Oil Prices and India

This editorial is based on **[Eye on oil: on oil prices and India]** which was published in The Hindu on 06/06/2023. It talks about reduction in crude oil production by OPEC+ countries and way forward for India.

Prelims: OPEC, **OPEC+**

Mains: OPEC+, Reasons behind reducing the crude oil production, Impact on India and way forward

The world's largest grouping of crude oil producers, commonly known as OPEC+, agreed to extend ongoing production cuts into 2024 as it seeks to keep oil prices from falling amid concerns about a global economic slowdown. OPEC major and leading producer Saudi Arabia also voluntarily vowed to reduce output by an extra 1 million barrels per day (bpd) in July 2023.

The more than 20-nation OPEC+ bloc, which has been striving to curtail supply in order to support prices in the face of flagging demand, had in a surprise move in April announced additional output cuts amounting to 1.66 million bpd. For India, which imports more than 80% of its crude oil requirements, the combined Saudi-cum-OPEC+ announcements of supply curtailment are a cause for some concern given the potential they have to push up global oil prices. Still, with India having sharply increased its purchase of crude from Russia, the price India pays for an imported barrel of oil has been steadily declining.

What is OPEC+?

- OPEC+ is a **group of 23 oil-exporting countries** which meets regularly to decide how much crude oil to sell on the world market.
  - At the core of this group are the 13 members of OPEC (Organization of the Petroleum Exporting Countries), which are mainly Middle Eastern and African nations.
- OPEC was **formed in 1960** as a cartel, which aimed to fix the worldwide supply of oil and its price.
  - In 2016, when oil prices were low, OPEC joined forces with 10 other oil producers to create OPEC+.
  - One of the members of the expanded group is Russia (world's third-biggest oil producer), which also produces more than 10 million barrels a day.
- Together, **OPEC+ countries produce about 40% of all the world's crude oil.**
  - OPEC nations **produce about 30% of the world's crude oil.**
  - **Saudi Arabia is the biggest single oil supplier within the group,** producing more than 10 million barrels a day.
- OPEC+ tailors supply and demand to balance the market. It keeps prices high by lowering supplies when the demand for oil slumps. The organisation can also lower prices by putting more oil into the market.

Why is OPEC+ Reducing Production?

- **Concerns about Weak Global Demand:**
    - China's economic recovery after Covid-19 lockdowns is losing momentum, which has raised concerns. As the world's second-largest oil consumer, this could impact global oil demand and prices.
    - Interference with market dynamics (Western price cap on Russian oil)
    - Fears of another banking crisis in recent months have led investors to sell out of riskier assets such as commodities with oil prices.
    - Slow growth and lower demand in developed nations and fear of a global recession could lead to lower oil prices.
    - **US debt ceiling negotiations** have affected oil. Investors fear that this could negatively impact oil demand and result in lower prices, causing uncertainty in the market.
- **Punishing Speculators:**
    - The planned cuts will also punish oil short sellers betting on oil price declines.
    - Saudi energy minister warned traders against heavy betting on oil market. Some investors interpreted this as a signal for possible output cuts.
- **US Output Rising:**
    - US crude oil production is set to rise by 5.1% in 2023 and 1.3% in 2024 due to growth in shale oil production and technology advancement. This could significantly impact global oil supply and prices.
- **Tensions with US:**
    - The US is considering passing NOPEC (No Oil Producing and Exporting Cartels Act), which would allow seizure of OPEC's assets on US territory if market collusion is proven. The goal is to prevent price manipulation and promote fair competition, but it has faced criticism for potential retaliation by the OPEC.
    - OPEC+ has criticised the International Energy Agency's advocacy for oil stocks releases last year of being politically motivated as the US is the biggest financial donor to IAE.
        - The IEA had argued these were necessary to bring down prices, but the IEA's predictions of price strength never materialised.
        - Moreover, the United States, which released most stocks, said it would buy back some oil in 2023, but later ruled that out.
- **Maintaining the Value of its Main Export:**
    - OPEC observers also say the group needs nominal oil prices to be higher to maintain the value of their main export in the face of inflation and currency devaluation.
        - Money printing by the West in recent years has lowered the value of the US dollar, the currency in which oil is traded.

What would be the effect of this reduced production in India?

India is the **third-largest oil consumer** and imports more than 80% of its total crude oil requirement. India imports roughly 70% of its crude from the OPEC members. On a decadal comparison, the imports have reduced drastically from 87% to 70% in 2021-22. However, OPEC still accounts for the majority of India's oil imports. The reduced production by OPEC+ will have a negative impact on India. Some of the possible effects are:

- **Higher Imported Inflation:** The production cut would raise crude oil prices, increasing India's import bill and worsening the **current account deficit** by around 0.4% of **GDP.** This will also affect the retail prices of petrol and diesel, which are already at record highs across the country. Increased prices of petrol and diesel would further lead to rise in the price of domestic commodities as well.
- **Lower Economic Growth:** Higher oil prices will increase the cost of production and transportation for various sectors, affecting their profitability and competitiveness. This will also reduce the disposable income of consumers, affecting their demand for goods and services. Higher inflation and lower growth will also pose a challenge for monetary policy.
- **Higher Fiscal Deficit:** Higher oil prices will increase the subsidy burden for the government, which has to bear the difference between the market price and the controlled price of kerosene and **liquefied petroleum gas (LPG).** This will widen the fiscal deficit and limit the scope for public spending on infrastructure and social welfare.
- **Higher External Vulnerability:** Higher oil prices will increase India's dependence on **foreign**

exchange reserves and external borrowing to finance its oil imports. This will expose India to currency fluctuations and global financial shocks. Higher oil prices will also affect India's trade balance and terms of trade with other countries.

What should India do?

- **Diversify Energy Sources:** India can focus on diversifying its energy mix by promoting and investing in alternative and renewable energy sources. This includes **expanding the use of solar, wind,** hydro, **and** nuclear power. By reducing its reliance on fossil fuels, India can decrease its dependence on OPEC for oil imports.
- **Promote Domestic Oil and Gas Production:** India possesses substantial untapped oil and gas reserves. The government can incentivize domestic and foreign oil companies to engage in exploration and production activities, both onshore and offshore.
    - Implementing favourable policies, such as tax incentives and streamlined regulatory processes, can encourage increased investment and boost domestic production.
- **Enhance Energy Efficiency:** India can prioritize energy efficiency measures across various sectors, including transportation, industrial processes, and buildings. This involves adopting energy-efficient technologies, optimizing industrial processes, and implementing stricter energy conservation measures.
- **Strengthen International Partnerships:** India can foster strategic alliances with oil-producing countries outside of OPEC to secure alternative sources of oil. Strengthening ties with countries like Russia, the United States, Canada, and others can provide opportunities for diversifying import sources and negotiating favourable supply agreements.
- **Develop Strategic Oil Reserves:** Maintaining an adequate strategic petroleum reserve can act as a buffer during supply disruptions or price fluctuations. India should continue to build and expand its strategic oil reserves to ensure a stable supply of oil during emergencies and reduce vulnerability to OPEC's decisions.
- **Support research and development:** Investing in research and development (R&D) for advanced energy technologies can lead to breakthroughs in energy storage, electric vehicles, and other alternative fuels. This can help India accelerate its transition to cleaner and more sustainable energy sources, reducing dependence on OPEC in the long run.
- **Encourage Public Transportation and Electric Vehicles:** Promoting the use of public transportation systems and electric vehicles (EVs) can significantly reduce India's oil consumption. Expanding the charging infrastructure and offering incentives for EV adoption can help accelerate the shift towards sustainable transportation options.
- **Engage in energy diplomacy:** India can actively engage in energy diplomacy and participate in international forums to advocate for fair and stable oil markets. Collaborative efforts with other oil-importing nations can help influence OPEC's decision-making and create a more balanced and transparent global energy market.

Drishti Mains Question:

India is heavily dependent on OPEC countries to meet its crude oil demand. OPEC has been reducing its crude oil production and has decided to cut the production further. Discuss the implication of this cut and suggest some measures to minimize its impact.