Tianjin Daxue Xuebao (Ziran Kexue yu Gongcheng Jishu Ban)/
Journal of Tianjin University Science and Technology
ISSN (Online): 0493-2137
E-Publication: Online Open Access
Vol:54 Issue:06:2021
DOI 10.17605/OSF.IO/9FD8R

HIKE IN OIL PRICE, ITS IMPACT ON INDIAN ECONOMY AND POTENTIAL REMEDIES: AN OVERVIEW

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Abstract: Oil price is crucial factor for an Economy. The oil price in India has hiked near about Rs100 in case of Petrol. The Indian consumers have to pay more price relatively to other Asian countries due to the imposition of different kind of taxes like CENVAT, Excise Duty, State VAT, Custom Duty etc. The GOI collects huge amount of tax revenue from oil incidence of which is on the shoulders of the consumers. Due to the hike in oil prices the prices of other related products also increase. Hike in oil price is a macro economic phenomenon. There is no recent literature regarding the recent hike in oil prices in India. This paper is Descriptive and Analytical in nature. It uses secondary sources of data. Potential remedies to get rid of such price hike is incorporated in this paper. Implementation of GST might reduce the price of oil in accordance with the ongoing four tier of taxation system of GST.
Keywords: CENVAT, Excise Duty, Custom Duty, Macro Economic Phenomenon, GST, Incidence, OPEC countries.

Introduction:

The Organization of Petroleum Exporting Countries (OPEC) is enjoying monopoly in exporting petroleum products. In economic sense, OPEC is a collusive oligopoly which is similar to that of monopoly to some extent. The members of OPEC are Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. These countries are later joined by Qatar, Indonesia, Libya, the United Arab Emirates, Algeria, Nigeria, Ecuador, Gabon, Angola, Equatorial Guinea and Congo.

India is an importer of OPEC countries and imported 213.93 million tones of crude oil in 2016 and 2017 for USD 70.196 billion or Rs. 4.7 lakh crores . India is the third largest importer of crude oil named after China and USA. India imports petroleum crude oil the most from Saudi Arabia (19.9%). In the year 2015 India imported 15.39% of GDP which was 17.11% in 2012. A comparative analysis of oil import as a percentage of GDP from 2012 to 2017; shows a decreasing trend which is a good indicator for Indian economy .

As there is a growing demand for oil and other petroleum products, a fall in the import as a percentage of GDP may signify that the production of import substituting goods has increased or India's home production is raised .But this is not the case. India's crude oil product fell to 35.6 million ton in the year 2017 which was 37.86 million tons in the year 2013 and 2014 which results in import dependency of India to increase to 82.8%. The leading states in India in case of crude oil production are Gujarat, Assam , Andhra Pradesh ,Tamil Nadu, Odisha etc

Why there is hike in oil price:

As already mentioned that OPEC is enjoying monopoly over the export of petroleum products . In monopoly producers are the price makers .To set a higher price Globally OPEC reduces its production . The causes of price hike is discussed in the following sub sections

Economic factor:

Imposition of VAT:

Goods and services tax is an indirect tax which is levied on the supply of goods and services which has less cascading effect relatively to Value Added Tax(VAT). VAT is levied on the amount by which the value of a product has been increased at every stage of the supply chain.

GST is not levied on petroleum products Therefore , it is caught into the trap of cascading effect . Let us take a hypothetical example.

Let oil is produced in India. This system is linked through production to sell will require manufacturer, distributors, whole sellers and retailers.

In VAT system, let us suppose govt. imposes 10% of Tax. The manufacturer buys the raw materials at Rs. 50 and bear another expenditure of Rs. 50 to produce it. The total cost of production will be Rs.100. Now 10% tax is levied on Rs.100 at manufacturing level and its price will become Rs.110. The distributor will have to incur Rs. 130 (Rs. 20 as profit) and with 10% tax total price now becomes Rs. 143(Rs. 130+ Rs. 13).

Now the distributor will add Rs. 20 as his profit and gives it to the whole seller at Rs. 163. the whole seller now will have to pay tax on Rs. 163 with 10% tax rate and sells the commodity at Rs. 179.30. Now retailers add Rs.20 as profit and sells the goods to consumers at Rs.199.30 and by paying tax the final market price at which the buyers can buy that commodity will be Rs.219.23(Rs 199.30 + Rs.19.93 as 10% of tax).

Now under GST system manufacturers buy raw materials at Rs.50 and have manufactured it at Rs. 50 so that the total cost of the production is Rs.100. Now under GST system a tax rate of 10% will be levied on Rs.50 (the manufactured amount) and it is Rs.5 .The tax is levied on his/her profit and so it will give the product to the distributor at Rs. 105 and the distribution will add a profit of rs. 20 determining price at Rs. 125.

The distributor will pay Rs. 2 as tax (10% tax on Rs 2) and the price of the product available for whole seller will be Rs.127(Rs 105 + Rs 20+Rs 2).Whole seller thus add Rs.20 to his profit and will pay a tax of Rs 2 on his profit determining price at Rs. 149(Rs 127+ Rs 20+ Rs 2) .Now ,retailer will purchase that product at Rs.149 and give it to the customers at the final market price Rs.149 +Rs 20+ Rs 2 = Rs 171

In pre GST system or under VAT price worth 219.23 and under GST it reduces to Rs 171.Total tax payment under VAT was Rs. 77.16 which in turn was Rs.13. So, the conclusion to that had the petroleum products been incorporated under GST system price of these products would have fallen

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Non economic factor:

International Relation: The decision of Donald Trump, the president of USA, to unilaterally exit the nuclear deal with Iran, a major oil exporting country caused a rise in market price due to deficient foreign relation between USA and Iran and thus fail in the production of oil in Iran. Iran produces 4% of the global oil supplies. Saudi Arabia stood in favor of USA and said to fill any gap left by Iran. Saudi Arabia and Russia have a good relationship over decision making in case of oil export and both the countries along with OPEC reduces the supply of oil to balance it with demand and also increase the oil price globally. It’s a bitter truth that being collusive oligopolists the motive of OPEC is to maximize profit.
The political and economic crisis also affected oil rich South American countries and it further resulted in free fall of crude oil production.

Impact of Rise in Price in the Economy:
Recent studies in wholesale price index reveals the fact that ,it is increasing as compared to recent past years. Hike in wholesale price index indicates a rise in prices of some commodities. Due to hike in oil price transportation cost increases resulting in hike in necessity commodities like potato, onion, rice etc. Basically it affects the price of potato because large amount of potato is being carried by tracks from one place to another. The fluctuations in the price of potato is due to rise and fall in oil price. But this is not the only reason.
In June 28, 2018, the $ 1 value of rupee touches Rs. 69.1 in India. There is a devaluation of money in recent months due to hike in oil price. In international trade if India produces export oriented goods and exports those to USA, then foreign export will be encouraged. On the other hand, India has to pay a larger amount to import goods and services from USA and cash reverses of foreign dollar will shrink. Again if India looks forward to produce import substitutes, then it will effect the economy positively. If India becomes more export oriented, then eventually the TOT (Terms of Trade) of India will fall and welfare will be reduced. If India concentrates on producing import substitutes, then volume of import will reduce and price of importable will also decrease which will eventually result in improvement of TOT an thus welfare level.
Effect of hike in oil price can be discussed in terms of fluctuations in rate of interest. As the price of necessary commodities rise as stated earlier, demand for money rises. Rise in demand for money encourages dissaving and will further result in reducing capital formation. Rise in demand or money may cause interest rate to rise (in economic sense) and it discourage investment as there is an inverse relationship between rate of interest and investment.
Thus, impact of rise in oil price can be predicted and some of these impacts have already prevailed in the economy.

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Potential Remedial Measures :

The potential remedies can be discussed with the help of the following subsections:

(a) RBI: Reserve Bank of India can supply more dollar in the money market and reduce the increasing demand for dollar. The foreign investors carry huge amount of dollar from India. This is one of the causes among many other causes explaining why there is inflation in India. Current Account Deficits (CAD) should be reduced. To reduce CAD, India has to make sure that there is a reduction in demand for dollar. As foreign reserve of RBI is strong, it can give direct market intervention by supplying more dollar in the dollar market and thus reducing demand for dollar which will further help in falling prices.

(b) Export: India should look forward o increase export and thus earn foreign money and enrich its cash reserve. It should be increased up to a limit because after a certain level, more export will deteriorate TOT. This is because as there is more production of exported goods, price of it will decrease eventually.

(c) Import Substitutes: Rise in the production of import substitutes will reduce foreign import. Less import means less outflow of foreign money to the other countries and it will enhance foreign resource in domestic country . A strong foreign reserve can also play a great role to stabilize an economy.

(d) Foreign Investment and Portfolio Investment: Foreign Investors should be assured with that, the Indian economy is not in danger. India has an investment friendly environment. Otherwise, portfolio investors will sell their shares and keep dollar away from India. There will be rise in demand for dollar and it will affect in rise in general price level. India has kept the foreign investment in hand and provide a satisfactory platform to them such that foreign capital reserves can be enriched.

These are some of the steps that my be undertaken by the government as well as monetary authority.

Now question arises what do the common people can do to reduce oil price. The answer is simple. Common people have to reduce consumption of oil and thus reduce demand for oil. People should use Bicycles or the alternatives like E Rickshaw to cover a small distance. Walking is a good exercise. So people can go on foot to cover a possible distance of time, heath and other conditions permit. Country like Netherland, Denmark ,Germany, Sweden , Norway, Finland, Japan etc stand in favour of cycling as it is also an eco friendly practice. In Majuli cycling is prevalent among the tourists to go to and froe specially from one Satra to other.

In Assam, it is seen that the passenger cars or buses keep the vehicles in starting on mode for a long time (as long as half an hour) and wait for the passengers to come. If for that time the drivers keep the start off then additional oil consumed by the engine will be reduced and oil will not be wasted. In this way wastage of oil should be prevented.

Conclusion:

We have to be more conscious and govt. of India and the monetary authority should undertake necessary steps to minimise the evil consequences of sharply price hike of oil so that general price level could be stabilised for economic growth in true sense.

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