

Foders, Federico

Book Review — Digitized Version

[Book Review of] Hallwood, C. Paul: Transaction costs and trade between multinational corporations: a study of offshore oil production, Boston, Unwin Hyman, 1990

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standing these problems, the country studies provide many new insights and a lot of interesting information.

The second part of the study deals with the importance of the specific bargaining institutions in the Nordic countries. Jackman analyses the role of the high centralisation of wage bargaining as compared to the effects of the ambitious employment policies and the systems for unemployment compensation. *Flanagan, Holden, and Holmlund* and *Skedinger* all consider the question how local wage increases (wage drift) are related to central wage increases. Unfortunately, their results and the findings of the country studies do not provide a definite answer to the question whether wage drift and central wage negotiations should be treated as separate processes that jointly determine wages, or whether central bargainers can indeed determine final wage outcomes. Particularly the interesting approach by Flanagan suffers from an identification problem because it is very difficult to discriminate between the determinants of wage drift and of central wage increases, which are likely to be affected by the same variables. This means that the interrelation between wage drift and central wage increases warrants more research. Finally, *Pissarides* and *Moghadam* compare relative-wage determination under centralised and decentralised bargaining conditions, but their approach proves to be theoretically and empirically unsatisfactory.

Although some of the papers in the second part of the book are not as convincing as the country studies forming the first part, this volume is a valuable contribution to the growing literature on union models and wage determination. It can be strongly recommended to all students of wage formation inside and outside the Nordic countries.

Claus Schnabel

Hallwood, C. Paul, *Transaction Costs and Trade Between Multinational Corporations. A Study of Offshore Oil Production*. World Industry Studies, 9. Boston, London, Sydney, Wellington 1990. Unwin Hyman. XVIII, 202 pp.

Yes, vertical integration in the oil industry still matters. As C. Paul Hallwood demonstrates in his book, this old controversy is still alive and calling for further work. It matters in a time in which economists seem proud of having rediscovered imperfect competition in order to help explain the shifts in country and firm shares in the world market experienced in the last decade. True, the profession's attitude toward monopoly and competition changes over time. After having reached a peak in the 1960s and 1970s, the sympathy cycle for perfect competition is now heading for a deep trough since the early 1980s; the line separating monopoly from competition seems to have shifted in favour of the former.

The study by C. Paul Hallwood fits quite well into these current developments. It is an enquiry into the organisation of the internationalised offshore oil supply industry, the industry which supplies intermediate inputs (goods and services) to the oil firms engaged in the exploration for and the production of hydrocarbons on a global scale. In the past, research focused on the downstream activities of oil firms, particularly on transportation, refining and marketing of petroleum products. Hallwood's is the first major attempt known to the reviewer to close this gap by looking at the upstream segment of the industry.

An important part of research carried out on the oil industry deals with the impact of vertical integration of major oil companies on competition in each of the affected (downstream) markets. In contrast, Hallwood finds and tries to explain the phenomenon of upstream disintegration cum competition in the oil industry. He explains it recurring to a modified version of Ronald H. Coase's transaction cost argument

concerned with the choice between alternative institutional arrangements for economic activities. The relationship between the oil firms and the oil supply firms being one of buyer and seller, Hallwood hypothesises that disintegration characterises the industry: oil firms do not recur to inhouse production of intermediate inputs; they buy most of them (up to ninety per cent) in the market. Independent operation of input production is justified by economies of scale derived from a wider market (all the oil firms instead of only one) and by transaction costs, the latter being preferred by the author as an economic explanation. It is somewhat confusing that on the one hand the oil supply firms are found by the author to be virtually unrelated to the oil firms and that on the other he hypothesises (again recurring to the transaction cost argument) that what prevails is quasi-vertical integration instead of complete vertical disintegration. Furthermore, while the scale economies argument in favour of independent operation of the production of oil supplies seems plausible, the transaction cost argument does not offer a convincing explanation of the observed ownership pattern, which, as described by Hallwood, does not include potential financial linkages between firms on each side of the market. An ongoing multi-year research project in which the reviewer is currently participating yielded preliminary evidence of a complicated financial relationship between the major oil firms and the major oil supply firms, involving direct and indirect share holdings in both ways as well as interlocking directorates. If this evidence should survive further critical examination it could possibly support Hallwood's hypothesis of quasi-vertical integration, though in a different sense. At the same time, it would challenge Hallwood's finding that the upstream oil supply market is competitive and thus strengthen the opinion that substantial barriers to entry exist in this market. Hallwood himself adds further reasons for anticompetitive behaviour by showing that the market is highly concentrated on both sides and that innovation constitutes the central force governing this "follow the customer" market. This means that little if any scope at all is left for price competition among the few performance-oriented suppliers, because innovation in a world of "idiosyncratic products" assumes close cooperation between the buyer and the seller during much of the R & D process. Future research (including that on financial linkages) will reveal what degree of vertical integration characterises this industry best. Any outcome near full or quasi-vertical integration will then have to be scrutinised from the point of view of US antitrust law, as far as the US market is concerned, and from the point of view of international law (EEC law, GATT norms), as far as the world market is concerned.

Another interesting issue raised by the author is the public policy designed and implemented by the governments of the relevant oil provinces to face the potential impact of the internationalised oil supply industry on their domestic economies. The British, French and Norwegian approaches are briefly reviewed together with the policies of selected developing countries (Venezuela, Brazil and China). The general conclusion is that with the exception of the U.K. protectionism prevails. Following the infant industry argument every country seeks to regulate the oil supply market in order to increase the share of deliveries by domestic firms. The conclusion pertaining to the U.K. is rather surprising as also is the author's opinion that the U.K. practices an "open door policy". It is well known that in order to apply for an exploration and production licence in the U.K., every consortium of oil firms is expected to disclose to the British authorities the source of the oil supplies needed to carry out the project. Until recently, the U.K. government required the consortia to respect a domestic content clause.¹ Due to the fact that the leading multinational oil supply firms estab-

¹ Foders, Federico, Rüdiger Wolfrum et al., *Meereswirtschaft in Europa. Rechtliche und ökonomische Rahmenbedingungen für deutsche Unternehmen*. Kieler Studien, 223. Tübingen 1989.

lished affiliates in the U.K. long ago, the dilemma faced by British regulators was to find an appropriate definition of a British company. In spite of such efforts, British protectionism had a paradoxical outcome: while not a single British company was able to penetrate the technological core of the international oil supply industry, the British policy effectively shielded the major multinational oil supply firms active in the U.K. from competition from third countries. This is also supported by Hallwood's survey of the oil supply sector in Scotland.

The book is divided into twelve chapters, the first two of which introduce the reader to the transaction cost argument and to the fundamentals of auctions. Chapter 3 takes up the issue of vertical integration. Important features of the offshore oil supply industry are discussed in Chapters 4 and 5, and illustrated with the author's survey of this sector of the British economy presented in Chapter 6. The remaining chapters deal with the particular customer-seller relationship observed in this market (Chapters 7 to 10) and with selected policy experiences at the country level (Chapter 11); Chapter 12 is a concise summary of the whole study.

The reader will notice that this rather small-sized book of some 200 pages is overloaded and, thus, not easy to read. Less material and more clarity would have added to the intrinsic value of the study. This notwithstanding, Hallwood's book remains the first serious and comprehensive enquiry into the oil supply industry. It is a piece of original research and a main contribution to the positive empirical analysis of the industrial organisation of multinational firms. It can be highly recommended to students and teachers as an exciting case study, and to researchers as a promising field for further work.

Federico Foders

Helpman, Elhanan, Paul R. Krugman, *Trade Policy and Market Structure*. Cambridge, Mass., London 1989. The MIT Press. XII, 191 pp.

This book is the normative sequel to the authors' *Market Structure and Foreign Trade*, which dealt with positive trade theory (i.e., the basis and the gains from trade) with imperfect competition and increasing returns to scale. In the monograph under review the authors examine the policy implications of imperfect competition. They do this by summarizing the large literature and synthesizing the large number of models introduced during the 1980s to examine the effects of introducing imperfect competition and industrial organization theory into international trade.

After a brief overview introductory chapter, Helpman and Krugman review the effect of tariffs and quotas in perfectly competitive markets in Chapter 2. Then the authors examine the policy implications of imperfect competition at home and perfect competition abroad (Chapter 3) and perfect competition at home and imperfect competition abroad (Chapter 4). These chapters are clear and well presented, and serve as background and preparation for the more difficult analysis of the subsequent chapters. Chapters 3 and 4 examine the new roles of tariffs, quotas and subsidies under imperfectly competitive markets at home or abroad. The authors begin by introducing simple models and then add various complications and note the effect of these complications on the results obtained. As contrasted to their earlier volume, the chosen level of analysis in this volume is partial rather than general equilibrium. The unifying tools of analysis used are the perceived marginal revenue of the firm and the ratio of price to marginal cost as a measure of market power.

In Chapters 5 and 6, Helpman and Krugman then turn to more complex cases of imperfect competition both at home and abroad. In Chapter 5, they deal with strategic export policy and in Chapter 6 with strategic import policy. The authors do this by