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The multinational firm and geopolitics: Europe, Russian energy, and power

Abstract: Multinational firms unavoidably exert influence over politics through power that is generated by both structure and process. While both political economy and management scholars address international firms, neither field has an adequate understanding of the reciprocal relationship between multinational firms and geopolitical systems. The links between multinational firms form a distinct type of international system for the private sector – one that is simultaneously enmeshed in geopolitics and international markets even as it is also autonomous from them. The scholarly literature on the power of business in politics has demonstrated how influence derives from instrumental agency as well as structural influence, but it has taken an unnecessarily restrictive view of politics and an overly materialist theory of power. Politics are about much more than government policies. In this paper I propose an analytical framework for understanding the multinational firm as a set of relationships. I then apply one key element of that approach – the relationships among firms as a direct source of geopolitical outcomes – to the natural gas trade of Eurasia in three eras that span nearly 40 years. I conclude that the influence of business on a broader understanding of politics – and not just policies – should be central to the study of international and comparative political economy.

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1 Introduction

Firms and states are bound together in two intertwined systems. Firms compose markets; the international political system comprises states. Firms adapt to geopolitical environments. They flourish or founder in institutional contexts created by states. Yet firms do not merely respond to the international system. Firms reshape that system in profound, sometimes surprising ways. As goods and

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capital cross borders, beyond the institutions of any single state, multinational firms manage risks in ways that affect markets and the very shape of the geopolitical system in which those markets are embedded.

To understand these relationships we must make sense of the multinational firm. Multinational firms are complex organizations with stakeholders – shareholders, management, labor, suppliers, customers, competitors, and domestic and foreign governments – whose interests must be balanced and negotiated both within the firm and in interaction with other agents. Their need to balance the conventional concerns of firms with the vagaries and risks of the international system leads multinational firms toward distinctive practices. Those practices, in turn, drive the organization of international markets that affect geopolitics. Multinational firms unavoidably exert influence over politics through power that is generated by both structure and process.

These webs of relationships constitute the most important facts about multinational firms. In this way, their practices transcend both scholarship on international political economy (IPE) and the literature on international business. While both political economy and management scholars address international firms, neither field has an adequate understanding of the reciprocal relationship between multinational firms and geopolitical systems. Scholars of international relations tend to imagine, implicitly or explicitly, firms as unitary automatons that respond to changes in political and economic parameters in predictable ways. Or, that managers react, but, evidently, do not think, interpret, or believe.

Scholars of the firm, in contrast, acknowledge these organizations' complexity and agency. Firms, as the economist D. H. Robertson once observed, are like "islands of conscious power" in markets that are coordinated as well by demand, supply, and price.[1] This managerial and organizational approach fails, however, to appreciate the sources of state power and the complexities of the international system. In this literature, it is the firm that contains multitudes, while depictions of the state tend toward oversimplification.

We need a more robust understanding of the multinational firm – not as constituent of unconscious waves of influence, but as an island of conscious power. Multinational firms rely not only on the adaptability of their managers, but also on the relationships they have built with other firms. How firms behave depends, therefore, on their stories about other firms. Some are narratives of brevity, others of longevity; of trust or suspicion; of reliability or fickleness. Tales of failure and success, of hard-earned lessons and profits, inform the present.

1 Robertson (1928: p. 85).

These links between multinational firms form a distinct type of international system for the private sector – one that is simultaneously enmeshed in geopolitics and international markets even as it is also, in many ways, autonomous from them. Firms operating in this context make choices against a backdrop of their notions and beliefs about other firms. These interpretations are the narratives of their structural and behavioral power over politics.

The scholarly literature on the power of business in politics has demonstrated how influence derives from instrumental agency as well as structural influence. Firms exert power over government policies through strategic action, as well as through seemingly automatic processes.[2] This literature has, however, taken an unnecessarily restrictive view of politics and adopted an overly materialist theory of power. Politics are about much more than government policies. Not all political outcomes result from policy choices. The decisions of and relationships among firms lead to geopolitical results with consequences for political economy even when there is no identifiable policy choice made by a government. This power over political outcomes, moreover, inheres in social facts of the economy: firms' interpretations of and relationships with one another.

The gas pipelines that link Russia and Europe present myriad examples of how firms choose strategies that are informed by their relationships with other firms. For four decades European energy firms did business with the Soviet gas ministry and Gazprom, its corporate successor, uneventfully – first across the Iron Curtain, through the collapse of the Soviet Union, and then as both Russia and Europe remade themselves and their institutions – by relying on innovative contract structures and longstanding cooperative relationships. These connections constrained the practices of a gas monopolist whose home market was beyond the reach of European regulators and – in retrospect somewhat astonishingly – depoliticized natural gas for decades even in the midst of the Cold War. These energy firms did not behave as they might have in a simpler domestic market. Nor were the firms agents or puppets of political regimes. The firms remade gas markets, and more than once.

European and, eventually, Russian gas companies made choices, again and again, that can only be puzzling from the conventional perspectives of IPE. Yet their decisions are not only essential to the geopolitics of Europe and Eurasia; at times, the companies' strategies literally constituted the politics. The original Soviet-European gas pipeline reshaped the alliance politics of the Cold War. Gas continued to flow as the Berlin Wall crumbled and the Soviet Union dissolved,

2 Culpepper and Reinke (2014). The classic statement is Lindblom (1977). Excellent recent contributions are Bell (2012); and Fairfield (2015).

with a pipeline that once traversed the Russian and Ukrainian Soviet Socialist Republics becoming an infrastructure that spanned two new sovereign states. A new firm – Naftogaz Ukrainy, owner of the Ukrainian pipeline – was born into the industry as a near-monopolist of transit for Gazprom's gas exports to Europe. Russian-Ukrainian bilateral relations cycled through amity and enmity during the 1990s and early 2000s, until the Orange Revolution of 2004–2005. Still the gas flowed, largely without major incident.

Even the spectacular gas crises of 2006 and 2009, when Russian gas stopped flowing across Ukraine to the European market, were far from calamitous for the relationships between European and Russian energy firms. Instead, the long-term relationships between Gazprom and a handful of European companies allowed them to trust one another and cooperate, so much so that together they began building a new pipeline that ultimately would maintain their long-standing partnerships but begin to disintermediate Ukraine. Later, as Gazprom's European partners lost billions of euros amidst collapsing European energy demand and rising worldwide gas supply, Gazprom renegotiated its gas contracts with European firms in ways that undermined the Russian firm's short-term profitability.

The pipelines that span country borders, as well as the amounts and prices of the gas that flows through the pipes, are themselves political outcomes, despite the fact that firms' strategies more than governments' policies caused them. Business power is, in these stories, ever present, and it is a direct power over politics. To understand these politics we need to situate the structural power of firms in an analytical framework that characterizes the relationships that both compose multinational firms and reshape geopolitical events.

2 The multinational firm as a set of relationships

The multinational firm is best understood as a set of relationships: within itself; with the sovereign of its home country; with the sovereigns of foreign countries in which it conducts business; and with other firms.[3] Like all firms, those that venture abroad are defined by their organizational complexity – not their sameness or simplicity.

The literature on multinational firms informed by scholars and practitioners was, for many years, focused on the origins of doing business abroad. A variety of motivations leads firms to invest and conduct business abroad. The search for

3 See Ghoshal and Bartlett (1990); Stopford and Strange (1991).

universal causes has largely come to an end, an exploration replaced by an appreciation of diversity.[4]

Firms exist in a world of uncertainty, not of calculable probabilities.[5] The executives who run those firms rely on data analysis up to a point, beyond which judgment must be exercised. Those moments of judgment are informed by their local organizational cultures, their habits of thought, and their prevailing interpretive frameworks.

Firms are complex organizations with behaviors and practices that are distinctive.[6] Among those practices are the attempts to reconstruct their environments to manage uncertainty and update their cognitive understandings of the world incrementally.[7] These organizations are defined more than anything else by the networks of relationships that both compose them and situate them within their business contexts.[8] The context is one of specificity, rather than generality: relationships that vary over time but which build upon those histories.[9] That external environment of the firm includes incentives, but the context is anything but parametric.

Multinational firms are therefore "embedded," to use Karl Polanyi's original formulation, in a variety of social, political, and institutional contexts.[10] These firms compose industries – organizational fields – of peers, competitors, suppliers, and customers.[11] Multinational firms both influence and are reshaped by the institutional contexts of their home countries. And they interact with the governments of other countries, thereby becoming constituent of patterns of international relations.[12]

So multinational firms both make and re-make their own practices and, thereby, business environments.[13] Even when scholars believe they have deduced

4 Wilkins (1970, 1974); Jones (1996); Forsgren (2008); Guillén (2013).
5 Knight (1921); March and Shapira (1987); Beckert (1996). For recent applications to the study of international political economy, see Abdelal, Blyth, and Parsons (2010); Katzenstein and Nelson (2013); Katzenstein and Nelson (2014).
6 For an overview of the economic sociology of the firm, see Swedberg (2003: ch. 4); Dobbin (2004); Davis (2005).
7 Cyert and March (1963). Also see March and Sevon (1988).
8 See Powell (1990); Smith-Doerr and Powell (2005).
9 Ghoshal and Bartlett (1990); Kogut (1988); Uzzi (1996); Gulati (1998); Gulati and Gargiulo (1999); Gulati, Nohria, and Zaheer (2000); Ghoshal and Westney (2005); Forsgren (2008); Hadjikhani, Lee, and Ghauri (2008).
10 Polanyi (1944). See also Granovetter (1985); Beckert (2003).
11 DiMaggio and Powell (1983).
12 Heidenreich (2012) describes these as, respectively, "structural," "micro-institutional," and "macro-institutional" embeddedness. See also Westney (2005).
13 Herrigel (2010). See also Kostova, Roth, and Dacin (2008).

what firms ought to want from their putatively evident material environment, the firms themselves, as Cornelia Woll has shown, surprise us through their struggle to discern their own preferences.[14]

Firms therefore learn; they do not merely react. This organizational learning is essential to our understanding of what firms are and how they behave.[15] The challenge is, in particular, how to make sense of ambiguous events, to make sense of moments that lend themselves to multiple interpretations.[16] Or, as Frank Knight puts it, the task for managers is "deciding what to do and how to do it," rather than knowing or deducing either.[17]

2.1 Relationships inside and out: boundaries and sovereigns

Three sets of relationships represent the most familiar, intuitive elements of the multinational firm. The first collection of relationships is within the boundaries of the firm itself: between executives and directors; between management and labor; and between those who run the firm and those who own it. These individuals and groups are embedded in social and contractual relations that are informed by their own historical evolution.[18] The firm as a whole, then, is better understood, according to James March, as a kind of coalition, a system for adjudicating conflict. He writes: "The composition of a firm is not given; it is negotiated. The goals of the firm are not given; they are bargained."[19]

The second relationship is between the firm and the government of its home country.[20] In this sense the state within which a firm is situated is itself a collection of, in the words of Peter Katzenstein, "domestic structures" that cohere into a national institutional context.[21] Even in our current era of internationalization, national institutions produce diverse corporate practices along a range of dimensions and thus create both *de facto* and *de jure* home environments.[22] Comparing business-government relations across nations and over time presents fascinating conceptual challenges and simultaneously promises considerable insight into

14 Woll (2008).
15 Chandler (1977, 1992). See also Herriott, Levinthal, and March (1985); Levitt and March (1988).
16 March and Olsen (1975).
17 Knight (1921: p. 268).
18 Granovetter (1985); Morgan (2001).
19 March (1962: p. 673).
20 Vernon (1971, 1972, 1974). A useful overview is Haggard, Maxfield, and Schneider (1997).
21 Katzenstein (1978).
22 Sally (1994); Pauly and Reich (1997); Doremus et al. (1998).

how firms behave as they internationalize their operations. What is clear from decades of research, however, is that to ask the question of whether the state or the firm is the master of the other is to do irreparable damage to the nuances of their relations.

Neither dominance prevails in any systematic way, regardless even of patterns of government ownership of firms.[23] The state is not the agent of the multinational firm; nor is the multinational firm an agent of the state.[24] The mere fact of state ownership – even majority control – of a firm reveals little about how the firm behaves in an industry. A fully private firm may resemble a para-public entity; a state-controlled firm may be tasked with maximizing profits for its shareholder. Much more important, according to economist and management scholar Raymond Vernon, is "the complex system of relations between the governmental apparatus and the enterprise apparatus in the economy."[25] In this system of relations firms exhibit structural power that is historically specific.[26] Each system must be investigated; however, we can deduce precious little about strategies from the set of shareholders.[27]

Multinational firms' structural power in politics extends beyond their home countries to other nations as well. The third set of relationships is composed of those between the firm and the governments of countries in which it conducts business. A firm's operations within another nation's set of institutions must either conform to local patterns and practices or, through engagement and influence, seek to change those institutions. These relationships depend on bargaining power that, over the course of an investment, changes over time.[28]

2.2 Relationships across and among: how firms interpret one another

Perhaps the most complicated and least well-understood set of relationships that defines multinational firms is in organizational fields composed of other firms. "The most salient part of the environment of any firm," Hans Thorelli observes, "is other firms."[29] Markets rarely approach perfect competition. Those that do are

23 Culpepper (2011).
24 Vernon (1971: p. 115).
25 Vernon (1972: p. 117).
26 See Culpepper and Reinke (2014); and Bell (2012).
27 A good recent overview of these debates and findings is Musacchio and Lazzarini (2014).
28 Vernon (1971); Moran (1974); Stopford and Strange (1991); Boddewyn and Brewer (1994). A good review is Haggard (1990: ch. 8).
29 Thorelli (1986).

the least interesting of all, particularly to firms that avoid settings in which barriers to entry are low, the bargaining power of suppliers and customers is high, and rivalry is intense. Those are, after all, the least profitable.[30]

Multinational firms flourish in oligopolistic markets characterized by imperfect competition and, therefore, higher profitability. Particularly in such markets, the relationships among firms create patterns of rivalry and partnership that are far from a collection of discrete, arm's length transactions. Markets are, in this understanding, characterized by "regular, recurrent involvements" among firms.[31] These relationships include a firm's often intimate understanding of and connection to the firms to which it sells.[32] Over time, that intimacy can evolve into trust.[33]

Thus the usual juxtaposition of the hierarchal organization of a firm with the market is often unhelpful. The market, rather, is better characterized as "a dense network of cooperation by which firms are interrelated."[34] Inter-firm cooperation is one of the defining institutional facts of firms in general, and multinational firms in particular.[35]

Firms in relationships with one another unavoidably have histories. Those are histories of trust, which can be built, broken, and restored. So, too, are they histories of rivalry or cooperation. Patterns of relations among firms have meaningful pasts, which are subject to interpretation and reinterpretation. Such relations exist institutionally well beyond the experiences of individual executives. These are historical, collective memories that become part of organizational cultures and worldviews.

The decisions of firms, as well as the relationships among them, directly produce political outcomes, even if they are not the results of government policies per se. A richer understanding of structural power is thus as a web of interdependencies tying together states and firms.

The most influential theoretical traditions in IPE cannot account for this understanding of firms and their direct influences on geopolitical outcomes. The central challenge is that, in general, these frameworks were conceived in ways that treated firms' strategies as either epiphenomenal to international politics or as mere inputs into national policy-making.[36] The national interest may indeed be

30 These are the basic contours of competitive strategy. See Porter (1996).
31 Wilkins (1986: p. 21).
32 Penrose (1960, 1968).
33 See Sako (2008); Farrell (2009). An alternate understanding is that these contracts among these firms are relational and long-term, rather than discrete. See Hart (1993).
34 Jones (1997: p. 19).
35 Richardson (1972).
36 Abdelal (2013).

more than the sum of the preferences of powerful firms, and state power necessarily influences the context within which firms operate.[37] The interests of firms are, however, also exogenous to the preferences of policy makers and the state's grand strategists. The system of firms is just as important to political economy as the system of states.

3 Firms and the politics of energy in Europe and Eurasia

Europeans use natural gas to generate electricity and heat. Gas is cleaner than fuel oil or coal. Gas is also, however, more difficult to move around – from the land under which it is found to the power plants, factories, and homes where it is used. The vast majority of gas that is consumed is delivered through a pipe; a small, but growing percentage is, at considerable expense, liquefied, shipped, and then re-gasified upon arrival. Europe does not have very much gas, and its resources have been dwindling. Uncertainty prevails in the industry: the long-term prices of oil, gas, and electricity; the stability of contract structures; the pace of technological innovation; the durability of political regimes; and the ebb and flow of military and diplomatic conflict.

Trillions of cubic meters of gas exist, fatefully, near Europe: underneath the territory of what is today the Russian Federation and what was once the Soviet Union. During the 1960s, the Europeans and the Soviets struck a bargain.

3.1 From contracts to relationships: 1967–2005

The East–West gas trade began with piped deliveries in 1968 to Austria after several years of negotiations between the Soviet authorities and the firm ÖMV. A few German firms then negotiated with the Soviets to purchase gas, with first deliveries in 1973. French and Italian firms soon joined, much to the dismay of the US.[38] Even at the height of the Cold War, the Europeans and Soviets managed to make a deal. The Soviets, desperately in need of hard currency, would sell their plentiful gas. Europe would stay warm in winter and generate enough electricity to power their industrial growth.

37 See Gilpin (1975); and Krasner (1978).
38 See Högselius (2013); and Jentleson (1986).

The Europeans and Soviets needed to balance the risks between them. The price of the natural gas would be indexed to fuel oil. The logic of oil indexation was two-fold. Gas would, first of all, thereby always be competitive with what was then a substitute. More important, however, was another logic: if the Europeans and Soviets built a pipe to bring the gas from point A (the Soviet Union) to point B (Europe), the two nodes would not constitute a market, and so there could be no market price. To prevent cycles of renegotiations based on ephemeral moments of bargaining power or the vagaries of Cold War tensions, the indexation to fuel oil – the price of which being exogenous to both their actions – would simplify their relationship. The capital expenses of a pipeline were justified by long-term contracts, which spanned decades. The Europeans contracted to purchase minimum annual volumes – known as take-or-pay, a practice that both ensured supply security for Europeans and a predictable revenue stream for the Soviets.

These practices thus anchored expectations and created norms to address more than probabilistic risks: they addressed the inherent uncertainty about price, technology, and politics. And then – almost incredibly – this arrangement worked well for all concerned for about 40 years against all odds because the agents involved developed and maintained their relationships with one another. All of this commerce flourished despite the Cold War geopolitical context, and against the wishes of the US. The gas continued to flow as the Wall fell in 1989; as the Soviet Union collapsed in 1991; as Russia and Ukraine became new sovereign states and underwent massive regime change; as the Cold War ended and the Warsaw Pact dissolved; and as the North Atlantic Treaty Organization (NATO) expanded, to the dismay of Russia, very nearly up to its borders.

The Brotherhood pipeline, first commissioned in 1967, continued in the middle of the 2000s to bring the gas from Russia, through Ukraine, then Slovakia, before branching off north toward Germany and France and south toward Italy. The Ukrainians also depended on the pipe to bring gas and on the fees that Gazprom paid to Naftogaz Ukrainy for the transit of gas. Naftogaz inherited only the pipeline infrastructure spanning Ukraine when it was carved out of the Soviet gas ministry into a corporate entity. Thus, Naftogaz was the repository of none of the historical relationships between European firms and Soviet gas authorities. Indeed Naftogaz still does not contract with European firms. Its primary contractual relationship is with Gazprom.

And so the European market was characterized by an oligopoly of suppliers, with Russia among just a handful, including Norway and Algeria. For Russia, however, Europe was in some ways a monopsony, at least as a metaphor: Gazprom sold gas to firms in many countries, but it earned two-thirds of its revenues from sales to just a handful of firms in Germany, France, and Italy. Ukraine itself faced a monopolist supplier in Gazprom, but Naftogaz Ukrainy was nearly a monopoly supplier of transit to Gazprom: during the 1990s roughly 90% of Gazprom's exports to Europe passed through the Brotherhood pipeline.

All of which delivered unto Europe and Eurasia a kind of pipeline brotherhood – a squabbling, roughhousing one at that. This unhappy brotherhood was unhappy in its own ways, of which many emerged. Although governments played important, recurring roles, it was the firms that drove change. Governments retained rights essentially to veto firms' multinational agendas – and so essentially delegated responsibility for energy policy and elements of grand strategy to the firms, which were tasked by their shareholders with maximizing profits. Governments were advised and consulted. The decisions, however, were taken by the firms.

The firms, then, were few. Gazprom and Naftogaz Ukrainy, of course, made up the mostly unhappy Slavic pair. Gazprom, the bare majority of whose shares are owned by the Russian state, had been charged with social goals within Russia and, occasionally, in other post-Soviet states: to sell precious cubic meters of natural gas at prices below what the firm could charge its western European customers.[39] The dependence of the Russian state on Gazprom for tax revenues and dividends, however, led the government to prioritize Gazprom's maximization of profits in western Europe. The mere fact of the state's majority ownership, therefore, increased rather than diminished its needs for Gazprom's export strategy to be financially robust.[40]

In western Europe, meanwhile, the private German firms E.ON and BASF (through subsidiaries Ruhrgas and Wintershall, respectively) sought to purchase much-needed gas from Gazprom upon its transit across Ukraine. So, too, did the Italian firm ENI, 30% of which the Italian state owned. And the two French firms GDF SUEZ (33.3% of whose shares were controlled by the French government) and EDF (with a larger government stake of 85%) followed the Germans and Italians in both importance and chronology. The European energy firms had to balance sometimes competing needs of economically priced gas and a secure supply.

The essential story of the relationship between European firms and, first, the Soviet gas ministry and, later, Gazprom was the development of trust. Negotiations led to contracts; contracts led to pipeline infrastructure, which led to deliveries. For several decades, the Soviets and then the Russians learned to trust European firms, while in Europe executives learned to trust Gazprom. The long-term contracts became reference points to manage political and commercial uncertainty, rather than mere legal structures.[41]

39 Abdelal (2001).

40 Abdelal, Tarontsi, and Jorov, (2008a,b,c); Abdelal (2013).

41 Högselius (2013).

3.2 Relationships amidst instability: 2006–2012

The European firms relied on neither Gazprom nor Naftogaz Ukrainy, but on the management of conflicts between them. Such conflicts were, alas, not altogether infrequent. For the conflict of their interests were inescapably zero-sum, or so it seemed for many years. They kept it together, for the most part and for 15 years after the collapse of the Soviet Union.

The Orange Revolution of 2004 brought to power a Ukrainian government with renewed, pro-Western ideas about foreign policy vectors and dealing with the East. A convoluted series of tactical miscalculations by Naftogaz Ukrainy and bluff-calling by Gazprom led ultimately to the breakdown of contract negotiations during the summer and winter of 2005. At stake were the fees that Gazprom would pay to Naftogaz for transit and the prices that Naftogaz would be charged for the gas it consumed. The yearly contracts, which expired on the first of January each year at 10:00 a.m., offered a dramatic, and potentially spectacular, moment for either calmness or chaos.

Chaos prevailed in January 2006 – dramatically – and in January 2009 – nothing short of spectacularly. Gazprom accused Naftogaz of stealing gas. Naftogaz accused Gazprom of shutting off the flow of gas. The European customers, either way, did not receive the gas for which they had paid.[42]

Europe, broadly conceived, was obliged to choose between two incompatible narratives. The so-called gas wars were either failures of Russian supply or Ukrainian transit. The interpretive challenge for firms was not probabilistic; this was not a matter of risk. European firms resolved the uncertainty with trust and shared history. The policy lessons from the two stories differed in obvious ways, and their resonance was far from uniform. Central European executives and policy makers interpreted 2006 and 2009 as crises of Russian supply. So, too, did US policy makers. Even European mass publics mostly blamed Gazprom.

The dominant European energy firms did not see things that way. For they knew Gazprom. They had been in business with Gazprom for decades. Each firm's relationship with Gazprom was comfortable – not cozy, not friendly – and built on years of trust and mutual understanding. So E.ON, Wintershall, ENI, GDF SUEZ, and EDF interpreted the excitements of 2006 and 2009 as crises of Ukrainian transit. Their subsequent behavior followed from that conclusion: they built new pipes for the same Russian gas to circumvent Ukraine.[43]

The Germans had been in business with Gazprom since its original incarnation as the Soviet ministry of gas industry. As E.ON's Uwe Fip, who managed

42 Abdelal (2013).
43 Abdelal and Tarontsi (2011a,b).

the Gazprom relationship, observed: “The gas crises do not make us nervous.”[44] Indeed, Fip continued:

> *Our relationship is now four decades old, our having signed the first contract in February 1970. It is a longstanding partnership. One has to be prepared for a few surprises now and then, but it is a good partnership. Gazprom has always been a reliable partner. We have never concluded that Gazprom is unreliable.*[45]

Gerhard König, the chairman of WINGAS, Gazprom’s joint venture with Wintershall, echoed these sentiments. For König, they relied on “trust and mutual understanding, built up over many years and interpersonally.”[46] So when the time came to decide which lessons to draw, he insisted, “the question of Gazprom’s reliability never even came up in Wintershall. We have absolutely the full picture because we know them so well. There is no need for us to mistrust them.”[47]

The Italian and French executives shared this interpretation. Paolo Scaroni, the chief executive of ENI, was even more insistent about the historical record, including the 2006 and 2009 crises: “Russians have always fulfilled their obligations in gas contracts. Not once have the Russians failed to do so.”[48]

The strategic conclusion was, then, clear: European firms elected to disintermediate Ukrainian transit but maintain their reliance on Russian gas. E.ON, Wintershall, and Gazprom, along with GDF SUEZ and the Dutch Gasunie, built the Nord Stream pipeline to bring Gazprom’s gas directly from Vyborg in Russia across the Baltic Sea to Greifswald in Germany. The capacity of Nord Stream allowed the German and Russian firms to divert 40–50% of the gas that had usually made its way westward along the Ukrainian pipeline route.

The Nord Stream pipeline was a geopolitical outcome of considerable significance, which resulted from the power and influence of firms.[49] US policy makers were disappointed. The Ukrainian government was, naturally, desperately disappointed. Central Europeans expressed alarm at this joint west European-Russian resolution of the Ukrainian pipeline impasse.[50] Radoslaw Sikorski, then the Polish defense minister, called the project the “Molotov-Ribbentrop pipeline,” thereby

44 Author’s interview with Uwe Fip, Senior Vice President for Gas Supply East, E.ON, Essen, Germany, 29 November 2010.

45 Author’s interview with Fip.

46 Author’s interview with Gerhard König, Chairman of WINGAS, Kassel, Germany, 30 November 2010.

47 Author’s interview with König.

48 Author’s interview with Paolo Scaroni, CEO of ENI, Rome, Italy, 15 June 2010.

49 A fuller account of the story is in Abdelal (2013).

50 See, for example, Adamkus et al. (2009).

invoking the 1939 treaty that shaped the fate of central and eastern Europe.[51] Nord Stream was thus a political – but not a policy – outcome.

These decisions by and relationships among these energy firms remade the geopolitics of the energy sector in Europe and Eurasia. Although national governments had, of course, necessarily gone along with these plans, the firms' executives were both originating and executing on the strategies. Loud complaints were heard from Brussels, from Washington, DC, from Warsaw and Vilnius, and emphatically from Kyiv. But the firms were running the show and making the *de facto* energy policy of Europe.

3.3 Liquidity, price formation, and the end of an era: 2012–2014

Toward the end of the first decade of the new century, the financial crisis that originated in New York and later ravaged the entire world economy manifested itself in Europe in particular ways. A crisis originally of private leverage became public: a sovereign debt crisis that began in Greece eventually spread across southern Europe. Output growth slowed, as many European nations entered what was eventually revealed as a prolonged recession. As the European economy slowed, so, too, did European demand for energy – particularly in power generation and the industrial sector. While total EU natural gas consumption was 516 billion cubic meters (bcm) of gas in 2008, that demand had shrunk to 452 bcm in 2012. A decade of European gas market integration and infrastructure development led natural gas prices to converge across the continent.

The American unconventional gas revolution, at the same time, was transforming US energy markets. Enabled by lax environmental regulation, a prodigious pipeline network, and a permissive subsoil property rights regime, a handful of small American companies engineered a transformation in natural gas production. Gas prices plummeted in the US, although they remained high in Europe and downright expensive in Asia.

The combination of these demand and supply shocks was impressive.[52] Liquefied gas that had been destined for US markets was diverted to Europe and Asia. Europe, with already more gas than it could use, found that its theretofore not-very-liquid gas trading hubs were flooded, as it were, with gas that no one really wanted. European gas prices converged further. And so the spot prices for

51 See "Poles angry at pipeline pact," *The Independent* (1 May 2006).

52 Abdelal, Maugeri, and Tarontsi (2014).

gas at European hubs collapsed, as did spot prices for liquefied gas on world markets.

Indeed the prices for gas at European hubs fell – for the first time in memory – below the oil-indexed prices for piped gas from Russia. The result was disastrous for Gazprom's customers. They were obliged by take-or-pay clauses in their contracts with Gazprom to purchase gas that they did not need at prices that were significantly above those that prevailed on the spot markets. Because their residential and industrial customers paid prices for gas that were tied to the spot prices on the hubs, those firms were losing money buying piped gas from Gazprom without any ability to pass along the price difference. In March 2011, for example, E.ON announced that it would post losses of €700 million because of high, oil-linked prices of gas.[53]

Two debates engulfed Europe's gas markets. One held fewer consequences but was nonetheless animated: was it the supply or the demand shock that had been more influential in wreaking havoc on traditional business models? E.ON's Klaus Schäfer summarized the prevailing view in Germany:

> *The revolution in the European gas markets was probably less of a supply-driven than a demand-driven event. The combination of declining demand due to the financial and economic crisis, coupled with significant regulatory changes, which opened the market for competition, in combination with take-or-pay contract structures were the main drivers of change. LNG and shale were part of the story, but secondarily: as if more oil were put onto the fire.*[54]

Although others emphasized the supply shock and indirect influences on patterns of liquefied gas sales, everyone could agree that the fundamentals of European gas consumption had, at least temporarily, changed.[55] "We have experienced," as the head of the Italian gas regulatory authority observed, "a complete decoupling of spot markets from oil-indexed gas."[56]

The second debate was what would be done about the revolution. The divergence between long-term, oil-linked gas prices and short-term, spot prices on the gas hubs might be temporary, or it could last long enough to transform fundamentally both how gas is priced and the business models of European firms and Gazprom. As E.ON's Schäfer observed:

53 "E.ON and Gazprom in Gas-price Deadlock," *Petroleum Economist*, September 2011, 30.
54 Author's interview with Klaus Schäfer, Member of the Board of Management and Chief Financial Officer, E.ON SE, Düsseldorf, Germany, 20 November 2013.
55 ENI (2013).
56 Author's interview with Guido Bortoni, President, Regulatory Authority for Electricity and Gas, Rome, Italy, 17 July 2013.

> *Then European companies were obliged to ask themselves: what will this mean? These companies reacted in very different ways. Some bit the bullet and continued with the take-or-pay contract structures and high prices for a short period at the beginning of the crisis. Some took the hit in terms of earnings but made progress renegotiating the price. Others started arbitration as early as possible.*[57]

The relationships between European customers and Gazprom influenced how the renegotiations proceeded.

The trend, overall, was for European firms to negotiate the end of the two signal contract clauses of the past four decades: oil-indexation and take-or-pay, which would be replaced by indexation on spot gas prices on the hubs and potentially highly variable yearly purchase volumes.[58]

Gazprom, understandably, resisted both. In doing so, Gazprom defended not just its interest in the prevailing higher oil-indexed prices, which were determined by contracts signed by both parties, but also the underlying logic of four decades' worth of the Eurasian gas business. Oil indexation had eliminated the possibility of either party's influencing the price or taking advantage of temporary improvements in bargaining power. Take-or-pay clauses created incentives for suppliers to invest in infrastructure to deliver gas to customers over years and decades. Gazprom argued that changing the fundamentals of the gas contracts was a bad idea for both parties.[59] One emphatic objection was to the idea of linking long-term gas prices to the spot prices on hubs. Although the hubs had grown to be more liquid, in fact it was impossible for a major consumer of gas to purchase volumes large enough to supply a national economy from the hubs. The hubs were largely balancing markets. "Hub trading doesn't mean gas can be delivered because it is often not physically available," Ilya Kochevrin of Gazprom insisted. "As legendary folk character Hodja Nassredin used to say, 'No matter how many times you say *sugar*, you won't feel sweeter in your mouth.'"[60] Alexander Medvedev, Gazprom's deputy CEO, complained that the spot markets could not provide more than a quarter of total gas volumes consumed: "Basing prices on 25% of volumes is nonsense."[61]

Several years of intense negotiations followed. Market participants understood – confidentially, since bilateral gas contracts were not public – that Gazprom accommodated its favored, long-term partners more than firms with

57 Author's interview with Schäfer.

58 Stern and Rogers (2012).

59 Komlev (2012); cf. Stern and Rogers (2013).

60 Author's interview with Ilya Kochevrin, Deputy General Director, Gazprom Export, Moscow, Russia, 22 October 2013.

61 "Gazprom Fires First Salvo in European Gas War," *Petroleum Economist*, June 2011.

which it had either austere or historically tense business relationships. Thus the character of these relationships helped to determine how the negotiations unfolded: Gazprom's long-standing partners managed their different interests internally and privately, for the most part.

Gazprom executives understood the pressure under which their customers found themselves. Over time Gazprom relented. Gazprom reduced prices retroactively for a number of customers, an accommodation that cost the firm between three and four billion dollars. The formula that determined the gas price was adjusted to include a larger influence – ranging from 15% to 20% – for the spot prices that prevailed on gas hubs.

European executives argued that the character of their relationships with Gazprom influenced the negotiations. E.ON's Schäfer described the situation:

> *The negotiations were challenging, but simply commercial. Even with the legal negotiations and arbitration as a backstop, we never stopped prioritizing our commercial relations. We disagreed, but we never had a single hostile meeting.*[62]

Schäfer accounted for this difference by referring to the firms' mutual histories:

> *The Russians have long memories and value partnerships. They understand that these are long-term engagements. E.ON and Ruhrgas stood with them during tough times. We were there when Nord Stream needed to be built. We were there when Russia privatized power generation. We were there even at the very beginning, when the Soviet Union first began exporting gas to Germany against US wishes. All of this has led to us being trusted partners.*[63]

The GDF SUEZ executive responsible for the Gazprom relationship observed that the breadth of their arrangements allowed negotiations to move back and forth between issues that were less contentious. "Because our relationship with Gazprom is multi-faceted," Philippe Perfumo observed, "we can discuss other topics."[64]

The ultimate result of these renegotiations remained unclear, however, though their political consequences would regardless be profound. Gazprom executives believed that ultimately these might be temporary accommodations to gas market idiosyncrasies. European executives, on the other hand, thought that the structural facts of the markets had changed so profoundly that there was no going back to the predominance of oil-indexation or the prevalence of take-or-pay

62 Author's interview with Schäfer.

63 Author's interview with Schäfer.

64 Author's interview with Philippe Perfumo, Senior Vice President for Long-Term Gas Supply, GDF SUEZ, Paris, France, 6 December 2013.

clauses. European firms pressed their case. Many in Europe wished essentially for natural gas markets that would resemble oil markets: liquid, interconnected, and dominated by spot pricing. Gazprom executives, among others, wondered if Europeans ought to be more careful what they wished for.

The energy markets of Europe and Eurasia have undergone a revolutionary transformation in practices and contract structures. European firms will likely be successful in renovating contracts so that even piped natural gas prices are indexed largely, perhaps exclusively on the spot prices that prevail on natural gas trading hubs. They may also be successful at ending their contractual obligations to take gas or pay for it.

The result would be a thorough undermining of the long-term relationships that have, for decades, served as the basis for the European-Russian gas market – leading perhaps as well not only to a change in Europe's energy security, but to a shift in some of the most consequential geopolitical terrain between Europe and Russia. One result has been to diminish the incentives for Gazprom to invest in the infrastructure to deliver gas to European customers and tie its fate further to Europe. The decision to abandon the South Stream pipeline project in favor of Turkish Stream reveals this emergent logic.[65]

The European firms and regulators driving this shift toward short-termism in the gas market envision a market of discrete, arm's-length contracts rather than intimate relationships. The market would be less opaque, with transparent prices set by daily supply and demand, rather than 20-year confidential contracts negotiated between firms embedded in 40-year-old relationships.[66]

Yet the benefits of this transparency may prove illusory, for the uncertainty that had been mitigated by relationships inheres in a different form in the inchoate spot-market-oriented system. European gas markets remain regionally fragmented, and the volume of gas traded on hubs is minuscule compared to the consumption of European societies. As one European executive observed, "Whatever is incomplete in a long-term gas contract is less incomplete than the incompleteness of gas markets."[67] Gazprom, its long-standing ties with European firms thereby undermined, may respond by trying to maximize its profits in ways that any good oligopolistic firm would: by seeking downstream integration and becoming a market maker, able to affect prices on spot markets unilaterally by manipulating supply. Europeans may find that they have traded transparency

65 Abdelal, Çekin, and Çelik (2015).
66 Stern (2012).
67 Author's interview with Bruno Lescoeur, Chief Executive Officer, Edison, Paris, France, 6 December 2013.

for negotiating power, a robust partnership for a new insecurity of supply. For Gazprom has already begun to look eastward, away from a decreasingly attractive European market toward a dynamic Asia to make up for smaller profits and, by extension, lost taxes and dividends for the Russian state.[68]

4 Conclusions and implications

Multinational firms are complicated creatures. These firms can be analytically interpreted simultaneously as agents and sets of relations embedded in both national institutions and networks of firms. The relationships among these firms influence, often decisively, how they behave. A coherent understanding of those relationships requires that scholars recognize firms as organizations with histories, local cultures, worldviews, and trust and mistrust that ebb and flow over time. Their strategies build on their pasts. Although multinational firms seek profits, the uncertainty that pervades their decision-making requires them to make sense of the world even as they continuously remake the markets in which they operate.

This understanding of inter-firm relations has broad applicability to the study of politics. The character of those relations – competitive, cooperative, complementary, collaborative, collusive – creates patterns of considerable importance in almost every industry.[69] When industries of strategic significance span political borders, the difference between the commercial and the political becomes indistinct. Indeed, the frontier has grown ever more porous. The norms and practices of commercial relationships have come to be more important for politics than the policies debated by parliaments and promulgated by governments.

European gas markets evolved reciprocally with geopolitics in the latter half of the twentieth century. Trade flourished, even in the face of the threat of nuclear annihilation, underneath the Iron Curtain for decades. Initially firms created flows of molecules and hard currency by writing contracts that made the price of gas exogenous to the behavior of either party; eventually they came to rely at least as much on trust engendered by years of inter-firm cooperation. These relationships allowed gas to flow, unhindered, throughout the Cold War as well as during the collapse of the Russian state during the 1990s and its later restoration. In the twenty-first century, rising geopolitical tensions between Russia and

68 Skalamera (2014).

69 See, for example, Brandenburger and Nalebuff (1996).

Ukraine failed to rattle European gas importers, which remained confident in their Russian partner even as gas became a key flashpoint in the Slavic dispute.

Without knowing what Gazprom executives and their European counter-parts thought of one another, it is impossible to make sense of their strategies. It was, in fact, their relationships – rather than impersonal market forces or conscious government practices – that drove the corporate strategies that have remade the geopolitics of the two regions. The most profitable and geopolitically significant gas markets in the world comprised firms whose theories of the market have generated the market outcomes themselves.

They are also political outcomes: steel pipes over land and under seas that bind nations together and, sometimes, drive them apart; gas without which societies might be deprived of light, heat, and power; price formation mechanisms that determine the fates of household and government budgets. So these are matters of power and politics, of business, process, and structure.

Yet the scholarly literature on the structural power of business would not, without some rethinking, recognize these politics. This is because they are not policies, and policy makers are not the decisive agents. Governments have not caused such politics to recur, nor are they somehow trapped by the decisions of the firms. Firms influence markets, governments, and policies, and some of what firms do constitutes politics directly. Such a broad understanding of politics invites scholarly inquiry into firms as inherently political actors.

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