4th Asian Energy Ministerial Round Table
Sustainable Growth and Energy Interdependence
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Session III: Energy Price Volatility

Speech of Minister of State (P&NG)

Excellencies, Ladies and Gentlemen

1. The topic ‘Energy Price Volatility’ is of great relevance to us all. It is even more so for an emerging economy like India which is a net oil importer. As the world’s fourth largest oil importer, India’s economy is greatly impacted by international oil prices. The current rise in international oil prices is a cause for worry for the world economy as a whole, which is still recovering from recession.

2. Oil prices remain an important determinant of global economic performance. Speaking from the perspective of an emerging economy, which is a net importer of oil, higher oil prices lead to inflation, increased input costs and lower investment. Tax revenues fall and the budget deficit increases, which drives interest rates up. Net oil importing countries normally experience deterioration in their balance of payments, putting downward pressure on exchange rates. As a result, imports become more expensive and exports less valuable, leading to a drop in real national income. All these call for

appropriate policy responses and are a major challenge for any developing country.

3. I need not dilate upon the causes for high volatility in oil prices as they are well known: lack of spare capacity across the oil supply chain, i.e., in production, refining and transportation infrastructure; surging demand; the price inelasticity of demand; uncertainties related to natural disasters or geo-politics; the huge increase of activity in the commodities markets; etc. While all these factors play their part in the volatility in oil prices, speculation in commodity markets, unregulated over-the-counter (OTC) transactions and trading in 'paper barrels' are also to blame.

4. Given the dual role that crude oil now plays both as a physical commodity and a financial asset, we need to improve our understanding of the inter-linkages between the physical and financial markets, if we are to address the issues of price volatility and price discovery in the oil markets. At the height of international oil prices in July 2008, India had given a call for bringing in regulatory mechanisms to prevent the influence of speculators on the price formation of oil. In this context, it is heartening to take note of the initiatives adopted by the US Commodity Futures Trading Commission (CFTC), which among other things, has joined hands with the UK Financial Services Authority and ICE Futures, Europe in order to expand surveillance and information-sharing on crude oil trading.

5. One thing is certain: price discovery of such a vital and finite resource as oil cannot be left entirely unregulated, whether in the commodity derivatives markets or the financial markets. We need to consider establishing position limits and moving OTC activity on to regulated exchanges. As an emerging economy, we support further initiatives by IEF and other international organizations, for putting in place suitable regulatory mechanisms. It is hoped that the roadmap adopted by the G-20 countries to strengthen regulation in this sphere, will render oil markets less opaque, dampen volatility and provide the much-needed stability in oil price formation.

6. What is the way out of volatility? If oil prices have to be made more stable and predictable, both oil producers and consumers have to recognize their inter-dependence and realize that their destinies are inter-twined. For encouraging investment by the oil producing countries, the oil consuming countries need to be in dialogue with the producing countries so as assure the producers of a stable demand in times to come. Reliable data relating to production and consumption is a crucial starting point to build trust among producers and consumers and to instill confidence among the producers to undertake fresh investments. And this is where JODI comes in,

7. While it is undeniable that more oil must be brought to the market through greater investments in the exploration and refining sectors, it is also true that consumers need to adopt energy conservation, energy efficiency and energy diversification to reduce our collective demand for energy. High oil prices or volatile oil

markets favour neither the producers nor the consumers. By raising the spectre of "demand uncertainty", they inhibit fresh investments. Hence all of us – whether we are oil producers or consumers – have to work as one to address the issues related to energy price volatility. Asia has the financial capacity, the technical wherewithal and the human resources required to meet the challenge ahead of us. We need to marshal our resources and leverage our respective strengths to produce more oil and gas, and bring stability to the international oil markets. I am sure our discussions today will be a step in that direction.

Thank you.

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