

Description

I begin by observing that oil prices have been far more volatile in the "OPEC Era" of oil pricing than in the previous era of the Seven Sisters and the Texas Railroad Commission. I explain that OPEC benefits from volatility because 1) short run net demand to OPEC is very inelastic, unlike long run net demand, 2) asymmetric effects of oil prices on world GDP imply multiple equilibrium prices for the cartel, and 3) fluctuations in price initiated by OPEC cause its revenues to vary countercyclically with macroeconomic activity, allowing OPEC to earn a risk premium in financial markets. I describe a history of destabilizing behavior, discuss the effect of the shale boom on OPEC's market power, and address an opposing point of view.

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