



Paying at the pump

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Petrol and Diesel prices continuing to rise

- In June 2017, India's state-run oil marketing companies switched to a dynamic pricing approach to set pump prices of petrol and diesel on a daily basis.
- The move was aimed at helping ensure a market-driven approach to fuel pricing by enabling oil firms to factor in day-to-day fluctuations in crude oil prices as well as movements in the exchange rate of the U.S. dollar to the rupee.
- As a result, with both crude oil and the dollar becoming significantly dearer over the last six months, petrol and diesel prices have remained on a steady upward trajectory countrywide since April 1.
- According to the Indian Oil Corporation (IOC), petrol hit a record high of Rs.88.26 per litre on September 11 in Mumbai, where fuel prices are the highest among India's four major metros.
- At that level, the cost of petrol to consumers had climbed 8.4% in this fiscal year.
- Besides the cost of crude oil and the exchange rate, the incidence of Excise Duty (levied by the Centre) and VAT (charged by the respective States), along with a nominal dealer commission that the oil companies pay to fuel pump owners, ends up approximately doubling the final price consumers pay.

Major consequences of this trend in fuel prices

- Diesel is used to transport goods and commuters and therefore has a direct pass-through impact on retail inflation.
- When consumers end up facing higher fuel bills for using their petrol-powered two-wheelers or cars, and are also unsure of how the overall increase in the cost of living is going to impact their monthly budgets, they are likely to curtail non-essential consumption expenditure.
- Thus, even as inflation accelerates, consumer spending, a key driver of economic growth, could start to soften.

Government to ease the situation

- Given the extent to which Central and State taxes inflate the final fuel prices paid by consumers, the governments have the option of trimming excise duty and VAT, even if this would entail foregoing some revenue in the short-term.
- In the longer term, policymakers must look at more enduring structural solutions including ways to reduce the dependence on crude oil imports.