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A SYSTEMATIC LITERATURE REVIEW OF OIL PRICE VOLATILITY AND ITS EFFECT ON INDIA'S ECONOMIC GROWTH

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ABSTRACT :



India imports more than four-fifths of the crude oil it consumes, which makes its macroeconomy unusually exposed to movements in international oil prices. This paper presents a systematic review of the empirical literature on the relationship between oil price volatility and economic growth, with particular attention to India. Following the PRISMA 2020 reporting framework, the paper sets out a transparent protocol for identifying, screening and synthesising studies, and then organises the evidence thematically: (i) the global foundations of the oil–macroeconomy relationship, (ii) transmission channels, (iii) the asymmetry between price increases and decreases, (iv) the distinction between price levels, shocks and volatility, and (v) India-specific evidence. The review finds that most studies report that oil price increases and heightened uncertainty dampen output and raise inflation in oil-importing economies, but that results for India are sensitive to the sample period, the volatility measure, the econometric technique and the policy regime (especially fuel-price administration and exchange-rate management). Important gaps remain: few India studies model volatility explicitly, structural shocks are rarely separated into supply and demand components, sectoral and fiscal channels are under-explored, and post-2020 events are thinly covered. The paper closes with research questions, objectives and policy implications for energy security, fiscal management and monetary policy.

KEYWORDS: *oil price volatility; economic growth; India; oil price shocks; systematic literature review; energy economics.*

JEL codes: C32, E32, O13, Q43.

1. INTRODUCTION

The economic importance of oil to the modern economy has given it a long history of association with economic instability. The primary issue associated with oil and its associated price volatility since the oil embargo and price surges of the 1970s, has been to analyze whether oil price volatility drives economic cycles, investment, inflation, and recession (Hamilton, 1983; Mork, 1989; Jones, Leiby & Paik, 2004). This issue is most important to net oil importing nations, as global oil price movements directly impact their import bill, current account, inflation and the government budget. The most notable case is India. Being one of the most significant oil importers, India is also among the largest oil consumers in the world and relies on imports for most of its oil. Additionally, there is growing demand for petroleum products for household and industrial purposes, and for transportation purposes in India. Consequently, there are multiple avenues through which oil affects the Indian economy including;

trade, current account, the exchange rate, producer and consumer prices, and even government subsidies and revenue as well as investor confidence. Within a short span, India also went through contrasting oil regimes; the rapid rise before 2008, the crash in 2014, the unique price movements in 2020 and the effects of the war in Ukraine on energy markets in 2022. During the same period, India also made a significant policy change of its domestic fuel pricing regime; the shift from an administered pricing system to a primarily market pricing system for petrol (2010) and for diesel (2014) has altered the reach of global prices to consumers and the treasury.

2. LITERATURE REVIEW

2.1 Theoretical Foundations and Transmission Channels

Several papers discuss the various channels through which the price of oil influences economic growth. First, there is the supply-side channel. Through this channel, an increase in oil price results in higher input prices, and, consequently, lower production and productivity (Brown & Yücel, 2002). Then, there is the demand-side channel, through which income is transferred from oil importers to oil exporters and reduced real disposable income leads to lower consumption (Jones et al., 2004). Finally, there is the real-balance and monetary channel, through which oil-induced price changes can tighten the monetary policy and can reduce economic activity (Bernanke, Gertler & Watson, 1997; Hamilton & Herrera, 2004; Cologni & Manera, 2008). Through the uncertainty channel, future price changes that cannot be accurately predicted encourage firms to delay their investments, since future prices cannot be guaranteed (Bernanke, 1983; Pindyck, 1991; Elder & Serletis, 2010). Another channel of concern is the reallocation channel that explains oil price shocks lead to costly relocations of capital and labor between different industries (Hamilton, 1988; Lee et al., 1995). Finally, there is an external sector and exchange rate channel for open economies where higher oil prices impact the currency of an open economy through deterioration of the balance of payments (Basher, Haug & Sadorsky, 2012).

2.2 Global Empirical Evidence

Hamilton (1983) documented the correlation of US recessions with earlier oil price hikes, creating the empirical study of this area. More studies challenged this claim, for example, Hooker (1996) showed the weakening of the relationship. This stimulated the use of non-linear models. Mork (1989) noted that price increases and decreases have an asymmetrical effect, and Hamilton (2003) suggested that net oil price changes can show shocks which go beyond a previous price high. Kilian and Vigfusson (2011) also argued about the use of some non-linear models, which meant there were doubts regarding the asymmetry of oil price shocks. Still, Rahman and Serletis (2011) claimed the presence of asymmetric effects through a more general framework. One major development was when researchers realized the different sources of an oil price change had different impacts on the economy. For example, Killian (2009) explained that the oil supply shocks had a completely different effect than the oil-specific demand shocks. A demand shock would occur during periods of strong activity in the world, which is different than a shock that occurs in a recession. Killian and Murphy (2014) and Baumeister and Peersman (2013) extended his work and analyzed how the effects varied with time. Blanchard and Gali (2010) believed that the effects of an oil price change were less severe in the 2000s compared to the 1970s due to lower wage rigidity and more stable monetary policy and a decline in oil consumption during production. Mohaddes and Pesaran (2017) revisited this with global data and the production of oil from the United States' shale fields and how this transformed the relationship between oil and the world economy.

2.3 Oil Price Volatility and Uncertainty

A distinct strand studies volatility rather than price changes. Lee et al. (1995) found that oil shocks have larger effects when prices have been stable, so that a given change is more disruptive when it is unexpected. Ferderer (1996) found that oil price volatility has a significant negative effect on output growth in the US, alongside asymmetric effects of price changes. Elder and Serletis (2010) and Jo (2014) document that oil price uncertainty reduces real economic activity, including at the global level. Aye, Dadam, Gupta and Mamba (2014) report negative effects of oil price uncertainty on manufacturing

production in South Africa. Rafiq, Salim and Bloch (2009) analyse oil price volatility and economic activity in Thailand, an emerging oil-importing Asian economy, and find that volatility affects some macro variables, such as investment and unemployment, more clearly than output itself. The measurement of volatility typically draws on the ARCH and GARCH family (Engle, 1982; Bollerslev, 1986), with applications to oil markets such as Narayan and Narayan (2007).

2.4 Evidence from Asian and Other Emerging Economies

Different economies offer different results for emerging markets. Some Asian nations showed results that had strong correlations for oil price effects with inflation and some cases, even output. Other countries had even greater results, when local currencies were used. Different pricing schemes for different time periods was how China and others analyzed oil prices. Differences in shock and country caused variation in results when other Asian nations were examined in another way. Malaysia showed how monetary policies in different countries altered the way oil shocks affected their economies. Oil-exporting and other African nations' results showed how the economy (i.e. if it imports or exports oil), how it sets fuel prices and other similar characteristics are major factors for positive and negative oil price effects. One island nation's result showed little if any correlation between the island nation's oil prices and growth.

2.5 Evidence for India

here are relatively few, very different studies regarding India. Earlier descriptive works. Bhattacharya and Bhattacharyya (2001) looked at the effect of administered pricing and higher oil prices on the Indian economy's output and inflation, highlighting the role of the government in consumer oil price pricing. Bhanumurthy, Das and Bose (2012) explored oil price shock transmission, oil pricing policy and their impact on India’s economy and emphasized that a policy response to oil price shocks (mainly oil pricing policy) determines the impact on fiscal, inflation, or the output. Oil consumption and economic expansion. Ghosh (2009) investigated the relationship between crude oil import demand and Indian economic expansion and confirmed a relationship between oil demand and income in India, reinforcing the idea of energy demand as a function of economic growth. Nonlinear and regime dependent effects. Ghosh and Kanjilal (2016) explored how oil price shocks affect the Indian economy and suggested the effects may be dependent on the economic regime. Cuñado et al. (2015), through an investigation on several Asian economies, concluded that oil price shock effects are also dependent on the type of oil price shock. Financial-market and exchange-rate channels. In 2016, Jain and Biswal studied the interaction between oil prices, gold prices, the exchange rate, and the Indian stock market. Kumar (2019) utilized a nonlinear ARDL method and investigated the effects of oil prices on both exchange rates and stock prices. Both studies show oil price transmissions to be indirect and potentially negative for economic investment and growth. On balance, studies in India suggest that oil price shocks do have significant effects, although most research focuses on how these effects are transmitted via trade or other indirect economic links.

2.6 Methodological Approaches in the Literature

The reviewed studies rely on the same techniques. Most use Vector Autoregression and structural VARs to do impulse-response analysis. Some employ Cointegration and Error Correction or the Autoregressive Distributed Lag bounds-testing approach. Others employ Granger causality to analyze the relationship between variables, or its extended form by Toda and Yamamoto to perform the same task. The latter approaches rely on net oil price increases to allow for asymmetric models. Another set of approaches employ nonlinear methods, as well as Markov regime-switching models. Most approaches model the uncertainty (volatility) by employing the conditional variance of the process as mentioned earlier.

3. GAPS IN THE LITERATURE

The review identifies the following gaps.

The following points are what the authors highlighted in their research on the existing gaps. 1. Systematic review on India is lacking. While some reviews (e.g., Brown & Yücel, 2002; Jones et al., 2004) are out there, these reviews tend to focus either on a global or on a US context and do not explicitly cover the volatility–growth nexus for India. 2. Volatility isn't often directly represented. Oil price levels and changes are more commonly used in studies. Theory would suggest a distinct uncertainty effect (Bernanke, 1983; Elder & Serletis, 2010), but few Indian studies relate uncertainty to growth. 3. Source of shocks are usually overlooked. As described in Kilian (2009), there are structurally different shocks for demand, supply, and precautionary; however, few Indian studies consider them separately. 4. Policy change and regimes are usually not given enough attention. For example, changing fuel price policies, subsidies, excise taxes, and inflation policies have not been captured adequately, making the model parameters more likely to become unstable. 5. Sectors and fiscal policies are neglected.Aggregate GDP is usually analyzed rather than sectoral data such as transport, manufacturing, and agriculture. Furthermore, disaggregated data regarding the fiscal deficit and the current account would be very helpful. 6. Data availability is limited. Annual GDP data limits the sample size, and quarterly data are not used as they should. Indices of Industrial Production are often used to supplement GDP data in some studies. Data series, including oil benchmarks and the crude basket in India, have changed. 7. Events, such as negative prices in 2020, post-pandemic economic activity, and disruptions to global energy markets in 2022 have yet to be addressed, and Indian research on the energy transition is limited. 8. Transparency is often an issue. Few studies disclose how sensitive their models are to alternate forms of volatility.

4. RESEARCH QUESTIONS

RQ1. According to the empirical literature, what is the connection and degree to which oil price fluctuations influence India's economic growth?
RQ2. How does the impact of volatility differ depending on the chosen oil price benchmark and the measure of volatility used in the studies, as well as data frequency and the choice of estimation method?
RQ3. Does Indian growth experience any asymmetric or regime-dependent effects of oil price changes and volatility?
RQ4. How does oil price volatility impact India's growth through inflation, exchange rate, fiscal, financial markets, investment, and sectoral output channels?
RQ5. What impact have policy decisions, such as the deregulation of fuel prices and the introduction of new monetary policy frameworks, had on observed effects?
RQ6. What areas, both in terms of methodology and subject matter, remain to be addressed in future research?

5. RESEARCH OBJECTIVES

1. Review, summarize, and combine research on oil price shocks and growth in the Indian economy. Use a structured, documented methodology to avoid bias.
2. Compare the research on India to international findings for other countries that rely on imported oil and are still growing.
3. Divide studies by how they defined oil price variation, their methodology, how often the data was sampled, the timeframe of the research, and their final findings.
4. Find evidence that there is a break or an irregular, non-symmetrical pattern in the relationship.
5. Map the way variations in oil prices affect the growth of the Indian economy.
6. Find what still needs to be researched and come up with proposals that should be taken by the Indian government and what research needs to be done.

6. METHODOLOGY

6.1 Review Design

This systematic literature review was developed in accordance with the methodologies suggested by Tranfield et al. (2003) for systematic reviews in the field of management and the PRISMA 2020 reporting standard (Page et al., 2021; Moher, Liberati, Tetzlaff & Altman, 2009). The methods used for the present review are provided below for transparency and future updates. Section 2 summarizes literature reviewed based on this protocol. When research teams search the databases, record counts must be provided in the final PRISMA flow diagram for each screening stage.

6.2 Data Sources and Search Strategy

We draw on Scopus, Web of Science, EconLit, ScienceDirect, JSTOR, Google Scholar, and the working papers of the Reserve Bank of India (RBI), the National Institute of Public Finance and Policy (NIPFP), SSRN and RePEc/IDEAS. To obtain relevant publications, we use a search query, an example of which is: ("oil price" OR "crude oil" OR "energy price") AND (volatility OR uncertainty OR shock*) AND ("economic growth" OR GDP OR "output" OR "macroeconomic") AND (India* OR "Indian economy") Citation analysis in both directions (i.e., looking for works that cite key papers and works that key papers cite) was conducted to ensure no important publications were missed.

6.3 Inclusion and Exclusion Criteria

Criterion	Inclusion	Exclusion
Population / context	Studies on India alone or including India in a multi-country sample	Studies with no India component (used only as background)
Exposure	Oil price level, shocks, volatility or uncertainty	Studies of renewable energy or electricity prices only
Outcome	GDP growth, industrial output, or closely related macro aggregates, plus intermediate channels	Purely firm-level or purely stock-return studies with no macro link
Design	Empirical, quantitative time-series, panel or structural models	Purely theoretical, opinion or non-empirical pieces
Publication type	Peer-reviewed articles, central-bank and institutional working papers	Non-reviewed blogs, news items
Language	English	Other languages
Period	From 1990 to the latest available year (to capture liberalised-era India), with earlier global studies used for background	Not applicable

6.4 Screening and Selection

The record export, screening, and de-duplication processes occur over three steps: the titles, the abstracts, and the full text. Two reviewers screen the records separately. Differences in screening decisions are settled through the review of the first two or an additional, third, reviewer. Reasons for the exclusion of a document after a review of its full text are noted.

6.5 Quality Appraisal and Data Extraction

Each study was evaluated for (i) how clearly, it presented the volatility or shock measure, (ii) the quality of the econometric methods (e.g. tests for unit roots and cointegration, treatment of structural breaks, and other diagnostic tests), (iii) data availability and (iv) whether methods and findings were described transparently. Information is collected in a standard extraction form for each study: author, year, the period of time under study, data frequency, the variables of interest, oil price

reference point, the measure of volatility, methods used, the major conclusions, and policy recommendations.

6.6 Synthesis

There isn't a consensus of methods across these studies, so doing a quantitative meta-analysis isn't recommended, thus, a qualitative review is preferred. The literature is broken down into themes related to the mechanisms of how policy reaches its goal, whether or not the policy is one-sided, the difference between volatility and the general level or sudden shocks to the economy, and the policy approach. With sufficient estimates, the results of the studies can be tallied and classified as directional and statistically significant.

6.7 Limitations of the Protocol

The validity of any database search results is influenced by what the database does or doesn't cover and by the specific search terms that you have chosen to use. There are a variety of publication biases and the potential for direct comparison of different research studies can be limited because of the inherent differences between studies.

7. DISCUSSION

7.1 Is the Relationship Negative?

Almost every paper around the world says the same thing about the relationship between output and inflation in countries that import oil. When oil prices increase or oil-related issues cause an uncertain situation in the country, output slows down or inflation becomes higher. This is the case even though some researchers in recent times say the relationship has become weaker since the 1970s. For India, it's easier to see the relationship when looking at inflation and foreign sectors, but researchers can't agree as much when it comes to output growth. Looking at the fuel pricing systems in India over the years helps us understand the situation. The shock from the change in oil prices went to the country's finances, not its customers, and oil-marketing firms bore the brunt of the shock. In the long run, there wasn't a visible impact on the country's economic growth.

7.2 Volatility, Uncertainty and Investment

Real-options reasoning claims that uncertainty creates investment opportunity which in turn leads to greater growth (Bernanke, 1983; Pindyck, 1991). Explicit studies of uncertainty find overall negative results (Ferderer, 1996; Elder & Serletis, 2010; Jo, 2014; Aye et al., 2014), but others note selective impacts (Rafiq et al., 2009). The real-options reasoning is particularly relevant for India given the central role of private capital and public capital (especially infrastructure) investment to the economy. Investment has generally not been examined as an intermediate variable in the literature regarding the Indian economy.

7.3 Asymmetry and Regime Dependence

There is some debate over the effect of different regimes on data as opposed to data from a single market, but in India both Ghosh and Kanjilal (2016) and Kumar (2019) have provided evidence for both a variation in effects across different regimes and an asymmetry of effects within Indian financial markets, respectively. However, the use of statistical methods to demonstrate such an asymmetry must be done with caution. One of the reasons for this is that such tests require linear, single-equation estimates. Due to several structural breaks in the sample, including the liberalisation in 1991, the 2008 global financial crisis, fuel-price deregulation, the shift to inflation targeting, and the COVID-19 pandemic, linear estimates in India may be unstable.

7.4 The Importance of Shock Origin

The structural VAR studies find that there are differing consequences of supply-driven price increases as opposed to increases driven by buoyant demand. For example, in India, higher export volumes caused by rising demand can help to partially offset the effects of higher oil prices on growth.

This phenomenon is supported by earlier studies that show supply shocks and demand shocks can have opposite effects.

7.5 Comparison with Other Emerging Economies

Asian nations showed us what to expect from these policies and systems (Cuñado & Pérez de Gracia, 2005; Cuñado et al., 2015; Du et al., 2010). However, India's size, domestic focus and services orientation help dampen the impacts of some oil taxation. They do little to stop India from being exposed through the trade and exchange systems. India is also a fuel tax system user, though taxation is not very intensive.

7.6 Methodological Implications

India specific literature reviews suggest that research should be conducted by taking the below mentioned steps (i) employ quarterly data or high-frequency growth proxies, (ii) compute conditional volatility using explicit methodologies and test other available options, (iii) detect structural break(s) and use non-linear specifications, (iv) determine structural shocks, and (v) report the checks of diagnostics and robustness. Using the series of GARCH based volatility in combination with Structural VAR or NARDL would be an interesting area of research (Engle, 1982; Bollerslev, 1986; Kilian, 2009; Shin et al., 2014).

8. CONCLUSION AND POLICY IMPLICATIONS

8.1 Conclusion

The systematic literature review presented in this paper, focusing on the link between oil price uncertainty and India's economic growth, is grounded in a meta-analysis. International research demonstrates that for oil importing nations, oil price growth and uncertainty reduce output and raise inflation, however, the literature on the subject is ambiguous and shows that these effects are non-linear, vary with time and also with the cause of the uncertainty. For India, the research shows that the link between oil prices and inflation, the exchange rate, financial markets, and, in some cases, output, is robust. The findings on growth vary due to differences in data, methods and policy regimes. The current literature on the subject has serious gaps. Volatility is barely modelled, and the focus of the literature is mainly on inflation. Very few research studies focus on fiscal, investment and sectoral links, and the recent events are almost ignored. These research gaps provide a solid basis for the research questions and objectives that this study focuses on.

8.2 Policy Implications

1. Energy security must be enhanced. The supply base should be further diversified, and additional strategic petroleum reserves should be developed. Greater use of long-term contracts and hedging should be made.
2. Growth should become less oil dependent. Greater focus should be placed on greater use of energy efficiency, public transportation, biofuels, natural gas, and renewables.
3. Fuel pricing and subsidy systems must become less volatile and should follow predictable rules and adjustment systems.
4. Distinguish between supply- and demand- driven shocks when analysing inflation. In case of a supply shock, do not overreact and focus on ensuring the foreign exchange and other macroeconomic policies can support an external shock.
5. Establish consistent and clear policies with respect to pricing and taxation of fuel to reduce investment uncertainty and increase confidence.
6. Protect the poor from the impact of higher prices by providing targeted subsidies instead of general ones. This will not waste fiscal resources.
7. Make more and better data on oil usage available by sector and frequently assess the impact of oil on the macroeconomy.

8.3 Future Directions for Research

Additional research is needed to create a complete PRISMA flow and a quality-scored evidence table. Future research should include building India specific models which include both structural shock identification and conditional volatility. Future research could include the impact of different policies and the impact on the various sectors and on fiscal policy. Research could be extended to include data for the energy transition and the 2020 and 2022 energy crisis.

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