

BY INVITATION

Is low crude price really a blessing?

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Weak prices may seem to benefit India but data on GDP growth point otherwise

India is one of the countries believed to be benefiting the most from weak crude prices – with positive impact on growth, current account deficit (CAD), inflation and fiscal deficit.

While this rationale looks intuitively appropriate (given that India imports about 80 per cent of its crude requirements), the actual gain is modest.

Available data suggests India's GDP growth tends to be stronger when oil prices are higher and vice versa. Since the 1990s, oil prices seem to have reacted more to global demand (global GDP growth) than was the case earlier. In fact, from 1991 to 2014, the correlation between oil price changes and world GDP growth (per cent year-on-year) was as high as .71.

This is not a surprise since India has become more integrated with the global economy since the 1990s.

Global cues

As of 2013, the share of India's total trade (exports plus imports) in merchandise and services taken together was as high as 56.4 per cent of GDP, higher than Russia, China, the US and Brazil. With exports contracting and underlying growth momentum remaining weak, weak oil prices do not seem to have had the anticipated effect on growth.

Essentially, if oil prices remain weak because of low global demand situation, it is quite unlikely that India would benefit much from low oil prices. However, given that India's crude oil imports account for about 80 per cent of total crude requirements, lower oil prices lead to considerable savings on the oil import bill.

Although India imported virtually same volume of oil between FY14 and FY15, import bill dropped by nearly \$30 billion. The savings were even more pronounced for the current financial year when India's oil import bill was lower by nearly 40 per cent despite a 7.2 per cent increase in volume of oil import.

Taxes reduce benefit

Sharply falling crude price failed to have commensurate impact on retail prices of petroleum products. For a number of months now we have been witnessing a situation of retail prices reacting much more slowly to the sharp decline in global crude prices as there has been an increase in taxes, thereby reducing the ability of oil companies to pass on the benefits to consumers. Historically, the oil sector has been the cash cow for the various governments, given the high incidence of taxation. Apart from customs duties on imports of oil, there are also excise duties, royalties, service taxes and even cess. On top of that, there are taxes imposed by state governments. The total incidence of tax is around 50 per cent of the actual cost. Revenues earned by the government from excise duties on oil has always been at around 50 per cent of total revenues earned from excise duties levied on manufacturing activity in the entire country. In fact, during FY15, the increased rates of excise duty in response to falling crude price was to such an extent that the share of excise duties earned from the petroleum sector (as a percentage of total excise duty revenues) increased sharply from 56.5 per cent in FY14 to 65.3 per cent in FY15.

Another way to look at this is to consider the role played by domestic oil companies. From FY11 onwards, the government stopped the practice of issuing oil bonds and started paying out directly to the oil companies for their under-recoveries.

However, the government only covers part of the under-recovery with the oil companies sharing the remaining part of the burden. That apart, state-owned oil companies also pay out dividends as well as corporate income tax to the government. Put together oil companies share a much larger burden of subsidies than the amount paid out by the government. Clearly, whichever way one looks at the situation, the oil sector subsidy does not appear to be a burden on the government. In essence, the petroleum sector plays a big role in helping the government keep its fiscal deficit in check.

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