

OPEC and the Ash Heap of History

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Almost twenty-five years ago, President Reagan went to the British House of Commons and said “freedom and democracy will leave Marxism and Leninism on the ash heap of history.” Reagan chose his words carefully, using a phrase – the ash heap of history – very similar to the one used by the Russian Communist revolutionary Leon Trotsky against his political enemies. Within a decade, the Berlin Wall was no more and neither was the Soviet Union.

Now it appears OPEC, another nemesis of the US from the prior century is heading for the ash heap of history as well, not because of geopolitics, but because of the hard work of engineers.

A combination of fracking, seismic imaging, and horizontal drilling has led to a huge reduction in the cost of drilling and an increase in the supply of oil and natural gas, not just in the US but around the world.

Case in point: in the past twelve months the US has run an \$8.4 billion goods trade *surplus* with OPEC, including Algeria, Angola, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, and Venezuela. What a difference from less than a decade ago. Back in 2007-08, the US ran a \$190 billion goods trade deficit with OPEC. The reason for the change in the trade balance is that the US is importing much less from OPEC, \$64.8 billion in the past twelve months versus \$253.4 billion at the peak in 2007-08.

No wonder so many of these countries are in turmoil. They’re losing money and also losing the political leverage they used to have over the US.

Although the media and other analysts focused on a recent attempt by some OPEC countries to limit production so they could try to raise oil prices, that effort failed and oil prices still ended up rising a little, which shows you how meaningless

those negotiations were in the first place. The oil market is much bigger than OPEC today, with prices much more likely to be altered by other factors.

This doesn’t mean it’s straight to the poorhouse for the Middle East elite. Even at around \$45 per barrel, they can generate substantial revenue. Yes, their governments will run budget deficits and will be forced to cut spending. More importantly, more of their revenue will come from China and Japan.

What remains to be seen is how this change affects defense commitments around the world. The US simply doesn’t have as large a direct interest in policing the sea lanes critical to the oil trade, unlike, say, China, and Japan, for example.

However, the US is going to have to grapple with whether it can just back away and let China gradually take its place. Maybe China would police those sea lanes in just as evenhanded a way as the US has for the past couple of generations.

Or maybe not. An empowered China might also enjoy throwing its military weight around, extracting various forms of “tribute” from other countries for the “privilege” of the security China provides. A Japan that depends on China’s military instead of ours may be less likely to continue to cultivate a strong relationship with the US.

Think of it like the end of the Cold War. Throwing the Soviet Union on the ash heap of history was a huge victory for the world. But it didn’t mean history was over, it eventually led to new challenges. We should all celebrate our newfound independence from OPEC, another sign of the resilience and strength of free-market capitalism. But, in part because of this victory, new challenges surely await us in the future.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-25 / 9:00 am	New Home Sales - Mar	0.520 Mil	0.518 Mil	0.511 Mil	0.519 Mil
4-26 / 7:30 am	Durable Goods – Mar	+1.9%	+1.4%		-3.0%
7:30 am	Durable Goods (Ex-Trans) – Mar	+0.5%	+0.4%		-1.3%
9:00 am	Consumer Confidence – Apr	95.9	96.2		96.2
4-28 / 7:30 am	Initial Claims – Apr 23	259K	260K		247K
7:30 am	Q1 GDP Advance Report	0.6%	0.4%		1.4%
7:30 am	Q1 GDP Chain Price Index	0.6%	1.0%		0.9%
4-29 / 7:30 am	Personal Income – Mar	+0.3%	+0.3%		+0.2%
7:30 am	Personal Spending – Mar	+0.2%	+0.1%		+0.1%
8:45 am	Chicago PMI - Apr	52.6	53.7		53.6
9:00 am	U. Mich Consumer Sentiment- Apr	90.0	90.0		89.7