COVID-19 Fiscals: Some Hope From Oil For India?

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With the pandemic affecting a glut in the global demand for crude, we construct three scenarios to show what India could do to take advantage of the reduced oil prices and ease the fiscal burden caused by this health crisis.

Keywords: Coronavirus; oil price; India

The COVID 19 pandemic is hitting the public and fiscal health of countries hard. At the time of writing of this article, it has infected about 1.5 million people across the world leading to about 89,000 deaths. The numbers for India are perhaps a little less disturbing with 6,000 infected and about 170 deaths. This could be because India went into a strict lockdown in the early stages of the spread or because of low detection rates. The lockdown of course has huge impact on the economy robbing millions of people of livelihoods and also necessitating additional expenditures on health care.

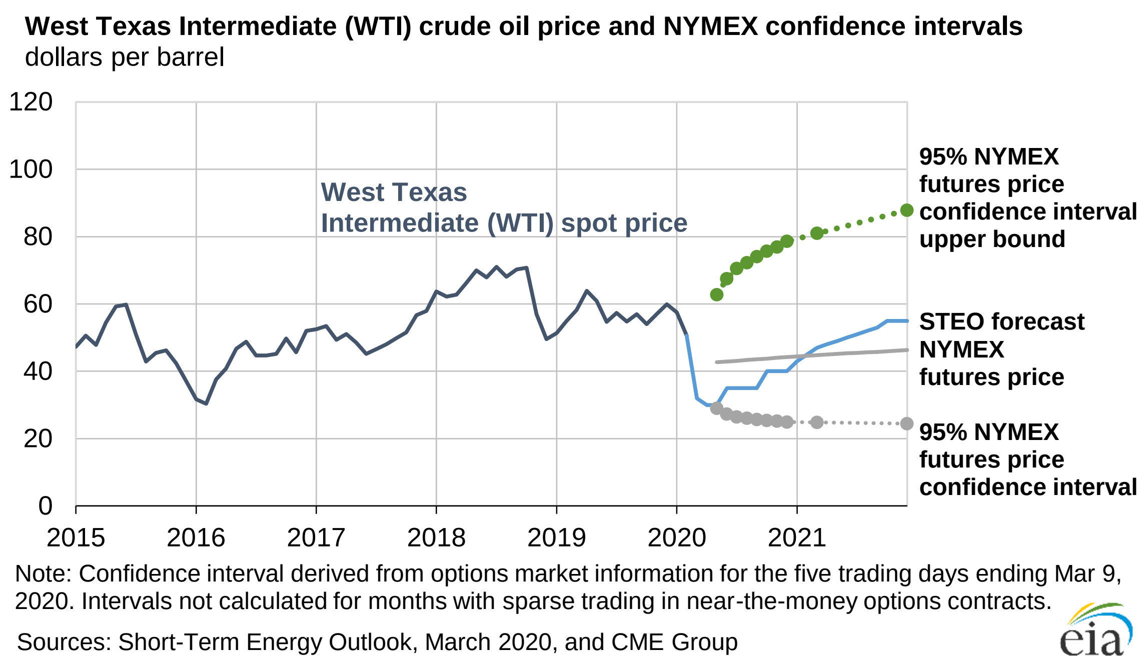
As of now a Rs. 15,000 crore fund has been set up for health care and a Rs. 1.7 lakh crore package has been announced to provide relief to vulnerable sections of the society. An additional package of Rs. 1 lakh crore is in the works for relief to small businesses.

This has implications for the fiscal health of the economy and may not be the last support the economy needs for relief, and recovery. However this piece argues that there is a silver lining to the fiscal situation and that this is an appropriate time to spend as much required to counter COVID-19 and take advantage of the world oil price situation to strengthen India's position and fiscal parameters later. In fact, the findings presented below suggest that spending more now can even improve its fiscal health.

India can hugely gain from current situation in the petroleum sector. It's the single most important sector in terms of revenue and expenditure for both central and state governments.

India spends about 30 per cent of its total import for fuel sources and majority of it is petroleum or crude oil. As per the all India study report submitted to the Delhi-based Petroleum Planning and Analysis Cell (PPAC), 70 per cent of diesel and 99.6 per cent of petrol is consumed in the transport sector alone. Hence, slightest change in international oil market will impact India's current account significantly. According to the PPAC, a decline of crude oil price by $1/bbl improves current account by Rs. 965 core and if the rupee strengthens by 1 against the dollar it improves oil bill by Rs. 553 crore. On the revenue side petroleum has generated about 5.7 lakh crore revenue in 2018-19 for the centre and states. This is definitely a substantial amount in total revenue for both.

Oil price is hovering around $20/bbl and its major consumers (US (20%), China (14%), Japan (4%), just like India, are currently battling with the pandemic and not likely to push the price of oil very soon. Some projections suggest that crude oil price could hit $12/bbl in the coming months.[1] Others like the U.S. Energy Information Administration (EIA), International Energy Association (IEA) predict similar trends for crude. Figure 1 below shows price trends forecasted by IEA. It is based on March 9, 2020 prices, when the pandemic scenarios was much more less grim in the US. Its lower price bound is hovering around $20/bbl and other predictive values lies between $30/bbl to $40/bbl.



[1] https://economictimes.indiatimes.com/markets/commodities/news/barclays-cuts-2020-crude-forecasts-by-12-on-virus-opec-deal-collapse/articleshow/74787305.cms

This article calibrates three scenarios to show how India's fiscal situation can improve banking on this fall in the in oil prices. For the sake of our argument, we will consider only two petroleum products i.e. petrol and diesel which are major source of revenue for government in the petroleum segment. We are assuming one financial year i.e. 1st April, 2020 to 31st Mach 2021 for our calculation.

Scenario 1: Back to normal quickly but less activity

To simulate this scenario, we will use oil consumption data of 2016-17, or the demonetisation year data.[2] Under this scenario, India will enjoy a huge price advantage. Price of crude is hovering around $20/barrel and according to sources it expected remain at that level for next six months. Thus we assume an oil price of $20/barrel for next six months and $30 for rest of the year. In this scenario, additional oil revenue generated for the government could be Rs 1.4 lakh crore.

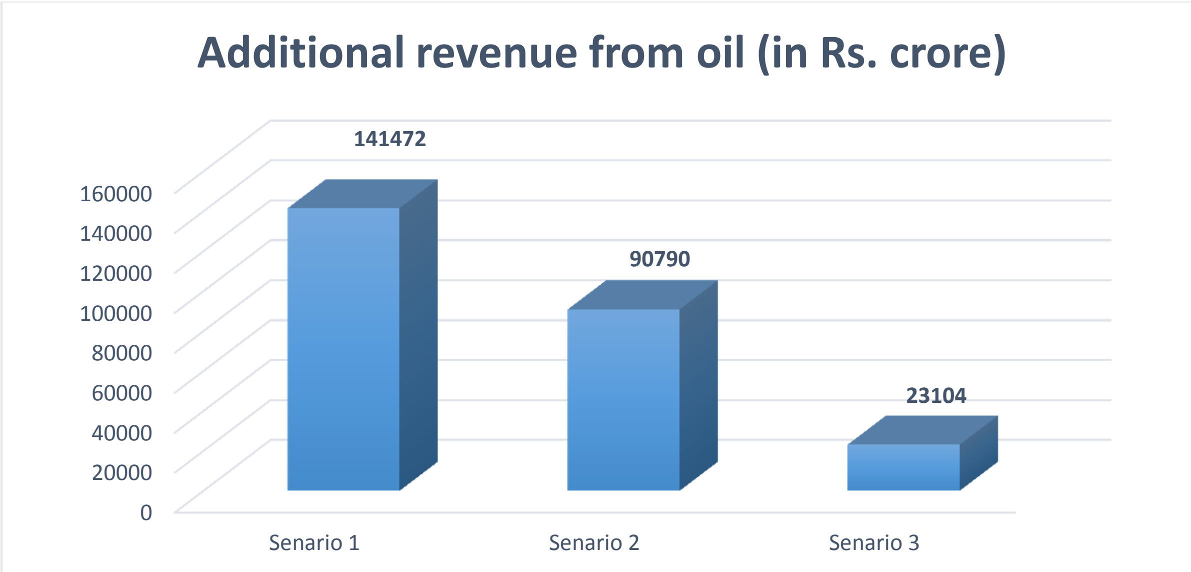
Scenario 2: Slow and staggered normalcy and so do the world

Under this situation, India will slowly recover and go back to normal economic activity. To simulate, we assume only 10 per cent activity in first two months, 30 per cent activity in next two months, 50 per cent in following two months and business as usual in remaining six months. Price situation would be same as scenario 1. In this scenario, the government can get an additional revenue of up to Rs. 90 thousand crore.

Scenario 3: India lags in controlling COVID-19 and USA recovers

USA is the worst affected country by COVID 19 pandemic and also it is the largest consumer of crude oil. In this scenario we assume that the US recovers quickly from the current pandemic and resumes normal economic activity. This makes the crude oil price shoot to $30 for first three months, i.e. April to June, then $40 for next three months and $50 for rest of the year. In India's case the demand situation will be slow in recovering and experience a staggered improvement like scenario 2. In this scenario, the government can raise additional Rs. 23,104 crores over the financial year.

[2] The reason for taking the demonetisation demand and not last year's is that economic activity will return to the level of a bad financial year.



Conclusion

The three scenarios described above suggest that starting economic activity before the European Union and the USA will give India a comparative advantage internationally, and more importantly in domestic business. It will also provide a window of opportunity for the government to improve its fiscal situation.

For this to happen however, India needs to start some economic activity as soon as possible, preferably by April 15, even if partially. Hotspots can be identified and locked down till the spread is contained. The government should not shy away of providing relief to vulnerable sections. The important thing is that as soon as India can get back to normalcy it can reap the advantages from a slack in global demand in a number of sectors; petroleum is the prominent one. But there are sectors which will have comparative advantage in the post lockdown period. The need of the hour is to identify such domains and quick start those activities.

Again, in a nutshell, India's strategy should be:

i. Back to normal as quickly as possible
ii. Spend entire resource on the hotspots (tests, tracking and isolation)
iii. Provide wage-coupons to daily wagers to contain them in the hotspots

India can use this opportunity improve its current account deficit (CAD) position and exchange rate. Lesser pressure in imports and opportunities of exports in health care related sectors should strengthen rupee and improve CAD.