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# 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.
  - 1994-1982: Fixed posted price with agreed differentials
  - 1982-2015: 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.
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- Slow development of incremental production capacity, to alleviate “cheating.”  
(If they have it, they’ll use it).
- Hold and manage spare capacity to offset shocks and dampen price volatility.  
(Pierru, Smith, and Zamrik, forthcoming in *The Energy Journal*)

# 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

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-- Thomas Stauffer, 1994

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

# ALESSI BALSAMIC VINEGAR



# 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

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### Seller's Indifference:

$$\mathbf{\$3.69} = \mathbf{\$12.99 / 1.08^{16}}$$

***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    ???



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### *Seller's Indifference:*

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

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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    ???

### Seller's Indifference:

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

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# How Do High Oil Prices Impact OPEC?

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Mostly **favorable** impacts,  
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Mostly **favorable** impacts  
due to demand and supply reactions (higher oil prices).

The Long-Run has arrived. It does not include high prices.

Mostly **negative** impacts,  
due to demand and supply reactions (stranded assets).

# How Do High Oil Prices Impact OPEC?

## Short-Run

OPEC will still defend the price... at a lower level.

due to... include high prices.

The Long-Run has arrived

## Long-Run

mostly **negative** impacts,

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- **To produce more now, OPEC must accept low prices—substantially below \$100/barrel, and expand investment in new capacity.**



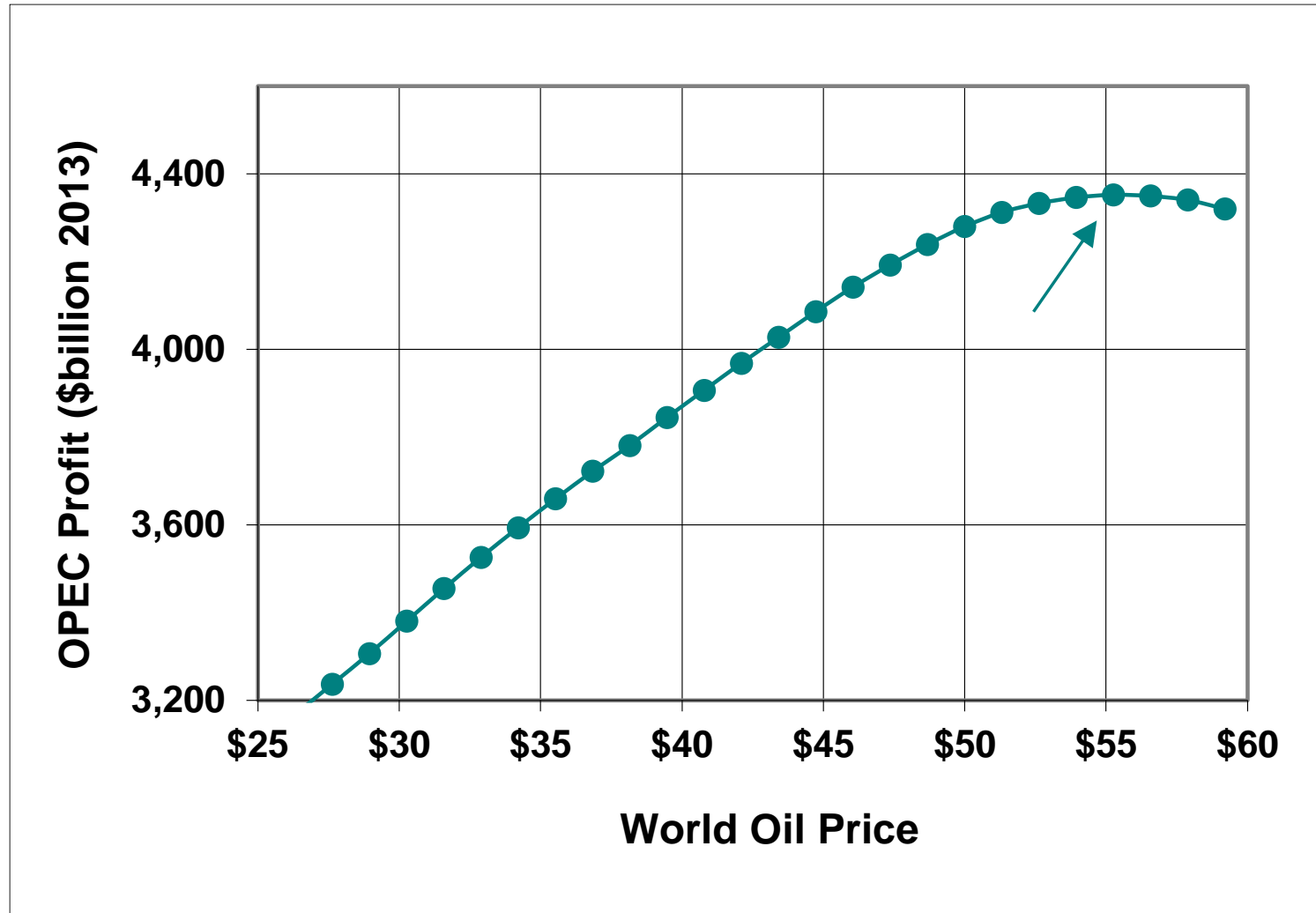
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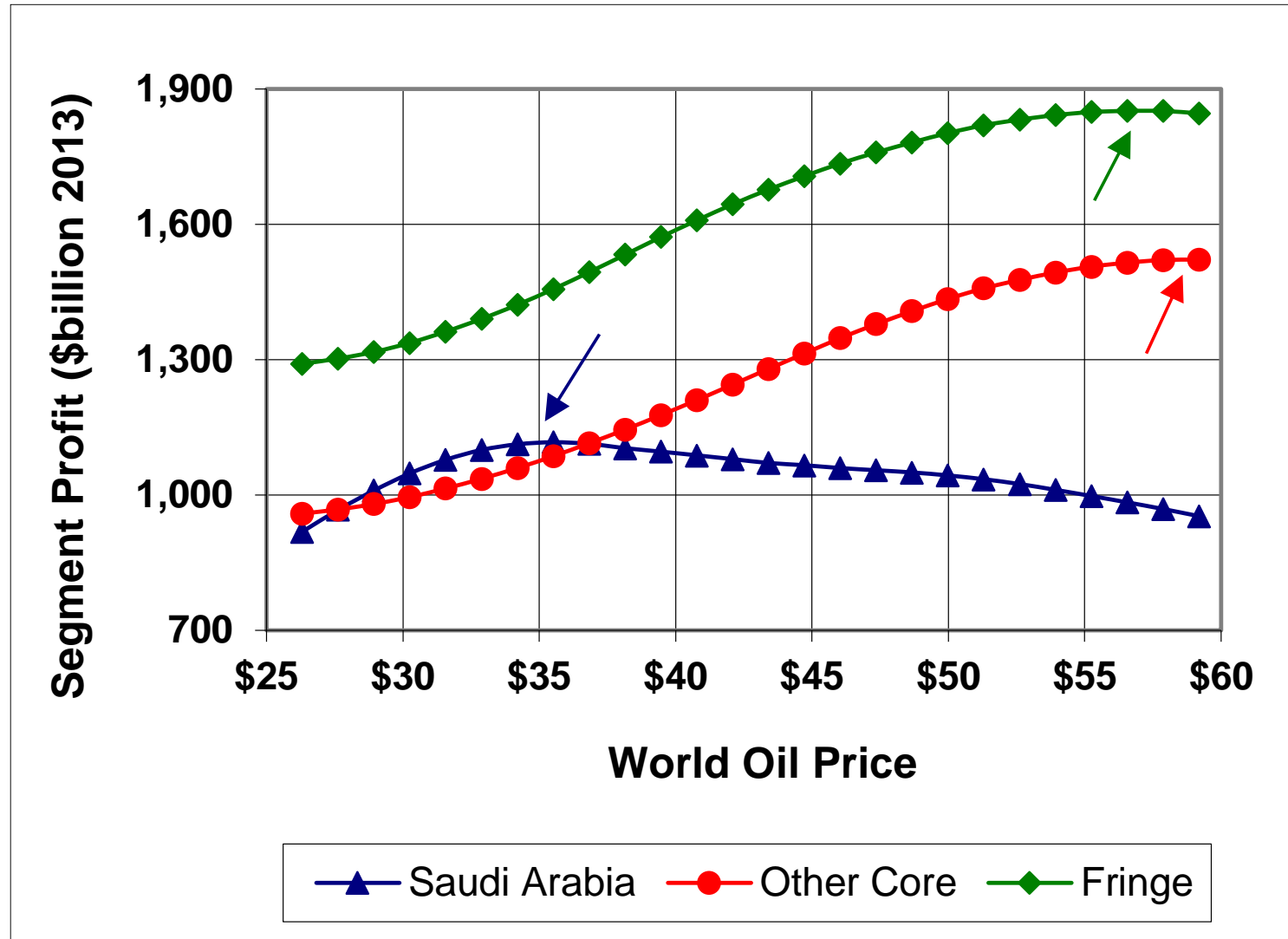
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- To produce more now, OPEC must accept low prices—substantially below \$100/barrel, and expand investment in new capacity.**
- Texas shale oil producers stand up and applaud every time the Saudis urge OPEC production cuts.**
- That alone should be 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



## **My Conclusions Have Hardly Changed Since 2005:**

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## **My Conclusions Have Hardly Changed Since 2005:**

- **The OPEC price represents a broad compromise among conflicting interests. The economic interests of OPEC members are not aligned.**
- **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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