



How high oil prices are the cause of Russia-Ukraine conflict, not the consequence, argues Devina Mehra

A study of past conflicts suggests that high energy prices prompt military aggression from oil-exporting nations

DEVINA MEHRA | APRIL 20, 2022 / 03:20 PM IST



Sure, we all know that oil and natural gas prices were impacted by the geopolitical tensions between Russia and Ukraine and the subsequent war, but what about the other way around?

Did high energy prices contribute to this conflict escalating into a full-fledged war? Is there at least a case to be made for this?

The theory of reflexivity popularised by George Soros comes to mind whereby fundamentals affect narratives and prices, but the cause and effect runs the other way around too, whereby price changes can change fundamentals.

It's one of those truths that appear obvious once they're pointed out to you!

Simply put: Oil/gas exporting nations are more likely to start military conflicts with their neighbours when oil prices are high.

Russia invading Ukraine this year is only the latest one in this series.

The pattern is very clear in each oil boom when governments/leaders of oil exporting nations, especially authoritarian ones, begin to look around for real or perceived grievances and end up escalating what may have been traditional friction points with their neighbours.

The Soviet Union entered Afghanistan in 1980 on the heels of the oil boom of the 1970s.

Russian tanks rolled across the border with Georgia in 2008, when oil was north of \$140. It ended with the 'liberation' of the South Ossetia and Abkhazia areas of Georgia.

In 2014, it was the annexation of Crimea by Russia from Ukraine, when oil was once again at a high.

And now we have the all-out war in Ukraine in 2022...

On the flip side, when the price of oil crashed in the mid-90s, the Soviet energy empire unravelled and eventually ended with the collapse of the Soviet Union itself.

Coming back to 2008, besides the Russia-Georgia conflict, the year had seen military disputes flare up around the world with Venezuela threatening Colombia; Venezuela and Bolivia expelling US diplomats; and Iran supporting the Hamas fight against Israel.

The common factor? Russia, Venezuela, Bolivia and Iran are all oil/natural gas exporters and energy prices were booming in 2008.

A 2017 study by Professor Cullen Hendrix of University of Denver tests whether this correlation goes beyond anecdotal evidence: do high oil prices really embolden oil-rich states to behave more aggressively—to start or escalate militarised disputes?

The study shows a 'contingent impact of oil prices in interstate disputes, with high oil prices associated with significant increases in dispute behaviour in petrostates', for which oil exports constitute more than 10 percent of GDP. Over the same period, non-petrostates did not see any such escalation in conflicts.

Second, the study also showed that these higher levels of geopolitical conflicts were due to petrostates initiating disputes, rather than becoming more attractive targets for conquest or coercion.

In simple language, when energy prices are high, energy exporters are more likely to take aggressive action against others—partly because they have the money to do so.

During the years of high oil and gas prices, Russian President Vladimir Putin was able to rebuild his country's economy and military. Oil revenues went up to over half of Russia's federal budget.

In any case, energy exporting nations tend to spend a higher proportion of their GDP on military expenditure than oil importing ones.

Data showed that if the price of oil is at \$100 a barrel, an oil exporting nation is 65 percent more likely to start an armed conflict than if it is at \$45 and 80 percent more likely than if the oil price is at \$23 a barrel.

High oil prices tend to make leaders of the exporting nations have fantasies of grandiosity and invincibility, make them ready to take on issues that may have been festering for a while.

At times there are other factors at play too like taking control of natural resources that the neighbour may have as was partly the case with Ukraine which had discovered substantial gas reserves of its own in Crimea and under the Black Sea.

This is on the aggression side. In addition, energy exporters can make vassal states that are beholden to them by giving discounted oil/gas when prices are high. This is the strategy Putin used with Belarus, for instance, to have a puppet regime there. He even gave generous gas subsidies to Georgia and Ukraine early in his regime before he had a falling out with their leaders.

High energy prices also provide a shield to the exporters as those dependent on oil or gas supplies from them can't afford strict sanctions.

This is very evident today, when Europe is in no position to say no to Russian natural gas, given its dependence on it... and Russia knows it!

Up to 74 percent of Russian natural gas goes to European or Organisation for Economic Cooperation and Development nations and there is no way those countries can turn off the tap, at least in the short run.

Replacing natural gas supplies is particularly tricky as you require either pipelines or specialised ships and port handling facilities. Switching suppliers is difficult and costly.

Even in general, it is easier to sanction countries that are making manufactured goods—you can stop buying Samsung phones or Toyota cars to sanction South Korea or Japan. It is far more difficult to do for countries supplying commodities whether that commodity is oil, coal, diamonds or even drugs. These once out of the country are easily fungible and cannot be distinguished—that is the very definition of commodities.

This is the reason why rogue leaders can continue for long in resource-rich countries as long as they are able to control the flow of these resources. These are a source of ready cash for them.

This doesn't mean that every oil-exporting nation becomes a rogue state threatening its neighbours—far from it.

Only that high energy prices give a way for exporters to flex their muscles to 'right historical wrongs' or control resources of their neighbours if they so want.

Clearly, changes in energy prices do more than just impact the budgets or countries and consumers, they can literally change the course of history.

(Most of the data cited above is from a study by Professor Hendrix, partly as quoted in the book 'Price Wars: How Chaotic Markets are creating a Chaotic World' by Rupert Russel)



DEVINA MEHRA is the Founder and Chairperson of First Global, a leading Indian and Global investment Management firm
