

**From Kaushik Basu, Chief Economic Adviser, Ministry of
Finance, Government of India**

25 June 2010

To describe the government's decision to deregulate petroleum and diesel as an act of raising prices is to get it completely wrong. It is one of the most major reforms of recent times and should have beneficial effects on the entire economy. What is being done is to put both diesel and petrol prices on a float. Prices will rise and fall in step with the international prices. For diesel, there will still be a per-litre subsidy from the government, to keep the domestic retail price below market level. But what is important is that it will no longer be a fixed price.

These changes, coupled with the price increase for LPG and kerosene, will have an immediate positive impact on inflation. I expect an increase of 0.9 percentage points in the monthly WPI inflation. But, since these changes will cause the fiscal and revenue deficits to decline, they will exert a downward pressure on prices. Hence, though the immediate impact of this policy will be to increase inflation, in six to nine months we will have lower prices than what would have happened in the absence of this much-needed reform.

More importantly, from now on, if there is a global shortage and the international price of crude rises, this signal will be transmitted to the Indian consumer. It will rationalize the way we spend money, the kinds and amount of energy we use, and the cars we manufacture. It is an important step in making India a more efficient, global player.