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US Sanctions on Iran: India braces for Headwinds as Waiver on Purchase of Iranian Oil Ends

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Background

India has historically been dependent on the imported crude oil to power its economy, which is amongst the fastest growing economies in the world. Successive governments have tried to reduce the crude import bill, but to little avail. With the domestic consumption growing at a fast pace and domestic output remaining stagnant, India's dependence on imported oil has risen to 83.7 per cent in 2018-19 from 82.9 per cent in 2017-18, similarly import dependence in 2015-16 was 80.6 per cent, which grew to 81.7 per cent in the following year, according to the oil ministry's Petroleum Planning and Analysis Cell (PPAC).

In terms of the quantum, India's oil consumption grew from 184.7 million tonnes in 2015-16 to 194.6 million tonnes in the following year and 206.2 million tonnes in 2017-18. In 2018-19, demand grew 2.6 per cent to 211.6 million tonnes.

On the other hand, domestic output continues its downward slide. India's crude oil output fell to 36 million tonnes in 2016-17 from 36.9 million tonnes in 2015-16. The trend of negative growth continues in the following years too with output falling to 35.7 million tonnes in 2017-18 and to 34.2 million tonnes in the fiscal year ended March 31, 2019, according to the PPAC.

US sanctions on Iran

Crude oil being a prized resource is more often than not a subject matter of geopolitical wrangling between global powers and countries that are considered international pariah owing to their strategic and military behaviour.

A lion's share of crude oil is produced in the Middle-East which has also increasingly become one of the most volatile and unstable regions in the world. India imports close to three-quarters of its crude oil, and about 10% of this is met by Iran, the other major trading partners being Saudi Arabia, Iraq, UAE, Venezuela, Nigeria, Mexico and Kuwait.

In May 2018, under the Trump administration, US pulled out of the 2015 landmark Joint Comprehensive Plan of Action (JCPOA). Under this Obama-era deal, involving five permanent members of the United Nations Security Council and Germany, Iran agreed to stop its nuclear programme in exchange of relief from economic sanctions. Immediately upon calling off the deal, President Trump signed fresh sanctions against Iran and warned countries against any cooperation with Tehran on its controversial nuclear weapons programme. However, some countries like India, China, Japan, South Korea and Turkey obtained a waiver or "Significant Reduction Exceptions" which allowed them to continue buying oil from Iran for a period of 6 months albeit at reduced quantities. Under the six-month waiver granted by the US government, India could import up to 300,000 barrels a day. This was about half of what it previously purchased in the period after sanctions were lifted.

Cut to now, the United States' latest decision to end waivers from sanctions, poses tough political and economic questions for India. For India, this move comes at an inopportune time, with the Lok Sabha elections underway. With the Iranian oil supply being reduced to zero there will be an upward pressure on the crude prices. The price of Brent crude, the global oil benchmark, rose as much as 3.3 per cent to $74.31 a barrel on 22nd April 2019, the highest intra-day level in almost six months.

New Delhi’s Options

Short-term

As India lines up alternate supply sources from other countries, recent American sanctions on a second crude supplier to India, Venezuela, hasn’t exactly helped matters.

As India anticipated the withdrawal of waiver, the Government consciously engaged with the Arab states, particularly Saudi Arabia and the UAE, to tie up alternate supply lines. The Government of India had so far derived the benefit of the falling crude oil prices, but the rise in global crude oil prices will have a cascading effect on New Delhi’s oil imports and its subsidy bill.
Benefits of importing crude from Iran were many as India and Iran had established a unique Rupee-Rial payment mechanism to continue trade under unilateral US sanctions, further, the Iranian oil came with more favourable credit terms and lower prices than available substitutes. The ending of waiver and a sharp reduction in imports will only make it harder for the Indian government to reign in the import bill for the current fiscal as apart from cost and credit terms for alternate crude are unlikely to be as favourable as with Iran, recalibrating state-owned refineries that process Iranian crude in order for them to process any other kind of crude will lead to substantial expenditure. With most of India’s refineries being state-owned, this cost too would have to be borne by the government.

Long-term

The government is focusing on measures such as increasing domestic production, promoting the use of biofuel and energy conservation to reduce dependence on imported crude oil. It changed exploration rules multiple times during the last five years to get the elusive private and foreign investment.

The previous New Exploration Licensing Policy (NELP) was replaced by a more comprehensive and liberal Hydrocarbon Exploration and Licensing Policy (HELP) that promised pricing and marketing freedom. HELP brought in the Open Acreage Licensing Policy (OALP) that gave companies freedom to choose areas they wanted to explore. Some of the key features of HELP are designed to attract foreign investment and they are as follows:

- Single License for both conventional and unconventional Hydrocarbons.
- Freedom to carve out blocks, EoIs can be made round the year with bidding rounds in 6 months cycles.
- Transition from Cost Recovery mechanism to Revenue Sharing mechanism.
- Full Marketing & Pricing Freedom.
- Fiscal Incentives-Low graded royalty rates.
- Low regulatory burden.
- Exploration rights on all retained area for full contract life.
- 100% PI allowed for foreign / private players.
- USD 5-6 billion in exploration activities and another USD 20-30 billion for development activities is expected.
- OALP launched in 2017:

o Round-I: 55 blocks awarded (59,000 Sq km.)
o Round-II: 14 blocks (29,000 Sq km.) (Bid Process Ongoing)
o Round-III: 18 EoIs (30,000 Sq km.), 5 CBM Blocks (1,957 Sq km.) (Bid Process Ongoing).

Conclusion

With US sanction on Iran beginning to hurt India's interest with respect to import of crude oil at the right price, it would require a long term policy and deft handling by India to ensure that its exemption from sanctions on Chabahar Port is not tinkered with. India officially took over operations of the port from December 2018 through a state-owned vehicle in partnership with an Iranian port operator. However, US sanctions have greatly hampered India's investment plans in the port with the project failing to generate interest from private Indian firms.

The new government in India already has a humungous task cut out for itself. The task to ensure energy security for the country and safeguarding its strategic investments, in a volatile world order.

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