

Microeconomics Case Study

As a consultant specializing in economics, you have been hired by the small island nation of Petrolo. Although Petrolo's landmass is small (about the size of Florida), it enjoys enormous oil reserves that rank number five in the world for high grade petroleum. To date Petrolo has not found it necessary to drill into its substantial but at a higher production cost of offshore reserves that are within the 18 mile territorial limit. Petrolo has prospered by pumping enough onshore oil to allow its government to provide handsome social benefits and low taxes to its population while maintaining full employment. Although its only industry is crude oil supply, the country enjoys one of the highest standards of living in the world.

Unfortunately, the industrial economies of the world have slowed tremendously in petroleum consumption; world demand for oil is now at a 25 year low; oil prices are at about 30% of what they were a year ago. Today a barrel of oil is selling for \$40 while Petrolo's current average cost of pumping oil is \$50 per barrel.

As the special consultant to the President, you have been asked to evaluate the economic impact of four options and make a specific recommendation for what the country should do. The options are:

- Option 1: Stop pumping until the market price reaches at least the extraction cost of \$50 a barrel.
- Option 2: Keep pumping to provide some cash flow.
- Option 3: Sell offshore licenses to private international companies, which would pay a royalty of \$15 per barrel with all extraction costs borne by the licensees.
- Option 4: Prepare a bond to finance entry into the leisure market with high-end hotels, casinos and entertainment venues. Although this would restrict drilling operations to southern half of the island, the northern end of Petrolo could become a magnificent tourism venue for the world's wealthy. Tax-free operations for the first ten years of operations for major hotel/casino operations would entice investment.

Assignment

Prepare a 4 - 6 page paper that uses 2 or more sources, adheres to APA standards and addresses the following:

- For each of the four options, identify three (3) potential economic impacts considering both possible benefits and downsides and implications for Petrolo's government and citizens.
- Based on your analysis and research, make one or more specific recommendations to address the issue.