OPEC’S Market Role: Changing Signs?

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Summary of OPEC’s Historical Market Role

• Restrict production to elevate price above competitive level.
  • 1974-1982: Fixed posted price with agreed differentials
  • 1982-2014: Official production quotas with member allocations
  • 2015-2016: Abandon quotas: Maintain OPEC market share despite falling price
  • 2017-2018: Return to official production quotas, include Russia, etc.
  • 2018- : ???

(Slow development of incremental production capacity, to alleviate "cheating.
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(Pierru, Smith, and Zamrik, forthcoming in The Energy Journal)
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Defense of the Market Share Strategy

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-- M. A. Adelman, 1992

“Deja Vu All Over Again,” *Energy Journal*, vol. 36, Special Issue 1, 2015
More Defense of the Market Share Strategy

• “By my assessment, high prices were unsustainable. If prices had not collapsed, OPEC production might have all but vanished.”

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“OPEC prices and non-OPEC oil production: Survivors and casualties of the ‘market share’ strategy,” OPEC Bulletin, vol. 25, No. 4
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Available in My Local Market

Alessi Balsamic Vinegar (Modena, Italy)

A.  Aged 4 years in wood $3.69 /bottle
B.  Aged 20 years in wood $12.99 /bottle
Sell More Now... or Save for the Future?

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$3.69 = $12.99 / 1.08^{16}

Current Sale = Present Value of Future Sale
Available in the World Oil Market?

Saudi Arabian Light Crude Oil (Persian Gulf)

A. Sell Now (2015 spot) $100 /bbl

B. Sell Later (save until 2050) $1,400 /bbl ???
Sell More Oil Now... or Save for Future?

**Saudi Arabian Light Crude Oil (Persian Gulf)**

A. Sell Now (2015 spot) $100 /bbl

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Seller's Indifference:

$100 - $5 = ($1,400-$5) / 1.08^{35}

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Does $60/Barrel Pass the Long-Run Test?

Saudi Arabian Light Crude Oil (Persian Gulf)

A. Sell Now (2017 target) $60 /bbl
B. Sell Later (save until 2050) $700 /bbl

$60 - $5 = ($700-$5) / 1.08^{33}

Current Sale = Present Value of Future Sale
How Do High Oil Prices Impact OPEC?

**Short-Run**

Mostly *favorable* impacts,

due to demand and supply rigidities and long lead times.
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• Texas shale oil producers stand up and applaud every time the Saudis urge OPEC production cuts.

• That alone should be the most obvious signal of OPEC’s mistake!
My View of Long-Term Prices, circa 2005

J. L. Smith, “Oil Prices, OPEC Wealth, and Cartel Cohesion,” CEEPR, MIT, April 21, 2005
My View of Discord Within OPEC

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• Prior to October 2014, the Saudis willingly accepted most of the burden of compromise, despite a natural interest in lower prices and risk of stranded assets.

• Three years later, have the Saudis already forgotten about the risk of stranded assets? Will they wake up in time?
Thank You!

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