All about Oil Shocks and their Economic Impact

What is the issue?

Recently, the U.S. announced a complete ban on Russian oil, liquefied natural gas and coal imports.

Is the world in the grip of yet another oil shock?

> *Oil shock is a sudden rise in the price of oil that is often accompanied by decreased supply.*

- Russia is the third biggest producer of oil in the world, behind the US and Saudi Arabia.
- Russian gas accounts for about 40% of the EU's natural gas imports.
- Sanction- The ban blocked any new purchases of Russian crude oil and certain petroleum products, liquefied natural gas and coal.
- It also banned new U.S. investment in Russia's energy sector and prohibited Americans from participating in foreign investments that flow into Russia's energy sector.
- If Russian gas stopped flowing into Western Europe, already heated prices would increase even more.
- An oil crisis can endanger economic and political stability throughout the global economy which is struggling to come out of a pandemic.
- The current geo-political crisis resulted in Brent hitting 140 dollars/barrel (14-year high) before settling down to 110 dollar/barrel level.
- Though there may not be supply constraints in the long-term with incremental productions coming from other producing countries like Iran, Venezuela, OPEC members and the US, energy prices will remain volatile in the near term.

What were the earlier oil shocks like?

- In the post-World War II era, there have been two major oil crises.
- **Yom Kippur war**- In 1973, Arab members of Organization of the Petroleum Exporting Countries (OPEC) imposed an embargo on supply to the US, Japan and Western Europe, for supporting Israel in the Yom Kippur war.
- These nations consumed more than half the world's energy.
- Oil prices quadrupled to almost 12 dollar a barrel.
- **Iran-Iraq war**- The Iranian revolution triggered the second oil shock in 1979 and peaked with the outbreak of the Iran-Iraq war (1980-88).
- In 1981, the price of oil stabilised at 32 dollar per barrel.

How has it affected India?

- **Price volatility**- The Indian government has been taking up bilaterally with crude oil producing countries, OPEC and heads of other international fora to convey India's serious

concerns over crude oil price volatility.
- Since India's import dependence from Russia for oil and gas has been very minor, no major supply-side impact is expected.
- **Price implications**- What has adversely affected India is the price implications arising due to the ongoing conflict.
- The price impact is two-fold for India — on its import bill and on the retail prices of auto and cooking fuel.
- **Logistics issue**- What becomes an issue is logistics — transporting oil and gas (including financing it in an event of sanctions).

How should India prepare to shield itself from future oil shocks?

- The Indian government has been taking significant policy decisions for energy transition towards a net zero future.
- Recently, responding to America's call, India had also committed to supporting initiatives for releases from the Strategic Petroleum Reserves for mitigating market volatility and calming the rise in crude oil prices.
- With the government taking measures to ensure that alternate resources of energy, India may be better off in the long term in handling any geo-political strains.

Reference

1. https://www.thehindubusinessline.com/blexplainer/all-ou-need-to-know-about-oil-shocks-and-their-economic-impact/article65223729.ece