Reduction in global oil prices

Why in news?

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Global oil prices have reduced by over 30% from their highs of over $86 in early October.

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What are the reasons?

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- There are certain fundamental reasons for oil’s whimsical swings in the global markets.
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- The earlier rise in oil prices was attributed to the US sanctions on Iran which tightened supply.
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- The recent reduction was attributed to –
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1. Concessions on sanctions by the U.S.
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2. Rising US oil inventories
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3. Possibility of Chinese recession.
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- Apart from this, speculative positions built up by hedge funds play a big role in oil price moves.
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What are the effects on India?

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- India's current account deficit is expected to stay below the 3%, along with a stable inflationary trends.
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- The rupee will appreciate which will reduce the oil import bill and the corresponding oil subsidies.
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- However, the leeway provided by retreating global prices has not been used by oil PSU's to re-align local fuel prices with market trends.
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What are the concerns?

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- **Retail price** - The crude oil is bought by oil PSU's from International markets, which handle oil from its crude stage till the time it is handed to the dealers in its refined form.
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- After refining, they pay excise duty on this refined petrol before selling it to dealers at a margin.
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- Though the central government recently slashed central excise taxes on fuel by Rs 1.50, they made oil PSUs to absorb the costs of Rs 1 per litre.
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- The government usually make the oil PSU's to absorb the costs whenever there is a possibility of a spike in global oil prices.
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- This is to make sure that the government doesn't lose any of its own revenue.
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- But this reduces the profit margins of oil PSU's deeply and they are not passing on full benefits of reduced prices to the retail level consumers.
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- Hence, only if the government does away with the Rs 1/litre cost absorption diktat to oil PSUs, price reduction will pass on to consumers.
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- It will also restore a transparent price determination process by oil PSUs.
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- **Low share price** - Also, oil PSUs are listed companies and the government is their biggest shareholder.
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- Asking them to absorb costs makes their share price lower in the stock markets, wherein the government will suffer an equity loss.
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- **Reduced revenue** - Every Rs 1 cut in the Centre’s specific oil tax results in a revenue loss of around Rs 13,000 crore.
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- Thus, any reduction in the central excise duty on oil will possibly increase the fiscal deficit and reduces the possibility of providing oil subsidies in the future.
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- The Indian government should thus push oil companies to hedge proactively against price risks by leveraging the new exploration policy and building up strategic petroleum reserves.
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Source: Business Line, Economic Times

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