Impact of Crude Oil Price Hike

Why in News

Recently, the **price of Brent crude crossed the USD 60 per barrel mark after over a year.** The rise in prices is **because of production cuts** by oil-producing countries and **expectations of improvements in global demand** as the **Covid-19 vaccine** is rolled out across the world.

- In April 2020, the **West Texas Intermediate (WTI) crude slipped below zero** for the first time in history, to a negative USD 40.32 per barrel.
- **Two crude oils** which are either traded themselves or whose prices are reflected in other types of crude oil include **West Texas Intermediate (WTI) and Brent.**

Key Points

- **Oil Pricing:**
    - Generally, the **Organization of the Petroleum Exporting Countries (OPEC)** used to **work as a cartel** and fix prices in a favourable band.
        - **OPEC is led by Saudi Arabia,** which is the **largest exporter of crude oil** in the world (single-handedly exporting 10% of the global demand).
        - OPEC has a **total of 13 Member Countries** viz. Iran, Iraq, Kuwait, United Arab Emirates (UAE), Saudi Arabia, Algeria, Libya, Nigeria, Gabon, Equatorial Guinea, Republic of Congo, Angola, and Venezuela.
    - OPEC **could bring down prices by increasing oil production** and raise prices by cutting production.
    - The global oil pricing mainly **depends upon the partnership between the global oil exporters instead of a well-functioning competition.**
    - Cutting oil production or **completely shutting down an oil well is a difficult decision,** because restarting it is immensely costly and complicated.
        Moreover, if a country cuts production, it risks losing market share if other countries do not follow the suit.
    - Recently, OPEC has been working with Russia, as **OPEC+** to fix the global prices and supply.
        In 2016, **OPEC allied with other top non-OPEC oil-exporting nations** to form an even more powerful entity named OPEC+ or OPEC Plus.
- **Reasons for Present Price Hike:**
    - **Limited Supply:**
        - Major oil-producing countries **had cut oil production last year** amid a sharp fall in demand due to the Covid-19 pandemic.
            Saudi Arabia pledged extra supply cuts in February and March 2020 following reductions by other members of the **Organization of the Petroleum Exporting Countries (OPEC)** and its allies.
        - In early January 2021, the **OPEC and Russia** (as OPEC+) agreed to **cut back on oil production to increase prices.**
    - **Rising Demand:**
        The **production and rollout of vaccines** for Covid-19 and the **rising consumption post the Covid lockdowns** last year have both led to a revival in international crude oil prices.

- **Impact on India:**
  - **Current Account Deficit:** The increase in oil prices will **increase the country's import bill,** and further **disturb its current account deficit** (excess of imports of goods and services over exports).
    - According to estimates, a one-dollar increase in crude oil price increases the oil bill by around USD 1.6 billion per year.
    - **India imports 80% of its crude oil requirements** and the average price of Indian basket of crude oil has already risen to USD 54.8 barrel for January 2021.
  - **Inflation:** The increase in crude prices could also also further increase **inflationary pressures** that have been building up over the past few months.
    - This will **decrease the space for the monetary policy committee to ease policy rates** further.
    - The government **had hiked central taxes on petrol and diesel** by Rs. 13 per litre and Rs. 11 per litre in 2020 to boost revenues amid lower economic activity.
  - **Fiscal Health:** If oil prices continue to increase, the government shall be forced to cut taxes on petroleum and diesel which may cause loss of revenue and deteriorate its **fiscal balance.**
    - The growth slowdown in the last two years has already resulted in a precarious fiscal situation because of tax revenue shortfalls.
    - The revenue lost will erode the government's ability 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.
  - **Positive Outcomes:** However, there could be a positive side for India too from the oil price hike.
    - The value of Indian oil and gas companies could be positively impacted. The government could get greater value from **disinvestment** in Bharat Petroleum Corporation Limited.
    - **Remittances** from the Persian Gulf could **increase.**

Difference between Brent and WTI

- **Origin:**
  - **Brent** crude oil **originates from oil fields in the North Sea** between the Shetland Islands and Norway.
  - **West Texas Intermediate (WTI)** is sourced from **US oil fields,** primarily in Texas, Louisiana, and North Dakota.

- **Light and Sweet:**
  - Both oils are relatively light, but **Brent has a slightly higher API gravity,** making WTI the lighter of the two.
    - **American Petroleum Institute (API) gravity** is an indicator of the density of crude oil or refined products.
  - **WTI with a lower sulphur content** (0.24%) than Brent (0.37%), is **considered "sweeter".**
- **Benchmark Prices:**
  - **Brent crude price** is the international benchmark price **used by the OPEC** while **WTI crude price** is a benchmark for **US oil prices.**
  - Since India imports primarily from OPEC countries, **Brent is the benchmark for oil prices in India.**
- **Cost of Shipping:**
  - Cost of shipping **for Brent crude is typically lower,** since it is produced near the sea and it can be put on ships immediately.
  - **Shipping of WTI is priced higher** since it is produced in landlocked areas like Cushing, Oklahoma where the storage facilities are limited.

Source:IE