

Petrol prices have  
seen a shocking hike  
economics essay



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The petrol prices have seen a shocking hike of Rs. 7. 5 on the 23rd of May. The increase is the first since December, 2011. It went up to INR 78. 16 per liter. The RBI was having a tough time coping with the rising inflation and this increase in petrol prices will make it very difficult for them to manage. The rise in price will also hit the common man who is trying very hard to make ends meet.

The rate of inflation (annual), based on monthly WPI, stood at 7. 23% for April (over April 2011) compared to 6. 89% for the previous month

The Petrol prices in the four major metros after the hike are as follows:

Metro

Before petrol hike

After Petrol Hike

Delhi

65. 64

73. 14

Mumbai

70. 66

78. 16

Kolkata

70. 03

77. 53

Chennai

69. 55

77. 05

The increase in fuel prices directly or indirectly affects all the major sectors of the country. It affects the transportation, textiles, auto, FMCG, manufacturing, agriculture sectors and so on. The impact of the indirect effect is that the prices of daily basic commodities get affected and this increase in price of goods would gradually force people to spend more and save less. 58. 4% of the Indian population belongs to the agricultural sector and their contribution to the total GDP is only about 18%. Such small amount of income being distributed over a large population have a huge impact on them as even a slightest fluctuation would make them poorer which will further the gap between the rich and the poor.

The graph below shows the petrol price fluctuations over the past two decades.

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About 50% of the total Indian exports earnings is spent on buying petroleum, particularly, crude oil, this has a negative impact on the country's overall economy. In the past five years, the amount of imports of the petroleum

products is almost 40 per cent of the total exports of India in the last six years. For the year, 2011-12, it has been as high as 51.2 per cent. Such large quantities of imports will exert huge amount of pressure on India's current account deficit.

This increase in the crude oil imports is not just because of the increase in the price but also because of the increase in demand of fuel in the country.

The amount of petroleum imports has increased from 82 million tons in 2002-03 to 164 million tons in 2010-11, thus increasing the import bills in terms of rupees by over 500 per cent between 2002-03 and 2010-11. These imports are one of the causes of the depleting foreign exchange reserves. In 2002-03, the percentage of petroleum imports with respect to the foreign exchange reserves were 23.18 and it went up to 34.80 per cent in 2010-11. This should be a major source of concern as a large chunk of the country's foreign exchange earnings are spent on import of a single commodity.

The ownership of vehicles in India is growing at compound annual growth rate of 12% for the two wheelers. 71% of vehicles are two wheelers, and they run on petrol. Also the sale of two wheelers is around seven times more than the sales of car within the country. Two wheelers essentially provide mobility to the aspiring and the middle class. This gives us a fair idea about the huge amount of petro consumed by the people.

India was the world's fifth largest importer of oil. It imports more than 2.2 million bbl/d, i. e. around 70 percent of its consumption. Its major imports come from the Middle East (34%), Saudi Arabia (18%) and Africa (22%).

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From the below table we can see that, the price of petrol has risen over the period of five years in different countries. India's and the emerging economies like Russia and China's petrol price has grown over by 60% during the past 5 years while the developed economies have only a max of 20% price growth over the past 5 years.

## **Country and Currency**

**2007**

**2012**

**% increase**

India (INR)

48.38

78.57

62.4

USA (US\$)

0.87

1.02

17.98

Russia (Ruble)

16.79

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25. 41

51. 34

China (Yuan)

4. 94

8. 33

68. 62

Japan (Yen)

136. 7

149. 4

9. 29

Germany (Euro)

1. 394

1. 631

17

UK (Pound)

1. 40197

1. 68137

19. 92

Both oil and petroleum products are scarce commodities. Therefore both demand and supply are less elastic. The demand-supply and other factors like cartel, hoarding, supply shocks etc., the prices are fluctuating (increasing) to such great levels causing demand pull, as well as cost push inflation. The inflated oil prices not only affect the poor people of the country but also rich people. But the impact is more significant on the poor people.

Increase in the international oil price leads to a domestic inflation, which thereby decreases the foreign exchange reserves. The supply of the foreign currency reduces thus appreciating the value of the foreign currency and depreciating the local currency which in turn increases the prices of imports. It also deteriorates the balance of trade of the country. All these factors push a country into the poverty trap.

International oil price hike affects both the public and the government. It brings in inflation and reduces the purchasing power of the people. It also affects the government's revenue and expenditure.

Government being the biggest consumer, it has a negative effect on the real GDP, on the foreign exchange reserves; it increases the total foreign debt of the country and also further deteriorates the current account deficit of the country.

With the increase in the fuel prices, the price of consumer products increases because oil is an essential component of the industrial and the

manufacturing sectors, also petrol and diesel is used for the transportation of goods, thus creating an inflationary pressure.

The government can take a few initiatives which can help in the long run. For e. g. there could be a fuel shift from petrol, diesel to Hybrid, CNG, non-motorized transport etc. Also we could undergo

a modal shift i. e. from road freight transport to rail freight transport. The government can also make fuel more affordable by targeting more on subsidies and improving the already existing schemes.

Also the vehicle's fuel economy standards can be improved there by making it fuel efficient. People can take a few demand side management initiatives like car pooling etc.