PETROL PRICES

Do falling prices impact income inequality?

RECENTLY, there has been a growing concern about the distributional implications of environmental policies at domestic and international levels. In Malaysia, where the majority of the population depend greatly on petroleum for their livelihood, petroleum price fluctuations have significant implications on the economy.

This article provides a summary of research findings that had been carried by Universiti Putra Malaysia and University of Groningen. The principal aim of the research is to measure petroleum price fluctuations on income inequality by focusing on the impact across ethnic groups in Malaysia. The full article of the research findings was published in *Ecological Economics* (volume 130, 2016).

Focusing the findings on the drop in petroleum prices, analysis shows that the distributional impacts are progressive. The real income for all household groups is reduced with the lowest income group less affected.

There is a shift in distribution of real income in favour of the Malays and Indians at the expense of the Chinese. The real income share of the Malays improves by 0.15 per cent in rural and 0.41 per cent in urban areas. The improvement in income share for rural Indians is 0.01 per cent higher than for urban Indians.

For the Chinese, a decline in real income share is more substantial in the urban areas than in the rural areas. Although declining petroleum prices improve the income inequality between the ethnic groups, the improvement is obtained at the expense of reduction in real income for all ethnic groups.

The analysis predicts that income inequality is improved because the declining petroleum prices reduce nominal income and index cost of living, in which the effects of the former are stronger than the latter. However, some findings are unlikely to be consistent with the reality.

Reduction in nominal income is consistent with the current economic situation. But the reduction in the cost of living is far from the reality although the analysis predicts falling petroleum prices force consumer price index to decline. Prices of other energy products such as electricity do not decline following the downward change in petroleum prices.

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Electricity is consumed largely as production inputs after petroleum products. Reduction in electricity prices would imply reduction in costs of production and, thus, reduce overall consumer price index, in particular food items. Electricity supply is mostly generated from the use of gas and petroleum-based fuels. Costs of these two inputs are recently cheaper following the downward changes in petroleum prices. Thus, reduction in electricity prices is reasonable.

The economic impact of falling petroleum prices depends largely on the consistency of policies. If policy reforms move towards market based for petroleum products, other related products that consume largely petroleum-based inputs also must be deregulated. Mixture of regulated and deregulated energy prices makes policy decisions more difficult.

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