policy developed to serve the interests of the population, and not the profits of a handful of energy giants, would involve ensuring an adequate supply and low prices, not to mention substantial investment in public transportation infrastructure. The subordination of the energy market to the demands of profit has also made it impossible to pursue rational energy policy on such issues as global warming.

Under these conditions, the various proposals advanced by the Democrats in Washington are noteworthy only for their cynicism. The House of Representatives passed a bill that would punish anyone found guilty of engaging in price gouging. Others have suggested measures—the same ones suggested and never passed whenever gasoline prices spike—that would temporarily cut federal taxes or create a "windfall profits" tax. Leading Democrats raise these proposals knowing full well they will never pass into law. However, even if they did, they would have no impact on the underlying problem—the domination of a handful of energy companies over a market that affects hundreds of millions of people.