COMMENTARY

Who Benefits From OPEC Production Cuts? The U.S.

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The Saudi crown prince Muhammed bin Salman has been undertaking a weekslong U.S. charm offensive. One of the key themes surrounding his visit is the kingdom's initiative to extend the oil production cuts that it leads jointly with Russia.

Despite an uptick in oil prices, a closer look at the oil market unveils the real winner of curtailing crude exports: America. U.S. oil output broke through the 10 million barrels a day mark for the first time in half a century. And, according to a recent statement by the Director of the International Energy Agency, it could reach a record of 12.1 million barrels a day in 2023.

Although the price of a barrel of oil has somewhat retreated from the January $70 heights, it is still $10 above its level a year ago and more than double what it was during the price collapse in early 2016. This has been helped along by phenomenal discipline within OPEC+, as the agreement on production cuts between OPEC, Russia and nine more exporting countries is informally known. Apparently compliance has reached a surprising 138% — exporters have made bigger cuts than initially pledged.

As always, however, the devil is in the details.

The bigger cutbacks are largely an optical illusion: Curtailed production is due to the protracted but inevitable collapse of Venezuela's oil industry. Just last year its oil production shrunk by 20%, taking close to 500,000 barrels of daily output off the market.

Moreover, the actual influence of the production cuts on the market is far from obvious. Policymakers in OPEC countries believe that restraining output created a floor under the crude price. Most likely, it helped, but it was not the only reason for the price recovery. The global oil market is extraordinary convoluted and multifaceted; behind every price movement there several overlapping price drivers. Despite heightened media attention to production cuts, other factors played an important role, for instance, relative U.S. dollar weakness, or upbeat global GDP growth forecasts.

At the moment, the new alliance (or ROPEC — OPEC plus Russia — as the media referred to it recently) is a major *cause célèbre*. Are we really witnessing the creation of a new colossus which can single-handedly balance the energy market? Those who believe that also believe the 2014-15 oil price crash was business as usual — just another cycle which can be managed by production cuts. But from what we've seen so far, it was not. It was a market shift, and one which favored the U.S.

Several factors played a role in said shift, but the biggest was likely the shale revolution. In essence, a leap in shale companies' efficiency caused a fall in the oil price. As a consequence, the entire petroleum industry had to become leaner and cut costs to adjust to the new equilibrium.

And once again, American shale companies were ahead of the pack. Cost reductions among global oil companies were estimated at 16% in 2015-16, while among U.S. shale producers they reached 26% on average in the same period.

It's survival of the fittest. In the grand scheme of things, Saudi Arabia and Russia are trying to balance not just one government, nor even a country, but the entire industry. Fundamentally, it's OPEC+ vs. market efficiency. In the longer run, however, this game cannot be won, because it will require an ever bigger sacrifice by those countries cutting production. To defend a certain price minimum, say $60 per barrel, the coalition of petro-states will have to carry on reducing their output.

Arguably, leaders of the Gulf states and Russia are falling victim to politics, a field in which it's better to be seen doing something than nothing. Especially when no one is sure what (if anything) would work. But who is the biggest economic winner in this game? Ironically, it's America yet again.

Each time Saudi Arabia and their allies restrict exports, they prop up the price and create a vacant market share which then gives a boost to those producers outside the agreement that are not bound by quotas. The biggest among them is the United States. Naturally, thousands of American companies are keen for a free ride.

All of that is happening already. The U.S. has just overtaken Saudi Arabia in oil production and is expected to rival Russia soon. No wonder U.S. oil companies were expected to be especially cordial with the Saudi delegation during the princely visit. But one might imagine that on the sidelines of the meetings many Saudis will be scratching their heads and wondering how and why did they get themselves into this pickle.

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