

11. How do higher global crude oil prices affect the Indian economy? What steps can be taken to gradually insulate India from global oil price volatility in the long term? (250 Words) **15**

Approach:

- Briefly, write about the recent increase in global crude oil prices.
- Discuss the net negative impact of higher global crude oil prices for all aspects of the Indian economy.
- Suggest the long-term measures to insulate India from global oil price volatility.

Answer:

Higher global crude oil price can be attributed to demand and supply factors. Recent price increase is mainly associated with supply factors like crisis in Venezuela and Cartelization by OPEC members and Russia. It is also affected by geopolitics such as the U.S. unilateral exit from nuclear deal and sanctions on Iran.

While oil exporting countries are benefiting, oil importers are adversely affected. In this scenario, Indian economy has been impacted in following ways:

- **Decline in Forex reserve:** crude oil import constitutes around 80% of import bill and price increase will lead to high import bill, therefore deprive India's forex reserves.
- **Current account deficit (CAD):** an increase in crude imports without subsequent increase in exports will lead to CAD.
- **Fiscal pressure:** for government, increase in prices will lead to an increased spending on fuel subsidies, which will put constraints on the available fiscal space.
- **Inflation:** Impact of higher prices will also be reflected on retail prices which can cause increase in general price level.
- **Decline in individual purchasing power:** rise in inflation could lower real disposable incomes of households and therefore hurt consumer discretionary demand.
- **Exports:** Oil exports form major component of our export basket. With rise of crude oil prices, these exports also become costly and hence, uncompetitive.
- **Corporate profitability affected:** several industries use crude oil and its by-products as raw material for their final products and rise in price will take hit on their profit margins.

Measures to protect India from volatile crude oil prices

- **Reduction in demand- Develop substitute of crude oil** – Expand the blending proportion by increasing the ethanol-based biofuel production as envisaged in the National Biofuel policy, 2018.
- **Reduce import dependency** - Transport sector accounts for 70% of the total diesel sales in the country. Therefore, it is required to swiftly migrate to electric mobility through incentive mechanism and development of supportive infrastructure.
- **Create Strategic Petroleum Reserves** as part of India's evolving energy security architecture.
- **Diversify India's energy basket** – India should break out from the dominance of fossil fuels and focus on renewable power supply including biofuels.
- **Increase in India's exports** – Schemes like Make-in-India, Special Economic Zones needs to be recalibrated to stimulate India's exports.
- Explore the ways to bring fuel under the goods and services tax. It will reduce undue burden on users and also prevent leakages and achieve efficiency.

The government should utilize current situation as an opportunity to push for initiatives that lead to reduction in the country's reliance on oil imports and promote energy security, and make our financial markets less volatile in the event of untoward developments in the oil market. In the meantime, the ongoing policy of building strategic reserves at some places may insulate Indian economy from short-term shocks in the global crude oil market.