

SLIPPERY SLOPE: ON INDIA'S ENERGY NEEDS

Relevant for: Indian Economy | Topic: Infrastructure: Energy incl. Renewable & Non-renewable

India's economic fortunes continue to be tied to the sharply fluctuating price of oil. At a gathering of prominent oil ministers in New Delhi on Monday, Prime Minister Narendra Modi urged oil-producing countries to reduce the cost of energy in order to aid the global economy in its path towards recovery. Mr. Modi also called for a review of payment terms, demanding the partial use of the rupee instead of the U.S. dollar to pay for oil, in order to ease the burden on oil-importing countries in the wake of the strengthening of the dollar. With well over 80% of its oil demand being met through imports, India clearly has a lot at stake as oil prices have risen by as much as 70% in rupee terms in the last one year. Notably, speaking at the same event, Saudi Arabian Energy Minister Khalid A. Al-Falih refused to openly commit to lower oil prices, opting instead to say that the price of oil could have been much higher but for the efforts taken by his country to boost supply. This is not surprising given the absence of significant rival suppliers in the global oil market willing to help out India.

India's policymakers now face the difficult task of safely steering the economy in the midst of multiple external headwinds. For one, the current account deficit widened to 2.4% of gross domestic product in the first quarter of 2018-19 and is expected to reach 3% for the full year. The rupee, which is down about 16% since the beginning of the year, doesn't seem to be showing any signs of recovery either. Further, the growth in the sales of petrol and diesel has already been affected adversely as their prices have shot through the roof. All this will likely weigh negatively on the prospects of the Indian economy, the world's fastest-growing, in the coming quarters. In this scenario, the decision to marginally cut taxes imposed on domestic fuels is unlikely to be of any significant help to consumers. What is required is a steep cut in Central and State taxes for the benefit to carry through to the consumers, which, of course, is unlikely given the government's fiscal needs. Another long-term solution to the oil problem will be to increasingly tap into domestic sources of energy supply while simultaneously encouraging consumers to switch to green alternatives. This will require a stronger policy framework and implementation. In the short term, the government could look to diversifying its international supplier base to manage shocks better. But such a choice carries geopolitical risks, such as in the case of Iran. Since it will take a length of time to wean the economy off oil imports, policymakers should also be willing to think beyond just the next election if India's over-reliance on oil is to come to an end for good.

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