Geopolitical Consequences: The Israel-Hamas War and India's Energy Strategy

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Introduction

The Hamas attack on Israel on October 7, 2023, and the subsequent Israeli siege of Gaza over the next month, have rattled the world with ghastly levels of destruction and hostility.[i] While the ongoing war's impact on national treasuries is concerning, its impact on global energy reserves and the oil market remains the most serious short-term issue. Oil prices have risen by $5 per barrel since the crisis began, despite the oil output remaining unaffected.[ii] Oil supply shocks could have disastrous implications for energy-importing countries and the global economy as a whole, bringing double digit inflation and stagnant growth.

Impact on Global Oil Markets

As soon as the Israel-Hamas war escalated to retaliatory strikes and the refusal for a ceasefire, the global economic markets began to ring the warning bells. The Middle East, with its expanse of valuable oil assets, is a point of strategic concern for most nations. It accounts for 31 per cent of global oil production, 18 per cent of gas production, and 48 per cent of proved oil reserves.[iii] Additionally, global recessions are often sparked by sharp increases in oil prices, resulting from conflicts such as the one in Gaza, making the ongoing violence in the region all the more concerning. The Israeli forces' last counteroffensive in the 1973 Arab-Israeli conflict, the Yom Kippur war, led to an oil embargo imposed by the Organisation of Petroleum Exporting Countries (OPEC).[iv] This set the precedent for a fourfold increase in the price of crude, sky-rocketing consumer prices, a monumental increase in business costs and a pronounced period of stagflation. There has been unending speculation from financial and political stalwarts on the conflict's impact on the global oil market and subsequent repercussions for international strategic interests.[v] International Monetary Fund (IMF) experts have been "Thinking the unthinkable" for the next big shock to the global economy and estimate that a sustained 10 per cent increase in oil prices shaves 0.15 percentage points off global economic growth.[vi]

The optimal situation for the global economy is one where the conflict is contained to the Israeli offensive on Gaza, without its proliferation to the broader region. In this case, the IMF has projected that oil prices should stabilise at their current level, 93 dollars a barrel, and could soon start to fall back.[vii] However, recent reports of the involvement of Libyan and Irani-backed Hezbollah and Yemini Houthi forces make this scenario less likely.[viii] This leads us to the most probable outcome, a situation where the Gazan hostilities seep into the rest of the Middle East as well. The arrival of United States' (US) carrier groups in the eastern Mediterranean suggests Washington is already making contingencies for this. If Iran were drawn into the war, it would create major global risks by disrupting energy supplies and pushing up oil prices.[ix] Experts highlight the imminent possibility of a broader regional conflict, embroiling Lebanon, Egypt and Syria, as well as other Arab states.[x] In those circumstances, oil prices could surge up to 150 dollars a barrel, sending inflation back into double digits in the US and Europe.[xi] A situation like this would disrupt the global flow of crude, especially if the Strait of Hormuz, which transports 20 per cent of the world's daily supply of oil, were to close.[xii] At present, international market observers expect the United States to strengthen sanctions against Iran, as a precautionary measure, given its close links to Hamas and

Hezbollah.[xiii] Furthermore, all eyes are on Saudi Arabia, the world's largest oil exporter and OPEC linchpin, who will play a critical role in how the crisis unfolds.

Effect on India's Strategic Interests

A long-drawn conflict in the Middle East could significantly harm India's energy interests, globally and domestically, even if the government is able to stabilise oil prices before the 2024 election. Brent crude oil prices rose over 3 per cent, crossing 87 dollars a barrel around the world, including India.[xiv] Gazing beyond short run economic dynamics, economists argue that any extension in the conflict would have catastrophic ramifications for India as crude oil prices will go beyond 90 dollars a barrel in India and a larger conflict may affect sea routes, pushing up insurance and transportation costs.[xv] Energy is a matter of grave concern for the country. India's 'energy poverty' is today perhaps the chief constraint on its sustainable economic growth.[xvi] Moreover, India's energy consumption is set to grow with its population, urban migration, and conspicuous consumption, making the deft handling of this crisis a crucial strategic priority for the country.

Over 60 percent of India's oil needs are reliant on the Middle East, and it has long recognised the energy security risks associated with both the region and its sustained reliance on oil.[xvii] Notably, amidst the Russia-Ukraine conflict, India seized the opportunity for substantial oil import discounts from Russia. Even as global crude oil prices surge, India remains steadfast in its continued importation from Russia, which were up by 80 percent in the month of Sept.[xviii] The potential impact of the Israel-Hamas conflict on India's crude oil import plans depends largely on whether the conflict escalates to involve OPEC nations, especially Saudi Arabia. This could lead to a severe crisis, with higher oil prices, a depreciating rupee, and surging inflation. Ergo, higher crude oil prices could have a destructive impact on India. Where many sectors are already under pressure with rising energy costs, India has to navigate these global market trends carefully. However, if the conflict remains localised between Israel and Hamas, the impact on India may be limited.

If the current conflict in Gaza escalates further, India's oil options are limited and constrained. Following Saudi Arabia's decision to extend its voluntary output cuts to the end of 2023, Russia seems to be the most viable option with the world's largest democracy but this prospect is not without its impediments.[xix] The share of Russian oil in India's overall imports rose to about two-fifths in the first half of fiscal year 2023-24, consolidating Moscow's position as India's top supplier.[xx] India's imports from Iraq and Saudi Arabia fell by 12 and 23 percent, respectively, during April-September 2023.[xxi] However, the possibility of continuing to buy discounted crude from Russia is slipping away. The Russian's flagship Urals crude was selling at around 40 dollars a barrel below Brent and is now selling at around just 10 dollars under, making the discount increasingly insufficient.[xxii] Moreover, the Indian government's discomfort in paying for Russian oil imports with the Chinese yuan has held up the payment for at least seven cargoes from Russia.[xxiii] Refining sources said traders have been ready to strike deals in dirhams, but Russian sellers have held out for yuan.[xxiv] The Indian government is reluctant about the rupee to yuan conversion costs as well as a threat that the yuan may become the dominant currency of trade in the region, another aspect of Chinese dominance in South Asia that India will not let pass.

On the Saudi Arabian front, the Middle Eastern oil producer decided to undertake a voluntary crude oil output cut in July, resulting in steadily rising oil prices since.[xxv] Saudi Arabia recently announced an extension of these voluntary output cuts, to be reconsidered in December 2023 for an extension or deepening of the cuts. India, a net importer of energy to fulfil 87 per cent of its needs, engages Saudi Arabia as its second largest oil importer.[xxvi] The output cuts by the Saudis led to a heftier import bill for the Indian government, along with heightened volatility, a state likely to continue for the next few months.[xxvii]

India's oil options seem to be heavily constrained on all fronts, making it crucial for the government to actively look for alternative sources and aim to sustainably reduce dependency on oil imports. For many, the possibility of Russia supplying affordable oil to major Asian importers, including India, is still open. Yet, India must diversify its oil sources to reduce risks. This should be aimed at fostering energy complementarities with fossil fuel exporters such as in the Gulf, Indonesia, and Guyana through cross-investments, long-term deals, and strategic reserves. India must also earmark adequate funds for the acquisition of energy-related assets abroad, such as fossil fuels, lithium and rare earths. This decision will hinge on factors like global oil prices, geopolitics, and India's economy. However, the energy transition, especially one with a focus on renewable energy brings with it the challenge of India's dependency on China for renewable technologies.[xxviii] A focus on green hydrogen and Cross Border Electricity Trade (CBET) may be able to address these issues. CBET projects are already underway with Bangladesh, Bhutan and Nepal.[xxix] India will need to leverage these and expand its network of CBETs significantly to avoid such sticky situations in the future. The Middle East conflict ought to serve as an alert to the world, particularly net importers like India. Oil instability and security issues are becoming increasingly difficult for states to ignore; ensuring a smooth and rapid transition to greener and more sustainable energy sources is vital for any nation's strategic nexus. The developing nations, particularly India, given its global ambitions, must prioritise the establishment of alternate energy sources and oil suppliers in order to offset any l

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