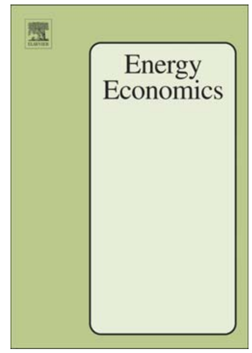

OPEC vs US shale: Analyzing the shift to a market-share strategy

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PII: S0140-9883(17)30022-1
DOI: doi:10.1016/j.eneco.2016.12.021
Reference: ENEECO 3543

To appear in: *Energy Economics*

Received date: 6 August 2016
Revised date: 22 December 2016
Accepted date: 24 December 2016

Please cite this article as: Behar, Alberto, Ritz, Robert A., OPEC vs US shale: Analyzing the shift to a market-share strategy, *Energy Economics* (2017), doi:10.1016/j.eneco.2016.12.021

OPEC vs US shale: Analyzing the shift to a market-share strategy

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This version: December 2016

Abstract

In November 2014, OPEC announced a new strategy geared towards improving its market share. Oil-market analysts interpreted this as an attempt to squeeze higher-cost producers, notably US shale oil, out of the market. Over the next year, crude oil prices crashed, with large repercussions for the global economy. We present a simple equilibrium model that explains the fundamental market factors that can rationalize such a "regime switch" by OPEC: (i) the growth of US shale oil production; (ii) the slowdown of global oil demand; (iii) reduced cohesiveness of the OPEC cartel; and (iv) production ramp-ups in other non-OPEC countries; while (v) reductions in US shale costs act against these factors. We show that these qualitative predictions are broadly consistent with oil market developments during 2014-15. The model is calibrated to oil market data; it predicts accommodation up to 2014 and a market-share strategy thereafter, and explains large oil-price swings as well as realistically high levels of OPEC output.

Keywords: Crude oil, limit pricing, market share, OPEC, shale oil

JEL Classifications: L12, L71, Q41

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