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Alberto Behar, Robert A. Ritz

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

Alberto Behar
Strategy, Policy, and Review Department
International Monetary Fund
abehar@imf.org

Robert A. Ritz*
Energy Policy Research Group
Judge Business School
University of Cambridge
rar36@cam.ac.uk

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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

*Corresponding author: Dr Robert Ritz, Assistant Director, Energy Policy Research Group (EPRG), Cambridge University. Mailing address: Judge Business School, Trumpington Street, Cambridge CB2 1AG, U.K. Telephone: +44 (0)1223 766638, Mobile: +44(0)7768 285267. E-Mail: rar36@cam.ac.uk
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