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A mixed blessing for India

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Lower petroleum prices hold obvious advantages for Indian consumers, but a bearish global oil market could also hurt several segments of the country's economy

The Oil Ministers of 12 member states of Organization of the Petroleum Exporting Countries (OPEC) concluded their meeting in Vienna on November 27 by deciding to continue with their three-year-old production quota of 30 million barrels per day (mbpd). Thus, they calculatingly ignored nearly one mbpd oversupply in the global oil market which has pushed the crude prices down by over 30 per cent since June 2014. The global oil glut, in turn, has been caused by a number of factors which include OPEC's own overproduction, rising non-OPEC production (particularly by the U.S.-based "Shale Revolutionaries") and lower demand from China and Europe. By declining to cut their output to shore up the prices, OPEC in general, and Saudi Arabia in particular, have refused to play the role of global "swing producer."

As most factors responsible for the current global demand-supply disequilibrium are systemic in nature, the world faces prospects for relatively bearish oil prices over the foreseeable future. Indeed, the prices have continued to fall with the Indian basket touching $72.51/barrel on November 27 — a decline of nearly $9 from the average during the first fortnight of the month.

As the world's fourth largest importer of crude, India can afford to exult at this precipitous crude price decline. Still, given the strategic importance of this development, a more comprehensive analysis is desirable.

A virtuous cycle in the economy

From the limited perspective of India's consumer economy, lower global oil prices undoubtedly augur well. Lower pump prices reduce pressure on the consumer who can spend the savings elsewhere, spurring the demand side of the economy. As petroleum products form a large part of the consumer price indices, lower crude prices result in reduced inflation, which in turn paves the way for lower interest rates and greater buoyancy in investments. Thus, lower oil prices can trigger a virtuous cycle in the Indian economy. After all, with India's imports running at an estimated 3.7 mbpd in 2013, a $30/barrel decline in oil prices amounts to a $40 billion savings bonanza on annual imports. The impact would be best felt on the petroleum sector where marketers have been groaning under subsidy burden. The transport sector would also be a direct beneficiary.

If we widen the impact analysis to consider the totality of the Indian economy, some challenges also appear. First, as oil producers are India's major markets and investment destinations, their economic decline may affect the country. Recent decline in the share prices of Bharti Airtel and Bajaj Auto due to the devaluation of the Nigerian Naira illustrates this more complex trend.

Second, apart from being the fourth largest oil importer, India is also the world's sixth largest petroleum product exporter earning over $60 billion annually — nearly a fifth of global exports. A bearish oil market would hurt this segment with reduced demand, lower unit prices and lower margins.

Third, the oil price decline coincides with resumed foreign interest in investing in India. It is difficult to assess their mutual correlation, but lower oil revenues may attenuate arrival of petrodollars into India.

Fourth, whenever oil revenues decline, countries that export Gulf oil try to tighten their belts by emphasising local production and downsizing their foreign labour force in which Indians dominate. Thanks largely to over five million Indian expatiates there, India was the world's largest recipient of remittances which topped $70 billion in 2013. The possibility of these remittances being reduced cannot be ruled out. This would have a serious impact on remittance-dependent States such as Kerala and Goa.

Fifth, lower crude prices may cast a shadow over the sputtering controversy over natural gas pricing norms in India as the latter generally follow the oil prices. Future investment decisions in oil-related sectors may get delayed.

Sixth, lower pump prices may cause higher fuel consumption as sales of automotive products soar. This would worsen commuter woes as well as cause increased urban pollution.

Finally, a decline in oil prices generally accompanies a global decline in commodity prices, particularly those of minerals and agricultural products. India remains a major exporter of these and would see lower realisation, particularly of Guar Gum, a critical input for the shale industry.

The long-term impact of lower oil prices is likely to be felt beyond the economic domain. Geopolitically, persistent lower oil revenue could propel a number of emerging exporters towards domestic political instability as the ruling elites lose their capacity to provide "stomach infrastructure" to the common man. Countries with lower per capita oil revenue such as Nigeria, Iran, Algeria and Venezuela may be more at risk. In general, however, lower oil revenues may have a dampening effect on regional or domestic disputes.

Measures to leverage oil prices

India can leverage the current low oil prices for long-term gains. To this end, the following measures can be considered. One, it can foster long-term crude supply relationships with exporters in return for stable prices, upstream engagements, inbound investments, etc. Two, it can enter into oil-for-infrastructure barter deals to boost project exports. Three, it can restructure public sector oil companies to make them more productive and globally proactive for leaner times ahead. Four, it can channel some of the oil bonanza to mitigate the increased cost disadvantage of renewable and alternative energy sources. Five, it can build its own strategic oil reserves.

The current downturn in oil prices underlines the cyclic nature of commodity trade and illustrates OPEC's reduced regulatory capacity consequent to it supplying only a third of global demand. While Shale Revolution may be a new and price-sensitive factor, it is unlikely to vanish with time or with lower prices. During past oil bear-hugs in 1986, 1993-99 and 2008, the lower prices invariably spurred consumption and the oil bounced back. There is no reason to believe that the oil prices shall not rise again. India would do well to recall an old oil adage, "The cure for high oil price is high oil price itself" — and use this rare, cyclic opportunity for long-term gains.

(Mahesh Sachdev has served as Indian ambassador to Algeria, Norway and Nigeria — all major oil exporting countries.)