Our View:
The IEA's Preposterous Economic Thinking

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I just read parts of the International Energy Agency's recently released *World Energy Outlook 2015*.

It is totally devoid of economics. The authors are economic illiterates.

The discussion of oil producer behavior is particularly disturbing. The authors believe producer actions are governed by income needs. The thought is preposterous.

Modern economic theory has shown that producers and manufacturers can sustain prices above marginal costs only if they have market power. A great article on this appeared in the October 18 *Wall Street Journal* titled "Wave of Megadeals Tests Antitrust Limits in US." The discussion of Herfindahl-Hirschman Index measurements of industry concentration (HHIs) in it is first rate.

The *Journal* authors note that the HHI for the food industry is around 3,000. In contrast, the HHI in markets where Safeway competes is 4,000. They also observe that Facebook has an HHI of 3,106, a number well over the level needed to sustain prices above marginal costs. The US Justice Department today considers 1,500 to be the threshold above which such activity becomes possible.

The current HHI for oil production, computed from data in the *BP Statistical Review of World Energy*, is 600. OPEC, in short, has no market power.

The HHI for oil producers rises to 1,450 if one treats the entire Middle East as one country (that is, if ISIS takes over).

To get an HHI for oil production that crosses the Justice threshold, one has to consider Russia and all Middle Eastern countries as one. This produces an HHI of 2,300.

Absent such developments, the IEA forecasts indicate a very competitive oil market out to the year 2040.

This means that if economic theory prevails—and not the IEA's nonsensical thinking on revenue needs—we will likely see low prices for quite a while. The surprise here is that producers were able to sustain high prices as long as they did.

Perhaps it would help if Fatih Birol and the *WEO 2015* authors spent a day with the workers in New York City who are trying to get fast-food outlets to raise their wages without having any market power. If they did, they might begin to understand how markets work.