

THE FREE ENTERPRISE BRIEF

The Strait that Moves the World

DIRECTOR'S NOTE

Energy Shocks are Never Just About Prices

The first instinct in an energy shock is to correctly look at prices. Many times, energy shocks are seen as the cause of economic crises.

Energy shocks are often less the sole cause of crises. Rather, they are the triggers that expose deeper structural weaknesses, building across economies, institutions, and the global economic architecture.

Today, the conflict in West Asia has sent energy prices rising and equity prices falling. Currencies are weakening, and deficits are set to widen.

This issue examines how energy shocks travel through the economy, and what they reveal along the way.

We take a historical perspective, analysing the oil shocks of the 1970s, which had worldwide reverberations. What began as an energy shock ultimately contributed to major changes in the global economic order.

Today, a similar pattern may be unfolding. Conflict in West Asia has created an energy shock. The immediate impact is not just increased prices but also disruptions in supply.

Price rises can be absorbed and passed on. Supply disruptions cannot. These disruptions can lead to prolonged output losses. These output losses then transmit across the economy, depressing demand and triggering a further slowdown.

The challenge for policymakers is not merely to respond to price increases. It is to recognise the signals behind the shock, and act before the shock forces the adjustment.

THE BIG QUESTION

What Can an Energy-Importing Country Do in Energy Crises?

The fact that India remains heavily dependent on imported energy, especially crude oil and gas, is not new. And the fact that energy supply shocks raise prices is not new either.

Price shocks present governments with two options: first, they can protect consumers by preventing higher prices from passing through. This raises government spending, either through pass-throughs or reduces government revenue if taxes are cut. Either way, the fiscal maths deteriorates. Second, they can allow prices to rise, leading to inflation and demand compression. In this way, the political maths deteriorates.

In practice, governments usually respond with some combination of the two. Price rises can only be absorbed to a certain point.

With oil prices crossing the USD 100/bbl mark several times, most analysts are factoring in sustained price rises in their models. India has already seen wholesale price inflation (WPI) rise to a year-long high. Inflation can prompt a hawkish shift in monetary policy.

In energy markets, price shocks almost always result from supply shocks. 1973, 1979, and, most recently, 2022 are examples of geopolitical-led disruptions to global supply.

For importing countries, solving for the price rise is just one problem. The bigger problem lies in the unavailability of fuel. Take, for instance, Sri Lanka. In the wake of worldwide oil and gas shortages, they have shifted to a four-day work week.

Sri Lanka's experience illustrates the extreme case: when foreign exchange constraints meet energy shortages, economies are forced into rationing rather than adjustment.

The problem only seems to be getting bigger. In a major escalation, both Israel and Iran are now targeting energy infrastructure. Ras Laffan, Qatar's main LNG export hub and a critical node in global LNG trade, has been disrupted by the conflict, raising concerns over prolonged supply tightness.

Unlike earlier energy crises, the impact is now being felt directly in the crores of India's kitchens.

More than 10 crore LPG cylinder connections have been installed in Indian households in the past decade. The price rise and

perceived shortages can be a political headache for the government.

The disruption is also being felt across the industrial and hospitality sectors. Shortages in supply may lead to shutdowns, temporary output losses, and job losses. These losses in economic activity, whether transient or not, carry second-order effects that are not felt instantly but manifest over months.

What should an energy-importing country do in such a situation? What can India do?

When crises hit, moves that should have been made years or decades ago come to light. Just as the COVID-19 pandemic exposed decades of underinvestment in health infrastructure, energy crises bring to the fore concentration in supply chains.

There are no near-term fixes. India's response must operate across three levels: managing the immediate price shock, navigating fiscal trade-offs, and reducing long-term vulnerability to external energy disruptions.

Energy Security

When India started purchasing oil from Russia in 2022, diversification worked in our favour. Even today, 70% of our crude comes from outside the Strait of Hormuz, reflecting stability in supply.

However, gas supply chains are far more concentrated. Europe suffered supply disruptions and skyrocketing heating costs as gas prices rose during the Russia-Ukraine war. Now, Asia stands at a similar juncture, as rising gas prices stand to disrupt economies and livelihoods.

With fossil fuel supplies concentrated in a few geographies, diversification of sources can only go so far. Solar, wind, geothermal, and nuclear are domestic energy sources. Harnessing them to their full potential could make us energy independent, insulating us from volatility.

Electrification, supported by an expansion in renewable energy, is the way forward. Take China, where its electrification of transport has reduced its oil dependency.

India will have to massively expand investments in renewable energy generation and double the 500 GW target. India has built significant private-sector capabilities in renewable power generation.

Expanding renewable purchase and consumption obligations will create demand assurance. To harness this expanded renewable power generation, grid upgrades and energy storage systems are crucial.

These are expensive investments – and public money alone will not be enough. State Distribution Companies (DISCOMs) are heavily indebted. So are State Road Transport Undertakings (SRTUs) – that will drive the electrification of buses.

Repeated bailouts and persistent operational weaknesses in public utilities have made it harder to crowd in long-term private capital.ⁱ

Reforms are crucial in this sector. Reducing distortionary pricing and cross-subsidisation are key interventions. However, any radical change is politically expensive to implement.

Public utilities must become more efficient and service-oriented. Their

management must be professionalised. In the interim, risk-sharing mechanisms are needed to bring in private capital and investment.

The recent cooking gas shortage has led to another shortage in India – that of induction cookers. Electrification of cooking can reduce reliance on gas in the future. However, the transition will require a whole-of-government approach. Demand can be aggregated, as was done with LED bulbs. This can also be converged with the solar rooftop initiative.

Green hydrogen has the potential to decarbonise hard-to-abate sectors, such as fertilisers, cement, and steel. Initiatives such as the Green Hydrogen Mission are accelerating this shift.

A recent government release highlights India's push to develop a green ammonia ecosystem, positioning it as a key pillar of the broader green hydrogen strategy.ⁱⁱ

At the same time, another trade-off confronts Indian policymakers. Clean energy supply chains are also concentrated.

China accounts for nearly 80 per cent of solar photovoltaic manufacturing and battery cell production.ⁱⁱⁱ

India's domestic manufacturing capabilities and critical minerals processing will need to be significantly enhanced to meet growing domestic demand.

This was true for existing goals, but it will be even more important for more ambitious ones.

Managing Macro Trade-Offs

Oil shocks do not just raise import bills; they strain public finances. For India, the fiscal question is not whether to intervene, but how

much room exists to do so without undermining macroeconomic stability.

Any attempt to shield consumers operates through the fiscal channel — either by reducing tax revenues or by increasing expenditure. Both widen the fiscal deficit.

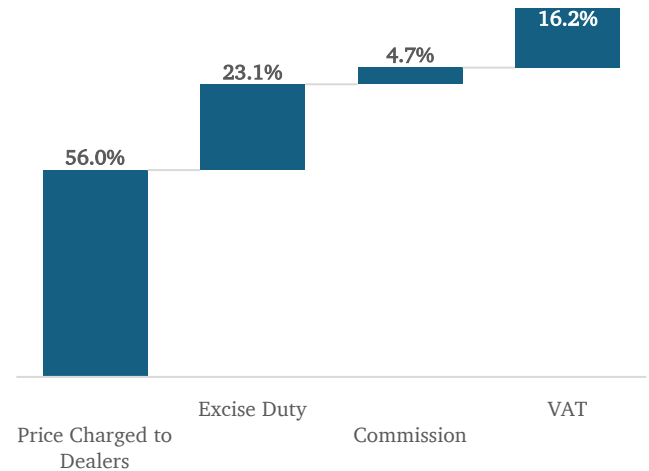
Oil shocks tend to widen both the current account deficit and the fiscal deficit simultaneously — the so-called “twin deficits” problem. As import bills rise, so does pressure on the rupee; fiscal expansion can amplify that pressure, creating a feedback loop of currency depreciation and imported inflation.

Excise duties on oil during periods of price moderation have helped India build fiscal buffers when they were needed. Indirect taxes account for nearly 40 per cent of the retail selling price of petrol and diesel in New Delhi. The excise duty is levied by the Central Government, while VAT is levied by state governments.

There is fiscal room to absorb oil price increases, preventing a spillover to the wider economy. The goal should not be to eliminate price rises or spikes, but to smooth them.

The government has used excise-duty reductions as a buffer. Excise duties have been reduced by Rs. 10/litre for both diesel and petrol, in a bid to check price volatility.^{iv}

Figure 1: Breakdown of Petrol Retail Selling Price in Delhi (%)



Yet, large and persistent tax cuts risk converting a temporary shock into a structural fiscal weakness. The key distinction is between temporary smoothing measures and structural fiscal commitments. Temporary tax reductions or targeted transfers can cushion short-term shocks. Permanent tax cuts or broad subsidies, however, risk locking in fiscal slippage long after prices stabilise.

Fiscal expansion during an oil shock can complicate monetary policy. If governments attempt to suppress prices through fiscal means, central banks may still be forced to tighten policy to anchor inflation expectations. The result is a misaligned policy mix: loose fiscal policy alongside tighter monetary policy.

The West Asia conflict has triggered shock, but India’s response will determine whether it remains exposed to the next one.

EXPLAINER

The Many Forms of Natural Gas

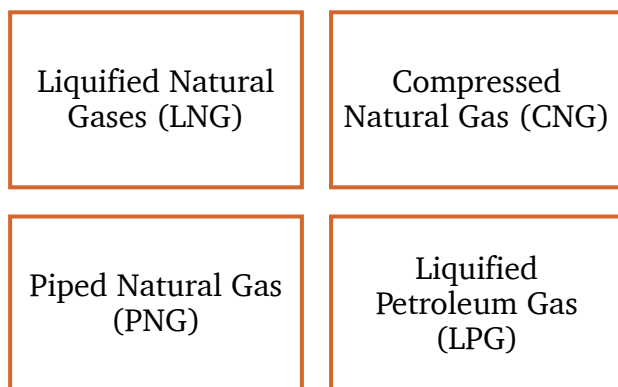
Often, all fuel gases are grouped together. Yet, not all gases are the same. The

difference arises not from the source but from how the gases are processed, transported, and stored.

There are petroleum-based gases, such as liquified petroleum gas (LPG). Then, there are natural gases, including compressed natural gas (CNG), piped natural gas (PNG), and liquified natural gas (LNG).

First is liquified petroleum gas (LPG). It is derived from propane and butane. LPG is the most visible and relevant to the hundreds of millions of households in India. Stored in cylinders, it is India's primary cooking fuel – used in households, street vendors, restaurants, and hostels.

Nearly two-thirds of India's LPG demand is met through imports. Crucially, 90 per cent of these supplies flow through the Strait of Hormuz.^v Prices have risen, and shortages are being felt.



Second, natural gases are usually methane-based. LNG, CNG, and PNG are not different fuels; they are different forms in which natural gas is stored, transported, and delivered. LNG is natural gas cooled to a liquid for long-distance transport. CNG is natural gas compressed under high pressure, mainly for transport. PNG is natural gas supplied through pipelines to households, businesses, and small

industries. India imports 47 per cent of its LNG requirements from Qatar.

LNG is a critical input for industries such as fertiliser, steel, ceramics, and foam, among others. Power plants use LNG for power generation. Fertilisers alone account for nearly a third of India's LNG consumption, followed by city gas distribution (CGD), which covers the delivery of CNG and PNG to households.^{vi}

Natural gas matters because it is widely seen as a “bridge fuel” in the energy transition. It is seen as a lower-emissions substitute for coal and oil that can support economic activity while renewable energy systems scale up.

CNG is a major transport fuel in many Indian cities, especially for auto-rickshaws, cabs, buses, and parts of the small commercial vehicle fleets.

PNG, as the name suggests, is piped. These are the piped gas connections that deliver cooking gas directly to households, removing the need for cylinders. These are also connected to commercial establishments and small industries.

Government policy is accelerating the shift towards piped gas. In a recent notification, the Government of India is making it easier to install PNG infrastructure and improve last-mile connectivity. The GoI expects that faster, time-bound approvals and a predictable regulatory framework will help accelerate this shift.^{vii}

Price shocks can either be absorbed or eventually passed on to consumers. However, supply disruptions cannot. A factory that is lying idle cannot resume production immediately, even if supplies are restored.

Rising input costs feed into higher retail prices, which will reduce demand.

This has important second-order effects. Labour can be considered as ‘derived demand’, i.e. the demand for labour is dependent on the underlying product or service. Falling demand can then lead to a decline in labour demand.

This will either create unemployment or prompt a reverse migration of labour back to agriculture, as we saw during COVID19. India’s share of the labour force in agriculture grew from ~ 42 per cent to ~ 45 per cent.

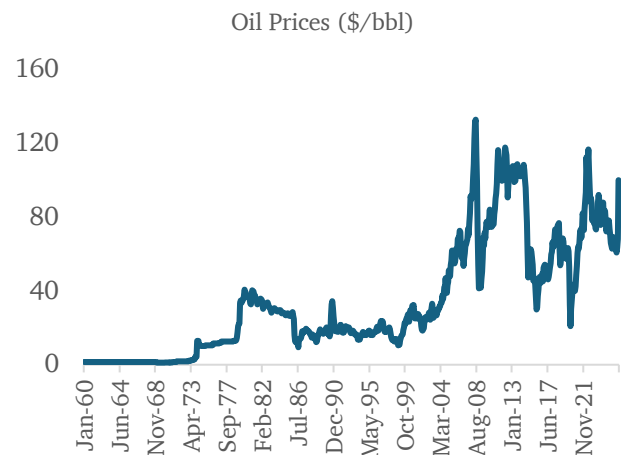
Loss of income or lower productivity lowers purchasing power, and hence depresses overall, or aggregate demand in the economy.

PERSPECTIVE

Oil Shocks in the Past

This is not the first energy shock the global economy has seen, and nor will it be the last. These shocks, emanating in oil markets, have triggered resets in geopolitics and upended the global economy, asserts Daniel Yergin.^{viii}

Figure 2: Monthly Oil Prices (\$/bbl)



Source: World Bank Commodity Prices Pink Sheet

Yet energy price shocks are often triggers, not the cause, of economic crises. These shocks expose weaknesses that have already been festering in economies.

The post-World War II economic order was marked by an unusual combination of stability and prosperity, delivering sustained growth across much of the world. The Bretton Woods system was intentionally designed to reduce the severity and frequency of financial crises. The architects, including Keynes, saw the flow of international capital, or ‘hot money’, as a key culprit.^{ix}

However, this stability came at a cost: the cost of capital.^x High capital costs, in turn, are correlated with lower productivity growth. And the slowing productivity growth has been captured by many scholars.^{xi} So, while growth was high, between 1945-73, it was not sustainable.

This stability masked a buildup of structural weaknesses beneath the surface of a rapidly expanding global economy.

Ten days after the start of the Yom Kippur War in 1973, OPEC countries declared

production cuts and an oil embargo. By January 1974, the price of a barrel of oil was 380% higher than it had been in September.

Till the 1970s, energy prices were mostly administered in the United States. Coordination failures resulted in artificial gluts and shortages. Regulated prices gave the market little flexibility to adjust, according to Yergin.

The first oil price shock did not hit a stable global economy. The post-war economic order was weakening. Productivity growth was slowing, inflation was rising, war necessitated fiscal expansion, and the Bretton Woods System stood on the verge of collapse.

The convergence of these crises led to stagflation, a phenomenon in which both prices and unemployment rise. Conventional wisdom at the time held that the Phillips Curve showed an inverse relationship between inflation and unemployment.

This implied that low unemployment could be achieved with moderately high inflation rates. If the Phillips Curve held, then expanding the money supply could lead to higher employment. So, the money supply expanded, building up inflationary pressures.

The United States ordered air strikes against North Vietnam in 1964, with the United States Congress passing the Gulf of Tonkin resolution. Starting from air strikes, to nearly 500,000 troops at the peak, the Vietnam War added to fiscal pressures in the United States, reinforcing the inflationary buildup already underway.

Inflation, which was averaging 1.5 per cent per annum in 1960, accelerated to 5 per

cent by 1969.^{xii} The oil price shocks made moderate inflation severe, leading to a spiral.

It remains to be seen whether the West Asia war will drag on – and how much it contributes to US debt and inflation.

At the same time, a crisis was brewing in the global monetary system. Under the Bretton Woods system, the US Dollar was gold-backed, with other currencies pegged to the USD.

Countries accumulated USD as reserves, and soon the stock of USD surpassed that of gold held by the United States. As the money supply expanded, this became increasingly incompatible with a system of fixed exchange rates.

The high inflation levels of the 1960s prompted many countries to convert their USD into gold. Eventually, President Nixon suspended the exchange of dollars for gold, and the Bretton Woods system was no more.

By the end of the decade, inflation had become entrenched across advanced economies. The second oil shock, triggered by the Iranian Revolution in 1979, pushed prices even higher.

The same year, Paul Volcker was named the 12th Chairman of the Federal Reserve. Oil prices nearly climbed 3x to USD 34 by the mid-1980s. The global supply disruption resulting from the Iranian Revolution was ~7 per cent.^{xiii}

In Volcker's mind, there was only one objective: tackling inflation.

By 1980, annual inflation in the USA had nearly reached 15%. The US economy then went through what commentators call the 'Volcker Shock'. Rather than targeting interest

rates, the Fed directly targeted restricting the money supply.^{xiv}

As a result of these moves, the federal funds rate (FFR), the equivalent of the policy rate, peaked at 20 per cent in 1980. The economy plunged towards another recession, with liquidity constrained, and unemployment rising. This brought the Fed directly into the line of fire of those affected – farmers, small business owners, prospective homebuyers, among others.

There was also a huge political cost and pressure. In 1980, Ronald Reagan was elected as President of the United States. There was pressure on the Fed to reduce interest rates from the Reagan Administration, not dissimilar to the pressure current Fed Chair Jerome Powell faces. Despite this pressure, Volcker did not give in.

Inflation and the recession soon bottomed out. By 1983, inflation had fallen to ~4 per cent, and unemployment rates had moderated. Since then, inflation has remained moderate, and unemployment levels have been broadly stable. There was a newfound stability in the global macroenvironment, which many macroeconomists termed the ‘Great Moderation’. That is, until the next crisis.

The 1970s have fundamentally shaped the political and economic reality we see today. Not just energy markets, but this crisis upended the world of macroeconomics and its theory. Keynesian economics had failed, according to its harshest critics.

The stagflation of the 70s saw the rise of monetarist and neoliberal economic ideas. The supply-side policies of Reaganomics and Thatcherism took hold. The world took a neoliberal turn.

The economic crisis brought to the fore the need for ‘structural reforms’. Deregulation, privatisation, open trade, and austerity – the terms most associated with the ‘Washington Consensus’ became standard policy prescriptions for emerging economies. Indeed, even India’s 1991 reforms largely followed this playbook.

Economic growth theory changed. The standard Solow-Swan growth model told us that economic growth was determined by technological progress and the savings rate. However, the mechanics of both were left unexplained.

Supply-side economics led to a renewed emphasis on endogenous growth theory – the view that economic growth results from internal, not external, forces. The rate and determinants of technological progress, as well as the savings rate, were due to internal factors, not external ones.

History suggests that efforts to maximise stability can come at the cost of efficient capital allocation and long-term growth. Excess regulation and state intervention in economies can lead to inefficiencies and a lack of innovation.^{xv} This lent further credence to supply-side economics.

For short-term macro, the key lesson here for central bankers globally was that to combat runaway inflation, incrementalism will not work. The learnings from breaking inflation also led central banks down the path of inflation targeting.^{xvi} Today, most major central banks have a mandated inflation target.

The disruptions in oil supply also led to the creation of new institutions and greater cooperation between countries. The International Energy Agency (IEA) was

established in direct response to the 1973 crisis.

If history is any guide, energy shocks matter most when they collide with deeper structural pressures.

First, economic orthodoxy rarely survives systemic crises. The stagflation of the 1970s exposed the limits of prevailing Keynesian frameworks and ushered in monetarist and supply-side approaches.

Today, inequality in wealth and income remains widespread. According to the World Inequality Report, the top 10 per cent of the population earns over 50 per cent of the world's income, whereas the bottom half earns less than 10 per cent. In terms of wealth, the top decile controls more than three-quarters of the world's assets.^{xvii}

Second, global monetary systems break down, and a new one emerges. The 1970s crises led to the end of Bretton Woods and the adoption of a floating exchange rate system. International financial flows liberalised, and globalisation was the buzzword for the remainder of the 20th Century.

Today, the global monetary system stands on another precipice. While the US dollar remains dominant, rising debt levels and shifting reserve patterns suggest growing strain in the global monetary system.

Public debt in the US (defined as general government gross debt) has exploded, touching 122 per cent of GDP in 2025. The dollar enjoys reserve status because the market has faith in the United States government's ability to repay that debt. The US dollar's share of global foreign-exchange reserves has fallen to its lowest level since the mid-1990s.^{xviii}

Third, new institutions evolve to meet the challenges of the time. Just as the Bretton Woods institutions post-WW II, or the creation of the IEA in 1973, each crisis throws up new institutions or new groupings of countries to drive cooperation.

The failure of the United Nations Security Council to prevent war, the International Monetary Fund (IMF)'s inability to address financial crises in developing countries, and the multilateral development banks' (MDBs) struggles to close the financial gap for Sustainable Development Goals (SDGs) and climate finance highlight significant gaps in global governance.

Can new plurilateral groupings, such as BRICS, grow in influence? It is too early to say – but history tells us that new institutions will evolve.

The lesson is not that today's events will unfold in the same way. When structural pressures build, a sudden disruption, such as an energy shock, can trigger far-reaching changes in economic policy, institutions, and the global order.

STRATEGIC QUESTIONS

Managing the Next Shock

Can India reduce its exposure to global energy shocks fast enough? Or will diversification and electrification remain too slow to offset rising demand?

What reforms are needed to attract sustained private capital into energy infrastructure?

Can the financial and operational challenges of DISCOMs and public utilities be resolved without repeated state intervention?

Can India reduce its dependence on fossil fuel imports without creating new vulnerabilities in clean energy supply chains?

How should policymakers balance the push for rapid energy transition with the need for domestic manufacturing and supply chain resilience?

The Fairfax Centre for Free Enterprise Team

Managing Director: Ranveer Nagaich | ranveer.n@free-enterprise.org

Directors: Prateek Goyal and Diewakarr Anupam Mittal

About Fairfax Centre for Free Enterprise

Fairfax Centre for Free Enterprise is a registered Section 8 (not-for-profit) company and an independent think tank headquartered in New Delhi. We operate at the intersection of regulatory reform and grassroots economic empowerment, engaging government, industry, and civil society to drive measurable outcomes for India's 63 million MSMEs.

© The Fairfax Centre for Free Enterprise

ⁱ Arvind Subramanian et al., “Businesses overseeing stealth reform in India’s electricity distribution,” Project Syndicate, August 2025. <https://www.project-syndicate.org/commentary/businesses-overseeing-stealth-reform-india-electricity-distribution-by-arvind-subramanian-et-al-2025-08>

ⁱⁱ Government of India (2026), “Initiatives to Promote Green Ammonia under the National Green Hydrogen Mission,” Press Information Bureau, available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2247329®=3&lang=1>

ⁱⁱⁱ International Energy Agency, Solar PV Global Supply Chains, 2022. <https://www.iea.org/reports/solar-pv-global-supply-chains>

^{iv} Press Information Bureau, Government of India, “Press Release,” 2026. <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2245970®=3&lang=2>

^v Government of India (2026), “Inter-Ministerial Briefing held on Recent Developments in West Asia,” Press Information Bureau, available at: <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2238525®=3&lang=1>

^{vi} Business Standard, “West Asia crisis: LNG supply cuts hit Indian industry amid Hormuz risks,” March 9, 2026. https://www.business-standard.com/industry/news/west-asia-crisis-lng-supply-cut-india-industry-hormuz-risk-qatar-126030900626_1.html

^{vii} Press Information Bureau, Government of India, “Press Release,” 2026. <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2244760®=3&lang=2>

^{viii} Columbia University Center on Global Energy Policy, “The 1973 oil crisis: Three crises in one and the lessons for today,” 2023. <https://www.energypolicy.columbia.edu/publications/the-1973-oil-crisis-three-crisis-in-one-and-the-lessons-for-today/>

^{ix} UBS Center for Economics in Society, Fear, Folly, and Financial Crises, n.d. https://www.ubscenter.uzh.ch/static/932e160fd2476a4abbfcfda359b1c168/UBSC_PP2_fear_folly_and_financial_crises.pdf

^x UBS Center for Economics in Society, Fear, Folly, and Financial Crises, n.d. https://www.ubscenter.uzh.ch/static/932e160fd2476a4abbfcfda359b1c168/UBSC_PP2_fear_folly_and_financial_crises.pdf

^{xi} Bradford DeLong, Slouching Towards Utopia: An Economic History of the Twentieth Century, 2022.

-
- ^{xii} CORE Economics, “Working paper,” n.d. <https://files01.core.ac.uk/download/232012917.pdf>
- ^{xiii} Brookings Institution, “What Iran’s 1979 revolution meant for U.S. and global oil markets,” n.d. <https://www.brookings.edu/articles/what-irans-1979-revolution-meant-for-us-and-global-oil-markets/>
- ^{xiv} Federal Reserve History, “Anti-inflation measures,” n.d. <https://www.federalreservehistory.org/essays/anti-inflation-measures>
- ^{xv} UBS Center for Economics in Society, Fear, Folly, and Financial Crises, n.d. [https://www.ubscenter.uzh.ch/static/932e160fd2476a4abbfcfda359b1c168/UBSC PP2 fear folly and financial crises .pdf](https://www.ubscenter.uzh.ch/static/932e160fd2476a4abbfcfda359b1c168/UBSC_PP2_fear_folly_and_financial_crises.pdf)
- ^{xvi} Federal Reserve Board, “Working paper,” 2025. <https://www.federalreserve.gov/econres/feds/files/2025025pap.pdf>
- ^{xvii} World Inequality Lab, World Inequality Report 2022, 2022. <https://wir2022.wid.world>
- ^{xviii} J.P. Morgan, “De-dollarization: Trends and implications,” 2023. <https://www.jpmorgan.com/insights/global-research/currencies/de-dollarization>