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The influence of OPEC membership on economic development: A transaction cost comparative approach

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ABSTRACT

This paper examines the effects of OPEC membership on economic development. Using the theory of transaction cost economics (TCE), we show that OPEC satisfies the characteristics of a hybrid organisation under TCE. Thus, membership in OPEC should improve economic development by reducing transaction costs. We suggest that this effect is stronger in less developed countries because of information asymmetries among regulatory authorities and firms. We also posit that membership in OPEC can alleviate the resource curse of its members by reducing the price volatility of oil and increasing bargaining power. We use a historical dataset of oil reserves that allows us to consider the period before the creation of OPEC in the analysis and find that the benefits of oil reserve endowment are higher for OPEC countries. However, these benefits decrease at higher levels of economic development.

1. Introduction

The *resource curse* refers to the tendency of commodity-exporting countries to be characterised by poor economic performance, to be governed by a non-democratic regime, and to be plagued by civil

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war (Auty, 1993). Exports of natural resources have a negative influence on economic growth (Sachs and Warner, 1997, 2001), which is paradoxical because natural resources should be a blessing for those countries that harbour this type of wealth. The capture of rents generated by the raw materials is often the cause of this depletion, which is exacerbated by weak institutions that encourage corruption and the waste of resources and income (Kennedy and Tiede, 2013).

There are sizeable differences among various countries with raw materials such as oil; Angola and Norway are excellent examples of this variation. Some countries have been able to exploit their natural resources better than others, which is particularly true for most countries belonging to the Organisation of the Petroleum Exporting Countries (OPEC). The creation of OPEC has allowed these countries to establish and wield market power against developed countries because OPEC is able to exert substantial influence on production volumes and oil prices. However, OPEC has also been described as a cartel that circumvents the competition rules and that is able to subject oil-importing countries to its rules.

It is possible to adopt a different perspective and consider OPEC a hybrid form of oil production organisation. Transaction cost economics (TCE) describes hybrid organisational form as an option for organisation of production. Hybrid forms are more efficient than the market organisational form when a transaction requires specific assets and has a high degree of uncertainty (Williamson, 1973, 1991), such as the activities involved in oil production, from extraction to refining. Hybrid forms allow their members to engage in cooperative behaviour through agreements between competing parties, such as networks or joint ventures, without entirely thwarting competition (Williamson, 1974). From the perspective of antitrust law, hybrid forms are frequently associated with collusion or with practices that restrict competition. Although OPEC is often considered to be collusive, it is an agreement that allows its member countries to share resources, make collective decisions, and continue to retain their autonomy. We can therefore understand OPEC to be a hybrid organisation that can provide greater efficiency to the market without thwarting competition.

The contribution of this article is threefold. First, we provide a new outlook on the analysis of the resource curse, investigating oil production from an organisational perspective through the prism of TCE. TCE predicts that hybrid modes of organisation lead to better economic performance when they are aligned with the characteristics of the transactions (Nickerson and Silverman, 2004). Our approach is to investigate whether the hybrid mode of organisation of OPEC is more suitable for oil production compared with producer countries acting alone or together with oil companies in a market framework.

Second, we examine the impact of OPEC membership on its member countries. We assume that membership in OPEC can reduce the risk of the resource curse by reducing transaction costs and because a country's institutions tend to grow stronger (North, 1987). OPEC strengthens country's institutions as a result of emulation and imitation of other member countries and as investments are pooled across members.

Third, as reported in the literature, oil wealth weakens institutions in countries characterised by poor institutional frameworks. Conversely, countries with strong institutions can avoid the resource curse (Frankel, 2012). Because more developed countries have the strongest institutions, we suggest that the relationship between oil wealth and economic growth depends on the level of a country's development.

2. Theoretical framework

2.1. The transaction costs paradigm

Williamson (1973, 1974, 1991) defends the position of firms that practice upstream or downstream internalisation of their activities when confronted with adverse market conditions, which leads such firms to create institutional arrangements with competing firms, suppliers, and/or customers. TCE distinguishes three possible governance modes of transactions: (1) market organisational form that is coordinated by prices; (2) firm organisational form or internalisation that is coordinated by hierarchy; and (3) hybrid organisational form or institutional agreement that is coordinated by means of a long-term contract. The firm and the hybrid forms reduce the sources of costs linked to contracting. These transaction costs are positively related to assets specificity and uncertainty. The quasi-rent generated