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Original research article

The rise of governments in global oil governance: Historical dynamics, transaction cost economics, and contemporary implications

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ABSTRACT

In this paper, I aim to explain why global oil companies created different governance structures to deal with similar challenges. I test several hypotheses derived from transaction cost economics. These hypotheses link movements in asset specificity and uncertainty to changes in the level of hierarchy and political involvement of governance structures. To test these hypotheses, I conduct a crisp-set Qualitative Comparative Analysis of seven important governance changes. The analysis leads to the following preliminary theory: increasing and highly volatile global oil production as well as declining market positions for important actors create long-term pressure for governance change. But they do not trigger this change, nor do they predetermine the form it will take. Actors actually change governance structures in reaction to more recent events. They will try to increase government involvement, if they face a more uncertain environment or contradictory market trends. They will more likely prefer stronger hierarchy at a given level of government involvement, if they have to deal with an increasingly diverse market environment.

1. Introduction

Managing price volatility is a constant challenge to global oil markets [57]. The sector combines high demand and supply inflexibility with long-term fixed investments into immovable infrastructures. In such an environment, abrupt price changes threaten not only the profit margin of multinational companies. They can also cause an ineffective allocation of resources and inadequate supply for national economies. Another effect is a reduced long-term income of oil producing countries, many of which depend on export revenues to guarantee their political stability [3]. In the end, ensuring stable and foreseeable prices is a common interest for all market participants. Given the constant nature of the fundamental challenge, the high diversity of governance structures is surprising. The drive for oil market stability gave rise to some of the most remarkable structures in the history of global governance.

In the 1930s, for example, multinational oil companies established a transnational commission to control their compliance with inter-firm agreements. This is the most important instance of what Theodore Moran called a "supra-sovereign" institution [50]. This concept transfers the common notion of "supranationality" to transnational relations. It captures instances in which non-state actors delegate control and sanctioning powers to joint institutions. Better known, but not less striking is how the oil multinationals managed the oil crisis in 1973. To mitigate the embargo's impact, the companies allocated remaining supplies among importers. They did so in actual opposition to national governments, which mainly aimed for preferential treatment [86,67]. The multinationals managed the crisis not in the "(external) shadow of hierarchy" [9,11]. They did so actually in open defiance[1] of presumably public-good oriented governments [45]. The global governance literature has yet to discuss this critical challenge to one of its core theoretical models.

No less remarkable is what actually did not happen. In the 1940s, multinational companies actively prevented a global organisation for oil. The failure of this Petroleum Agreement reduced oil governance to semi-formal cooperation between companies and governments. For the firms, this implied a constant threat of litigation under the US anti-cartel laws. Existing accounts see the main reasons for this outcome in the clever manoeuvring of independent oil companies and the intricacies of the American political system [48,45]. But the failure of the oil multinationals

[1] Behind the scenes, however, some companies were more accommodating. BP, for example, promised the UK government preferential treatment. This depended on the company's ability to "hide it in the numbers" [7].

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in achieving what should be one of their most important strategic goals remains surprising. Another instance concerns the International Energy Agency. Initially, most oil multinationals opposed the idea of an international organisation to prevent and mitigate supply crises. Only Shell expressively lobbied in favour of such an institution [86,p. 601f.]. In fact, the multinational companies stabilised the markets not only in pursuit of their own profit-oriented interests. They also took pride in being "the thin lubricating film" [86,p. 602] between producers and consumers.

All of this points to a paradoxical relation between private companies and governments. According to global governance studies, governments are the given public good providers since the emergence of the modern nation state. Only later did denationalisation decrease their governing power in favour of an unprecedented rise of private actors [90,37,20,89,60]. Companies – presumably purely profit oriented[2] – required additional external incentives to provide public goods. These might consist in a threat of governmental actions. Also, a transnationally active civil society [70] influences a company's reputation or normative convictions [41]. Annegret Flohr et al. see this as a necessary condition for private norm entrepreneurship—pending further historical research [32]. Companies also provide public goods needed to conduct their business, if governments fail to do so [9–11].

But in oil, companies actually preceded governments as market stabilisers both nationally and internationally. This is an important difference to the loss of governmental control experienced for example in manufacturing or the financial sector (*e.g.* Refs. [89,59]). Other markets, however, followed a similar pattern. There never was, for example, strong international regulation for trade in natural gas. Here, companies aimed to stabilise the market by mutual integration and joint ventures. But oil is a remarkable case because of the success and intensity of private governance. Repeatedly, companies not only rejected but actively opposed and pre-empted public governance. In 1973, they fought governments for the opportunity to provide a transnational public good. Governments rather preferred catering to the "myopic self-interest" [45] of domestic constituents. All of this is potentially challenging to established perspectives on private governance.

Analysing historical governance changes has much to offer for contemporary energy analysts. Authors frequently described energy governance as fragmented and ineffective [17,33,35,71]. This implies several questions: why did this ineffectual structure emerge? Why is it surprisingly stable in the face of vital challenges that call for urgent and substantial reform? The history of oil governance points to the centrality of the private-public dimension in this context. Analysing processes along this dimension – and private hierarchisation as an alternative – allows a better understanding of past developments.

This paper provides a starting point for this endeavour. In this, it contributes especially to two specific sub-dimensions.

Its main contribution will be to the research of governance dynamics, *i.e.* the emergence of and subsequent changes to energy governance structures. This concerns especially transnational networks and non-state actors. Analysing processes of (de-)governmentalisation clarifies why these structures change. This includes the corresponding private-public interactions [30]. These interactions can even change the organising principles of energy markets. Finding the causes and pathways of these changes is an important task for energy analysts [62].

Another aspect concerns the role of markets. Liberal authors often point to the role of markets in providing transnational public goods [36,14]. This raises the question of what public goods markets can actually provide [30]. It also implies a need to understand the governance actions of market participants. Answering these questions is crucial for an adequate analysis of the development and effects of markets on energy governance.

Different authors called for a closer integration of energy security and governance studies with general social science approaches. Mostly, the goal is to strengthen research in the field of energy [34,44,62,63]. But there is much to gain for general governance studies as well. In the past, general IR considered oil firms mainly in the context of the overall extractive industries [39,41,16]. Other studies looked into their handling of individual cases, like Shell's presence in Nigeria [88]. One contribution analysed BP as an example of corporate norm entrepreneurship [32]. These studies do not yet consider fully the more systematic challenges the history of oil poses to global governance theory.

Energy governance studies have much to contribute especially to the literature on private authority [20,38]. Existing analyses often focus on states as actors, analysing for example the weakness of multilateral forums [8], or the possible governance contributions of the different G-formats [24,47,72]. Still others look for the impact of trade relations or domestic interest groups [71] on the entry of states into existing organisations and regimes. Others analyse state dissatisfaction as driving force for institutional change [19]. While these studies offer important insights, they do not yet address a crucial fact of global oil markets: Oil governance started out as an overwhelmingly private enterprise. Highly complex inter-company structures existed long before governments attempted to become more formally involved.

This does not imply that governments were absent in early oil market governance. They supported and created oil companies that later became core actors in the global system of market stabilisation [31,74]. They also influenced transnational company activities through legislation and legal means, providing an early example of what Börzel et al. call the "external shadow of hierarchy" [11]. Especially US American anti-trust law exerted an important influence on global market stabilisation by companies. But these activities never led to a comprehensive and proactive policy of institution-building. Governments shaped some important framework conditions for transnational oil governance. But they never attempted to stabilise global oil markets on their own. Even in the case of APOC – in which the UK government was a majority shareholder as of 1914 – state institutions refrained from influencing directly any purely commercial decisions [31]. This left the actual market stabilisation firmly in the hands of private management. It was only with the International Energy Agency in 1974 that governments became formally involved in global oil governance. This was more than a century after commercial oil production started in 1869.

Hence, analysing oil governance dynamics concerns the governmentalisation rather than the "privatisation of world politics" [15]. This includes analysing failed governmentalisation where one would expect it to succeed. It requires a study on the emergence or absence of different governance alternatives and the causes that lie behind the different outcomes. Arguably, such a study would not only clarify the specific mechanisms that underlie the effectiveness of the "market and rules" governance system pointed out by some authors [14,36]. It would also directly contribute to our understanding of the current fragmentation of international energy governance, including the non-emergence of a global energy organisation [73].

As of yet, there is no study that takes such a perspective as its starting point. Most of the existing analyses of companies as energy governance actors consider the motives and effects behind their contemporary transnational investment and integration strategies (see, for example [91]), or look into the processes by which they achieved national market liberalisation [92]. Common to these studies is their focus on the era after the Second World War as

[2] Kelly Kollman offers a convincing critique of the "companies as profit maximizers" assumption [46].