Oil Prices Crash

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This article is based on **Oil's rout: on fall in prices**, **What the dip in oil prices means**, **The sudden crash in crude oil prices offers many opportunities for India**, **How the country should make the most of a second oil windfall**. It talks about the impact of recent oil prices crash.

Recently, the International oil prices crashed by about to 31%, **the biggest fall since the 1991 Gulf War.** The fall in prices came after the disintegration of the **OPEC+ alliance** (made up of OPEC plus other producers including Russia) that triggered an **all-out price war** between **Saudi Arabia and Russia.**

In response to it Saudi Arabia has threatened to drive prices to such a low point that Russia will be forced back to the negotiating table and consequently, a price war has been started. **This reduction in oil prices may have several global repercussions.**

Background of the Price war

- In 2014-2015, Oil prices crashed. In order to sustain the oil-exporting economies, Russia and Saudi Arabia had held up oil prices by cutting production.
- However, Russia was facing issues on its energy front due to the **US shale oil industry** and **sanctions imposed by the US and European Union** against its energy industry.
- Thus, Russia decided to **unilaterally adopt an alternative strategy of increasing production and driving down prices** (this was against the OPEC+ agreement to cut down production in order to sustain oil-exporting countries), with the idea of driving high-cost oil producers and US shale out of business.
- But this strategy by Russia would hurt the **interest** of the Saudi-led **Organisation of Petroleum Exporting Countries.**

Why did oil prices crash?

The global oil market is now set to witness the rare conjunction of a low-demand and a high-supply scenario.

- **High-Supply Scenario: Price War**
    - The price war between Russia and Saudi Arabia has raised the possibility of the market being flooded with excess oil production, leading to a supply shock.
    - According to Goldman Sachs, this price war could drive the oil prices to as low as $20 a barrel.
- **Low Demand Scenario: Coronavirus impact**
    - China's efforts to curtail the coronavirus outbreak has **disrupted its economy and oil imports.**
    - This has slowed down the world's second-largest economy and has caused global economic disruptions.
    - Also, coronavirusAccording to some forecasts, **global oil demand growth in 2020 will be less than 0.48 million barrels per day,** down from 1.1 million barrels in December 2019, as the shut-down of factories in China, disruptions in supply chains, and travel restrictions imposed across the world depress demand.

Impact On Other Players

- It marks the **disintegration of the grouping called OPEC+** as the price war ended more than three years of cooperation on supporting the market.

    Also, failure of the OPEC and Russia to reach an agreement on oil production cuts, possibly signalling the **end of a nearly five-decade-long intervention by oil producers in the international market.**
- The **race to the bottom** could result in many casualties among global oil producers, including the US shale oil industry.

    A collapse of these shale oil producers may set off defaults in the bond markets, setting off a downward vicious cycle in US markets.

Impact On India

India imports more than 80% of its oil needs, the price crash offers a breather on the macroeconomic front. For example:

- **Current Account Deficit:** The collapse in oil prices will **cut the country's import bill,** and **soften its current account deficit.**
- According to estimates, **a one-dollar decrease in crude oil price reduces the oil bill by around $1.6 billion per year.**

- **Inflation:** The fall in crude prices will also help **ease inflationary pressures** that have been building up over the past few months.
    - This will increase the space for the monetary policy committee to ease rates further.
- **Fiscal Health: Low oil prices** offer an opportunity to raise some revenue and improve its fiscal balance.
    - The growth slowdown in the last two years has resulted in a precarious fiscal situation because of tax revenue shortfalls.
    - The revenue earned, can be used by the government to spend or meet its fiscal commitments in the form of budgetary transfers to states, payment of dues and compensation for revenue shortfalls to state governments under the goods and services tax (GST) framework.
- **Reviving Economic Growth:** Further, the additional tax revenue thus generated through higher excise duty should be used to clear all dues of the central government, whether to private companies, state governments, or others awaiting tax refunds.
    - Also, putting cash in the hands of households and small businesses may tackle the **slowdown in consumption in the Indian economy.**
    - The potential excise duty windfall from oil prices could come in handy for the government to provide relief to **beleaguered telecom companies.**
- **Negative fallouts:** However, there could be a flip side for India too from the oil price slump.
    - The value of Indian oil and gas companies will be impacted (Reliance-Aramco deal may get delayed).
    - Remittances from the Persian Gulf will reduce.
    - Centre’s disinvestment programme as the sale of Bharat Petroleum Corporation Limited (BPCL) could run into headwinds.

Way Forward

- During the last major oil prices crash (between mid-2014 and early 2016), the Centre and many States chose to appropriate most of the savings through regular hikes in excise duty and value-added tax on petrol and diesel. However, only a small proportion of cost reduction benefits were passed on to customers.
    - In a similar scenario, the gains made by excise duty, should be used for productive infrastructure investments and not be wasted on runaway revenue expenditure.

- However, this oil prices crash will eventually recover in the future. Therefore, it is imperative that India should persist with measures to reduce the country's oil dependency over the long run.
    - It should strive to increase the use of renewable, and catalyse a shift to electric vehicles.
    - More efforts should be put in to ramp up the stagnating domestic oil output.
    - The country's **strategic oil reserves** should be strengthened by making use of attractive buying opportunities in global markets.

Drishti Mains Question

Recent global oil price crash offers a breather for India on the various macroeconomic fronts. Discuss.