Impact of fuel price deregulation in india

ASSIGN BUSTER

Most of the essential commodities such as pulses, vegetables and other cereal items are likely to become expensive due to increase in the transportation cost. Also the price of cooking gas has also gone up by 35 Rs. per 14. 5 kg cylinder. All this is likely to inflict pain to a common man who is already bearing the brunt of high inflation this year. Though it is very difficult to gauge the impact of inflation due to these prices rise but as per the finance ministry's chief economic adviser, Kaushik Basu, the price rises would impact headline inflation (WPI) by 0. percentage points but will result in lower fiscal deficits.

The increase in the inflation would be short term and in six months the inflation would be lower despite index reflecting international prices. The total projected impact on inflation or whole sales price index is projected at 2. 05 by Kirit Pareekh (Annexure: Table 1) India ' s most closely watched WPI inflation unexpectedly accelerated in May to 10. 16% year- on -year while the food price index also rose sharply in mid -June to 16. 9%. According to Mr. HaJra, " Every two rupee- increase in diesel prices will have a 30 asis points rise as direct impact on WPI, and another 30 basis points by an indirect effect.

Moreover, in Annexure: Chart-2 we can find out that how regulated prices are creating an inflated demand for fuels. Let us presume that the interaction of demand & supply determines a price PO tor petrol. Now by giving subsidies, it reduces the prices of petrol to pl for mass consumers, which in turn inflates the demand of petrol to 01 from O for some level of supply. In market driven scenario supply too should have responded with a

decrease in supply from O to 02 to lower prices but hat is not happening due to Govt. subsidies which eventually is resulting into inflation.

Impact on Fiscal Deficit The primary reason of Govt. ‘ s decision to decontrol is to reduce its bulging fiscal deficit which at present is whopping 4. 12 trillion rupees, 6. 5% of the countrys GDP. The decision is likely to help reduce the fiscal deficit from the projected 5. 5 per cent of 2010- 11 GDP and free up revenues for other programmes After economic reforms of 1991 under Narsimha Rao Govt. , successive govt. s’ have shown little willingness to take significant steps to check fiscal deficit. The govt. expects to bring down the fiscal deficit to 4. % of the GDP in the fiscal year 2011 through generating revenue by fuel prices decontrol and 3G auctioning. Fuel accounts for a quarter of its estimated subsidy bill of Rs 1. 2 lakh crore ($25. 5 billion). Before Friday’s announcement, projected losses for oil firms are estimated at $24. 4 billion i. e. this year, based on an average crude price of $85 a barrel. Moreover, if we compare the movement of prices of Indian crude oil basket to movement of prices of fuel products it is evident that the rise in prices of former has een more steep compared to fuels prices (Annexure: Chart-I).

This too has contributed to the fiscal deficit. Fiscal Deficit How the fiscal deficit shall decrease in the long run can be understood with the help of following equation; We know that Here, Y: GDP or National Income C: Private Consumption Expenditure l: Private Investment Expenditure G: Govt Expenditure on Consumption and capital formation X: Export M: Import Also G = Taxes – Subsidies – Govt. Expenditures For India G is negative at the moment to the extent of 4. 12 trillioin rupees. In other words, the revenues

generated by the govt throug xpenditures it has incurred. taxes are less than the Now, since subsidies have been reduced therefore Govt saving shall increase which may then be put into some other use. However, withdrawal of subsidy would also mean more private consumption and less private savings but that is not going to have any impact on Fiscal deficit which is nothing but Govt. Income (Taxes) minus Govt. Expenditure. Impact on retail oil market The threat of diminishing market share looms large before the state owned firms such as Indian Oil Corp, Bharat Petroleum Corp Ltd and Hindustan Petroleum Corp

Ltd, which control more than 95 per cent of about 40, 000 refined fuel pumps operating in India although they will gain from market rates of gasoline and diesel. State-run retailers were anticipating a revenue loss of $24. 4 billion this year, based on an average crude price of $85 a barrel prior to the price rise. Reliance Industries Ltd had shut down all its pumps five years ago when the government started subsidizing fuel sold by state firms. RIL which operates the world’s biggest refining complex at Jamnagar hopes to restore the operations of all its pumps while Essar Oil is also intensifying its retail operations.

Impact on oil exports With the increase in domestic sales of Reliance, it may decide to reduce exports and sell to the more lucrative domestic market. Impact on private oil retail firms The government has released only gasoline prices so far, which accounts for about 10 per cent of the oil products retailed in India, although it is diesel, which is more lucrative as it accounts for more than a third of the oil consumed in India being used by trucks,

buses and increasingly by cars. Once the price of diesel is decontrolled, private firms will speed up retail expansion.

An example is Essar which plans to expand its retail network from the current 1, 342 to 1, 700 by end-March. Impact in bond market In order to finance the deficit in working capital due to sale of reduced-cost fuel, oil companies issue bonds to borrow money from the corporate bond market. This practice of bond issuance by oil companies will diminish as they would have more cash reserves as a result of recovery of otherwise lost revenues. The role of oil companies in the corporate bond market is not very significant as they account for $1. 1 billion in a $22 billion market. Political Issues