What are Oil bonds?

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In news– As retail prices of petrol, diesel are rising, the Finance Minister has said that the current government cannot bring down taxes because it has to pay for the oil bonds issued by the previois UPA government.

About Oil bonds-

- **Oil bonds are issued by the government to compensate Oil Marketing Companies (OMCs) to offset losses** that they suffer to shield consumers from rising crude prices.
- **These bonds do not qualify as statutory liquidity ratio securities**, making them **less liquid** when compared to other government securities.
- When fuel prices were too high for domestic consumers, governments in the past often asked oil marketing companies (OMCs) to avoid charging consumers the full price and the government said that it would pay the difference.
- But again, if the government paid that amount in cash, it would have been pointless, because then the government would have had to tax the same people to collect the money to pay the OMCs.
- Hence **an oil bond is an IOU, or a promissory note issued by the government to the OMCs, in lieu of cash that the government would have given them** so that these companies don’t charge the public the full price of fuel.
- Thus, by issuing such oil bonds, the government of the day is able to protect/ subsidise the consumers without either ruining the profitability of the OMC or running a huge budget deficit itself.
- Oil bonds were issued by several governments in the past but the ones in question now are the ones which the UPA government issued.

Mechanism of working of oil bonds-

- **There are two components to the domestic retail price** – the price of crude oil itself, and the taxes levied on this basic price, together they make up the retail price.
- The taxes vary from one product to another. For instance, as of now, taxes account for 50% of the total retail price for a litre of petrol, and 44% for a litre of diesel.
- T**here are two components of oil bonds that need to be paid off: the annual interest payment, and the final payment at the end of the bond's tenure.**
- **By issuing such bonds, a government can defer the full payment by 5 or 10 or 20 years**, and in the interim just pay the interest costs.
- As per the Finance Minister, the Union government will continue to pay for the next five years as the redemption of bonds continues till 2026.

Note:

In India, the first step towards deregulation was taken in 2010 with the announcement that oil bonds will be discontinued, and OMCs will be paid in cash. In June 2010, petrol prices were deregulated, mirroring the market price of crude. The government freed diesel prices in October 2014. In June 2017, India adopted the system of dynamic fuel pricing where the retail price of petrol and diesel fluctuate on a daily basis.