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Seaway Pipeline No Panacea for Cushing's Oil Glut

By [EconMatters](#), January 19, 2013, 01:58:20 PM EDT

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The weekly EIA report came out today and one of the noteworthy data points was the Cushing, Oklahoma storage numbers. Already at a record, Cushing added another 1.8 million barrels to storage sending total Cushing stocks to 51.9 million barrels of oil in storage facilities at the energy hub.

There has been 6.3 million barrels of oil added to Cushing during the last 6 weeks. To put these build numbers into perspective, [Cushing oil inventories](#) stood at 28.3 million barrels for this time a year ago, which is a build of 23.6 million barrels in a year.

Seaway Pipeline Expansion

The Seaway pipeline was recently expanded to 400,000 barrels per day from 100,000 barrels per day, and many analysts have predicted that this would solve the Cushing oil glut. But it is looking more and more that what the Seaway pipeline offers is a cheaper mode of delivery out of Cushing, and the real benefit is one of logistical optionality for transportation.

However, it is shaping up due to the sheer size of these build in inventories at Cushing that the Seaway pipeline is not a magic solution for the supply and demand fundamentals at play in the oil industry in the United States, there is just more US production, than there is US infrastructure in place to deal with the trending upturn in this production.

Oil is Fungible

In short, the US and global oil model isn't set up for the United States to be producing more than 7 million barrels of oil per day. Even if the Seaway pipeline could send 4 million barrels of oil out of Cushing, it wouldn't make a difference because Oil is fungible, so without major cuts somewhere else in the global supply chain, then you're going to have [supply and storage builds](#) somewhere in the supply chain.

Saudi Arabia can only cut back production so much

The Saudi's have already cut back production to fifteen month lows, how long is that going to continue



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as they need oil revenue just like everyone else? So Cushing is just a reflection and end point for the delivery of increasing US production, which ultimately is building more than there is demand from refiners for producing products, even with an increase in exporting of gasoline and other petroleum products.

Cushing never was landlocked

This should have been apparent to analysts as rail has been delivering Oil to refiners during this domestic boom, and so are barges taking oil out of Cushing, so large amounts of oil are getting to refiners. Some of it before it even gets to Cushing, and some after with the Seaway pipeline, and barges out of Cushing; and with the spread in 2012 of as much as 25 dollars, there were major incentives to get US oil to refiners in a myriad of ways.

Cushing builds reflective of bigger problem

Yet we have almost doubled Cushing's inventories in a year. This points to a much bigger problem with analysts missing entirely, thinking this was just a Cushing log jam problem. This is seeing the trees, and missing the overall forest, Cushing is just a reflection of the bigger problem, there is just too damn much oil sloshing around the world right now with nowhere to go.

You see this in stories about Nigerian crude for February delivery being unsold and stuck on cargo ships because there are no buyers with the increase in US domestic production. Iraq is producing more oil, and they need the revenue so expect more oil coming out of Iraq for the next decade with each year producing more than the previous.

The world is producing more oil than is consumed each day

The world global supply chain is producing more oil than the world needs every day, and this means storage has to build somewhere, and whether it is Cushing, or Nigeria, or China it has to be stored somewhere.

In the US, Cushing has expanded storage facilities the past couple of years, and has been a default place to send the extra oil. But even Cushing is rapidly reaching capacity limits, and even if on the margin the Seaway pipeline takes out more oil, refiners can only handle so much more before they become the bottleneck in the equation.

US Refineries not easy to build

Remember, refiners are not easy to build, and the US has only relatively recently ramped up domestic production, so even with substantial increases in fuel exports, there just are not enough US refineries to handle the increase in US oil production. In short, the oil model of the last decade was not set up with the US being a major producer. The US production increases is throwing the global supply models a major curve ball.

Therefore, the only way that Cushing inventories are going to go down substantially is if more US refineries are built, and that could take three to four years, if they are built at all given the regulatory and financial hurdles that have prevented progress in this area over the last decade.

Unintended Consequences

The bottom line is that the Seaway pipeline is no cure for what ails Cushing inventory builds. For what ails Cushing is the fact that nobody thought about the unintended consequences of a boom in US oil production due to high prices for the past decade.

The global economy has slowed down from the peak in 2007, but prices have remained high, this resulted in increased production projects globally, and the rise in US production just sent the supply levels over the edge.

Furthermore, nobody ever planned or expected that the US would start producing with these numbers ever again. This has thrown the whole supply chain on its back, Cushing is just a reflection of this fact, there is more oil than the world needs right now, and the world definitely didn't need an increase in US production.

Cushing builds still a problem

As a result you get Cushing, the manifestation of what happens when the unexpected happens before the oil models know what to do with the extra supply. You do not get the kind of builds at Cushing, with a new pipeline in existence for six months, a hefty spread, and rails transporting oil at unheard of levels, unless there is a much bigger problem than just increasing the Seaway pipeline by 300,000 barrels per day.

The Seaway Pipeline just steals business from Railroads & Barges

So Seaway doesn't solve the Cushing problem as many have hoped. All Seaway does is maybe take some business from barges and railroads in the transportation of the product.

But the problem was much bigger than these people ever realized, because Cushing never represented a landlocked, logistics equation.

Cushing builds represents the fact that right now there is just too damn much oil that is being produced versus consumption needs for that oil. So it has to be stored somewhere, and Cushing is one of the

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Too many chefs in the kitchen

The real problem is that nobody ever planned for the US to be producing 7 million barrels of oil every day and rising, there is just not enough demand in the world for this extra oil, so it has to be stored because everyone needs the money these days. And until prices drop substantially, no one is going to cut back producing this black gold.

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