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LET’S FILL UP THE TANK

Relevant for: Indian Economy | Topic: Infrastructure: Energy incl. Renewable & Non-renewable

Oil prices continue to decline globally, with crude hitting multi-decade lows, as global demand evaporates. Earlier last week, in unprecedented price action, the near-month contract for West Texas Intermediate (WTI) sweet crude oil dropped to -$37.63 a bbl. A negative price has never before been registered for a major global crude oil benchmark. The extreme price action is a signal that there is a global oil glut with few places to store oil. Global oil markets have been severely disrupted. While WTI does not feature in India’s basket, Brent Crude Oil, which does, is trading around $25 a barrel, the lowest in 18 years.

The economic consequences of COVID-19 are going to be drastic for India and the world. It is hard to say what kind of recovery the economy and markets will undergo when this is over, though there is much glib talk of it being “V”, “U” or “L” shaped. But whichever letter of the alphabet wins the race, one opportunity is clear: Even as India suffers from a lockdown, a silver lining for future recovery and reconstruction is the price of oil.

Given India’s growth aspirations and lack of self-sustaining oil production, a sharp reduction in oil prices is a bonanza. Normally, reduced oil prices would translate into surplus for the consumers and a fiscal bonus for the government through increased tax collections. However, given that the demand for petrol has slumped, those gains will not accrue right away. But India should look at this as an opportunity to strengthen its energy security by buying oil and filling up our Strategic Petroleum Reserves (SPR). Considering that India was the third-largest consumer of energy in the world, as well as the third-largest importer of oil in 2018, we are particularly vulnerable to oil price fluctuations. The dramatic reduction in oil prices offers a once-in-a-generation opportunity for us to fill up our reserves in an extremely cost-effective way.

Currently, we do maintain an emergency stockpile of oil reserves: Under the existing Strategic Petroleum Reserves programme, India claims to have 87 days of reserves. Out of this, refiners maintain 65 days of oil storage and the rest of the reserves are held in underground salt caverns maintained by Indian Strategic Petroleum Reserves Limited (ISPRL). The existing and planned capacity for the underground reserves is 10 and 12 days of import cover for crude oil respectively.

There are a couple of issues to be highlighted here. First, capacity does not directly translate into utilisation, which is partly because oil is an expensive commodity most days of the year. In 2019, the average closing price of a barrel of crude was $57.05. In 2018, it was $64.90, and in 2017, U$50.84. Of the existing 10 days of capacity, only about 50 per cent is utilised.

The second issue is with regard to the refinery holdings. In India, the SPR arrangement between the oil refineries and the Union or state governments is not specified well, though most of the refineries that hold stock are publicly-owned companies. In fact, a breakdown of which refineries hold SPR and in what form (crude or refined) or information about where they are located is not publicly available.

The first step, therefore, should be to introduce transparency and accountability in relation to the SPR. The procedures, protocols and facts about Indian SPR storage require greater public and parliamentary scrutiny, just like India’s other strategic reserves (for instance, foreign exchange). For this, there should be timely and reliable dissemination of information. Instead, it is now shrouded in secrecy.

The lack of transparency around our SPR holdings is compounded by the ambiguity surrounding the mobilisation process. SPR reserves are meant to be used in emergencies, where time is likely to be of the essence. The SPR mobilisation process could be made more efficient by laying out designated roles for different agencies to avoid redundancies in times of crisis. There should be role and process clarity regarding SPR mobilisation. For instance, to begin with, there should be clarity on who (or which agency) can define an emergency and therefore order a mobilisation.

Further, in order to mitigate risks better, India should look to diversify its SPR holdings. Diversification can be based on geographical location (storing oil either domestically or abroad), storage location (underground or overground) and product type (oil can be held in either crude or refined form). Storage and transportation costs could be saved by diversifying geographically. With oil dirt-cheap, if we can purchase more than we can store in our existing facilities, why not go abroad for more storage space?

For instance, one option could be to operationalise, modernise, and add to the oil tanking facilities at Trincomalee in Sri Lanka. Another opportunity would be to enter into a strategic partnership with Oman (Ras Markaz) for oil storage, which would also help India avoid the potential bottleneck of the straits of Hormuz. However, since many of these places could potentially be vulnerable to geopolitical risks, only a small part of India's overall SPR strategy should involve storing abroad.

Diversification could also be in the form of ownership — either publicly owned through ISPRL or by private oil companies, such as ADNOC of Abu Dhabi, which could fill up the SPR when prices are low and take advantage of price arbitrage. This could achieve a degree of price stability and reduce the cost for India to buy such large quantities of oil. The only requirement for this to work is to have a clear contract with the private companies about the mandatory minimum level of stock that they should preserve for use in emergency times. The Takshashila Institution, an independent think-tank, has raised several of these issues in a recent white paper. It serves as a timely reminder for policymakers to take action.

To ensure that SPR and oil security remain a priority in the near future, ISPRL should consider filling up the SPR reserves right now — and each time the price of Brent crude oil falls below a certain price, say $35 per barrel. Buying crude on the forward market is another option, but oil prices are in "contango" — which means that, contrary to normal times, future prices are higher than spot prices.

Energy is and will remain vital to India's aspirations for growth. The sharp fall in the price of oil presents an opportunity for the Union government to increase its SPR stockpile and achieve a degree of energy security. This is especially important at this time when every rupee needs to be conserved to get back on a positive economic track and lift the most vulnerable segments of our population.

The message is clear: While prices are low, we should fill up our reserve tanks and rent space abroad. The oil will come in handy when prices have gone up — and more importantly, when we need it.

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