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SEM 3-Special Paper Macro economics 1

A) THE REASON BEHIND THE SHARP SPIKE IN DIESEL, PETROL PRICES

Diesel prices on Monday reached Rs64.69 per litre in Delhi, a record high for the fuel. Petrol prices rose to Rs73.83 per litre, the highest since they were raised to Rs76.06 per litre on 14 September 2013.

What is the reason behind the price increase?

Retail prices of petrol and diesel in India track global prices of these auto fuels, not crude, although they are broadly linked to crude oil price trends, which have firmed up. As the supply cut by the Organization of the Petroleum Exporting Countries (Opec) and Russia led to a rally in global oil prices, the cost of the Indian basket of crude, which averaged $47.56 a barrel in 2016-2017, rose to touch $63.80 (average price) in March 2018, according to data from the Petroleum Planning and Analysis Cell, an arm of the oil ministry. The price was $76.84 a barrel on Monday. The Indian basket represents the average of Oman, Dubai and Brent crude.

Is there a cause for concern?

The worry over crude oil prices stems from India's energy needs being primarily met through imports, with the country importing 214 million tonnes of crude oil in 2016-17. Extreme volatility has marked crude oil prices, which reached a record $147 per barrel in July 2009.

What does this mean for the Indian economy?

That crude oil price is continuing to advance in global markets is bound to impact India's oil import bill and trade deficit. Lower oil prices had dramatically improved India's terms of trade in 2015-16, thus boosting India's gross domestic product (GDP).

A sharp spike in the price of oil will also reverse the declining trend on inflation and put pressure on central and state governments to cut taxes on petrol and diesel, which is likely to adversely impact their non-goods and services tax revenue. This is also expected to keep margins of state-owned refiners under pressure as they seek to absorb some part of their cost from being passed on to consumers and, in the process, impact the central government's dividend income.

What is the oil price outlook?

With crude oil accounting for about 90% of the production cost of auto fuel, experts believe that the global oil prices will remain firm with Opec looking to extend its cooperation with Russia on production cuts. This assumes significance, given that Opec accounts for around 40% of global production and India is one of the major Opec consumers. Experts also say that in the event of any trade war escalation, global economic growth could slow down and result in softer commodity prices, including that of oil.

What is India's strategy?

India has been seeking reasonable rates as its energy demand grows. New Delhi is also reworking its import strategy by stepping up the share of short-term contracts whenever the market is favourable and exploring long-term supply deals at discounted prices. The new energy architecture also involves acquiring hydrocarbon assets abroad and diversifying India's supply sources from geographies such as the US and adding renewable energy sources to its energy mix to tackle possible price shocks

B) Impact of rising prices of petrol and diesel on the Indian economy

Submitted by Devajyoti Haldar

The high prices of petrol and diesel have reached unprecedented levels since the first quarter of 2015-16. The price of petrol has climbed to a record high of Rs. 86.24 per litre on May 29 in Mumbai and diesel has increased to a price of Rs.73.79 per litre which the highest in India.

Asymmetrical relationship with the price of oil in global market

According to market experts, it has been seen that when the price of oil increases in the global market, prices of oil in India also increases. But when the price in global market reduces, the prices of oil in India are often not reduced.

Fall of GDP

The Economic Survey 2018 states that every $10 per barrel increase in the price of oil will reduce the GDP growth by 0.2% to 0.3% points. The survey has also stated that India's economic growth is expected to grow between 7% and 7.5% in the fiscal year 2019. But this growth may be hampered because of the rising prices of oil.

Fall in stock market

The rising prices of oil have also impacted the stock market. Jayanti Das, an economist, told BE, "The price hike of petrol and diesel causes inflation which influences RBI to increase the interest rates. This rising interest rate causes drop in indices and therefore the share prices slip." She also clarified that small changes in the prices of oil do not significantly hamper the stock market. But the present condition, where oil prices are showing drastic upward changes, is surely going to impact the share market.

Relationship between oil prices and inflation

When oil prices increase, it causes inflation. According to Jayanti Das, "Oil is an important input for the economy. It is used in vital activities such as fuelling, transportation or industrial machines. So, if the input cost rises, the price of the end product also moves up." The burden of inflation falls directly on the end consumers as they suffer price hikes of essential items. For example, according to the Indian Oil Corporation Ltd., the price of petrol rose to Rs. 83.83 in Kolkata on September 14, 2013. According to the official website of the Income Tax Department of India, the Cost Inflation Index (CII) which was 220 in the financial year of 2013-14 had moved to 240 in the next financial year. Additionally, that rise in the prices of fuel triggered a massive rise in the prices of essential goods. The increase in all prices has a direct effect on inflation. The weightages of petrol, diesel and LPG are 1.6, 3.1 and 0.64 respectively in the Wholesale Price Index (WPI). So, whenever there is an increase in oil prices, there will be an effect on the wholesale.

Impacts on transportation

With the increase of petrol and diesel prices, the sales of cars are getting affected. This leads to decease in the stock prices of the automobile sector. Many petrol pump workers have said that the fuel price hike has affected their business because many customers are buying lesser quantities of fuel or are avoiding private vehicles. The bus and taxi unions in Kolkata have managed to coax the state government to increase fares but that comes at the expense of end users. There is a possibility that flight and ship fares may also record an increase. Pranablal Majumder, a veteran educationist has told BE," The prices of almost all the necessary materials of our livelihoods including food and medicines are bound to increase due to the rising prices of petrol and diesel. It is because transportation of these necessary materials depends on fuel-powered vehicles. As the fare of transportation is increasing due to rise in fuel prices, the cost of these goods will also increase."

Impacts on agriculture and industry

Agriculture is the backbone of the Indian economy. Almost 52% people are directly or indirectly connected with agri-culture. Since the last decade, the agricultural economy has already declined and there is a fall of GDP in the agricultural sector. Mechanised farming is being seen as a solution. But the recent price rise of diesel is likely to hit the agricultural sector hard. With the rise in the price of diesel, the input costs to agriculture are likely to go up and will put the already stressed agricultural sector in higher peril. Prices of food items may see an increase and in that case, it is again the end users who will bear the brunt. Impact of the price hike of petrol and diesel on the industrial sector is also undeniable. Both medium and large industries need transportation. Price of oil has compelled to increase the expenditure of transportation which will hamper industrial growth. Moreover, many industries are highly fuel intensive. Rise in fuel prices will increase the input costs of industrial production.

Road ahead

To prevent the price hike of oil, petrol and diesel must be brought under the Goods & Service Tax (GST). On bringing petrol and diesel under the Goods and Services Tax, Union Minister Nitin Gadkari has said by bringing these under the GST, fuel prices can be cut by up to Rs.8. Moreover, the central government should immediately reduce the central excise on oil. State governments should also reduce Value Added Tax (VAT). Thomas Isaac, Finance Minister of Kerala has recently tweeted, "The sales tax on petrol reduced by 1.69% and diesel by 1.75% in Kerala. The retail prices are to decline by Rs.1; state government to forgo revenue of Rs.500 crore annually." According to Times of India report, central government levies excise duty of Rs.19.48per litre petrol and Rs.15.33 per litre diesel. State sales tax or VAT varies from state to state. In Delhi, VAT on petrol is Rs.15.84 a litre and Rs. 9.68 per litre on diesel. The central and other state governments should follow the Kerala government's model and should cut the sales tax to resist the price hike of oil.