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EDITORIAL ANALYSIS

Government Must Allow Greater Fuel Price Adjustments

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 Business Standard

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INTERVIEW ANGLE

"When external oil shocks force a choice between consumer protection and fiscal discipline, how should India sequence pass-through, targeted subsidies and strategic petroleum reserves?"

EDITORIAL SUMMARY:

Business Standard argues that Iran-Israel war disruption in the Strait of Hormuz has driven crude oil higher, forcing India's state-run Oil Marketing Companies into mounting under-recoveries while the government hesitates on full pass-through. Price controls are fiscally and macroeconomically unsustainable. The right policy response is targeted, time-bound subsidy support — not blanket price suppression — combined with accelerated Strategic Petroleum Reserve expansion, crude source diversification, and acceleration of ethanol, EV and green hydrogen alternatives.

INDIA'S STRUCTURAL CRUDE EXPOSURE

India is the world's third-largest crude oil consumer and one of its largest importers.

INDICATOR	VALUE
Crude import dependence	~85%
FY25 oil import bill	~\$137 billion
Pre-2022 Russian share of India's crude basket	<2%
Current Russian share	~30%+
Strait of Hormuz share of global oil trade	~20%
Strait of Hormuz share of global LNG trade	~25%

The arithmetic is brutally simple: when crude prices rise by \$10 per barrel, India's annual import bill rises by roughly \$15 billion at current import volumes, with cascading effects on the current account deficit, the rupee, inflation, and consumer purchasing power.

THE STRAIT OF HORMUZ DISRUPTION

The **June 2025 Iran-Israel war** episode reactivated the latent risk that the global oil market has lived with for decades — the disruption of the Strait of Hormuz.

Why Hormuz Matters

- **Geography:** Roughly 21 miles wide at its narrowest, the Strait connects the Persian Gulf to the Gulf of Oman and the open Indian Ocean
- **Traffic:** Roughly 20% of global oil and 25% of global LNG transit Hormuz
- **No bypass for most volumes:** While some Gulf producers have alternative export routes, the bulk of Saudi, UAE, Kuwaiti, Qatari, Iraqi and Iranian crude flows through Hormuz

Alternative Routes Mitigate but Do Not Eliminate Exposure

ALTERNATIVE PIPELINE	ORIGIN	BYPASS FUNCTION
East-West Petroline	Saudi Arabia	Crude to Red Sea (Yanbu) — bypasses Hormuz
Iraqi Strategic Pipeline (Petroline tie-in)	Iraq via Saudi Arabia	Limited operational capacity
Abu Dhabi Crude Oil Pipeline (ADCOP) — Habshan-Fujairah	UAE	Crude to Fujairah on Gulf of Oman, bypassing Hormuz

Alternative routes can handle a fraction of normal Hormuz volumes, not all of them. Disruption is therefore a price event before it is a supply event — markets price in tail risk even when physical shipping continues.

INDIA'S CRUDE SOURCING PIVOT

The most significant structural change in India's oil import basket has been the post-2022 **pivot to Russian discounted crude**.

- Pre-2022 Russian share: under 2% of India's basket
- Current share: approximately 30%+, making Russia India's single largest supplier in many recent months
- The discount margin — varying by grade and time — has provided India with both fiscal headroom and a degree of insulation from West-Asia-centric shocks

This pivot has been politically calibrated — India has not joined Western sanctions but has also not exposed itself to secondary sanctions risk — and economically consequential, materially reducing the FY24-25 import bill below counter-factual scenarios.

China continues large-scale Iran-China oil flows under sanctions-evasion arrangements, with roughly \$300 billion in annual crude-and-related trade across multiple channels — a market-shaping factor that affects global price dynamics even where India does not participate directly.

INDIA'S FUEL PRICING REGIME — THE POLITICAL ECONOMY

India's domestic petrol and diesel pricing has been formally **dynamic since June 2017**, when daily revision by OMCs (Indian Oil Corporation, Bharat Petroleum, Hindustan Petroleum) replaced the earlier fortnightly cycle. In practice, the dynamism has been suspended at politically sensitive moments.

The Freeze Cycles

- **2018-19:** Prices effectively frozen around the 2019 general election period despite global crude movements
- **2022:** Suspended adjustments around the Russia-Ukraine crude spike
- **2024:** Frozen through the 2024 general election cycle

During these periods, OMCs absorb the difference between international cost and domestic retail price as **under-recoveries** — an implicit subsidy carried on PSU balance sheets rather than the Union Budget.

The Excise and VAT Layer

PERIOD	CENTRAL EXCISE POLICY
2014-2020	Excise duties on petrol and diesel raised significantly
2021-2022	Partial rollback of excise hikes
2024-25	Modest further adjustments; PMUY expansion absorbed LPG burden

State **Value Added Tax (VAT)** on petrol and diesel varies materially across states, creating inter-state retail price differentials of several rupees per litre. The fragmentation has political utility but undermines a coherent national pricing signal.

THE UNDER-RECOVERY MECHANISM — OLD WINE, NEW BOTTLE

The implicit subsidy through OMC balance sheets is not a new phenomenon.

- **The oil bonds era (UPA period):** The government issued **oil bonds of roughly ₹1.5 lakh crore** to OMCs to compensate for under-recoveries. The bonds matured later, creating fiscal pressure across subsequent budgets.
- **The current era:** Under-recoveries appear directly on OMC profit and loss statements; recent quarters have shown losses on petrol and diesel sales for one or more OMCs; capex deferrals, debt accumulation, and dividend pressure follow.

The substance — public-sector enterprise absorption of consumer subsidies — is the same. The form has shifted from explicit bonds to implicit balance-sheet stress.

THE FISCAL COST OF SUPPRESSION

The fiscal cost of price suppression has been substantial.

- **2022-23:** ~₹22,000 crore LPG subsidy to OMCs, alongside ad hoc petrol-diesel relief
- **2024-25:** PMUY LPG subsidy expanded to cover Ujjwala beneficiaries with reduced refill price; partial excise cuts as a relief option

These are not the only costs. OMC capex deferrals delay refinery upgrades, retail expansion, and clean fuel transitions. Reduced OMC profitability lowers dividend flows to the government and depresses public-sector share prices.

CROSS-COUNTRY COMPARISON

COUNTRY	FUEL PRICING MODEL
China	State-controlled pricing with adjustment band; ceiling around \$130/bbl crude reference
United Kingdom, Germany	Full pass-through with carbon tax additionality
United States	Free market; no national price controls
India (formal)	Dynamic pricing since June 2017
India (de facto)	Periodic freezes during shocks and elections

China's model — a transparent adjustment band with a defined ceiling — is the closest comparator for an Indian price-band mechanism that combines consumer protection with fiscal discipline.

STRATEGIC PETROLEUM RESERVES — THE HEDGE

India's **Strategic Petroleum Reserves (SPR)** programme is the most direct hedge against external supply shocks.

INDICATOR	VALUE
Current SPR + commercial reserve coverage	~75 days of imports
IEA recommended import cover	90 days
SPR Phase I capacity	5.33 MMT across Visakhapatnam, Mangalore, Padur
Planned additions	Padur Phase II; Chandikhol (Odisha); proposed new sites — Bikaner (Rajasthan), Mangalore expansion, Bina (MP)

The SPR programme is operated through the **Indian Strategic Petroleum Reserves Limited (ISPRL)**, a special-purpose vehicle. Achieving the 90-day IEA norm requires both physical capacity expansion and the operational readiness to draw down stocks during disruptions.

THE DEMAND-SIDE HEDGE

India's structural import dependence cannot be reduced by sourcing alone. Demand-side substitution is the only durable hedge.

PROGRAMME	STATUS
Ethanol Blended Petrol — E20	Achieved nationally in 2025
Ethanol Blended Petrol — E30 standard	Notified May 2026
EV adoption	Supported by FAME II, PM e-DRIVE, NHEV pilots
Green hydrogen	National Green Hydrogen Mission 2023; target 5 MMT by 2030
Biodiesel and SAF	Limited scale, growing

Each percentage point of ethanol blending reduces petroleum demand by a roughly proportional amount; the carbon and import-substitution gains are material at the national scale.

WAY FORWARD

Business Standard’s recommended sequencing:

- 1 **Phased pass-through** — calibrated to international price movement, with daily revision restored in substance and not just in form
- 2 **Targeted PMUY-style subsidy support** for vulnerable households on LPG, sustained through a defined fiscal window rather than open-ended
- 3 **Transparent price-band mechanism** — defined adjustment corridor with publicly announced ceiling and floor reference points
- 4 **Accelerated SPR expansion** toward the IEA 90-day norm via Padur Phase II, Chandikhol, and proposed new sites at Bikaner, Mangalore expansion, and Bina
- 5 **Deeper crude diversification** — beyond West Asia, with continued Russian discount capture and expanded West African, Latin American and US sourcing
- 6 **Demand-side acceleration** — E30 implementation, EV adoption, green hydrogen, biofuel scale-up
- 7 **Transparent OMC disclosure** of under-recoveries to end the era of implicit balance-sheet subsidies

UPSC MAINS ANALYSIS

GS Paper 3 — Economy and Energy Security

- Energy security: import dependence, crude sourcing diversification, SPR
- Fiscal policy: oil bonds legacy, implicit subsidies, PMUY targeted support

- Inflation management: pass-through, price-band mechanisms
- Energy transition: ethanol blending, EVs, green hydrogen

GS Paper 2 — International Relations

- Strait of Hormuz geostrategy
- Russian crude pivot, sanctions navigation
- Iran-India relations, Chabahar Port
- Energy diplomacy with Saudi Arabia, UAE, Iraq

Keywords: Strait of Hormuz, Iran-Israel war 2025, dynamic pricing 2017, oil bonds, under-recoveries, PMUY, Strategic Petroleum Reserve, ISPRL, IEA 90-day norm, Padur Phase II, Bikaner-Bina SPR, Russian discounted crude, E20, E30, National Green Hydrogen Mission 2023, PM e-DRIVE, FAME II.

Price suppression is fiscally cheap in the short term and fiscally expensive in the long term — the difference between the two appears on PSU balance sheets, in delayed capex, and in deferred energy transition investment. Business Standard's deeper argument is that India's response to external oil shocks must be sequencing, not silence: phased pass-through plus targeted subsidy, transparent price-band plus accelerated SPR, crude diversification plus demand-side substitution. The shock from Hormuz is a forcing function. The question is whether India uses it to consolidate the structural energy transition or to repeat the freeze-and-absorb cycle one more time.

Source: Business Standard

● KEY ARGUMENTS AT A GLANCE

Iran-Israel war disruption in the Strait of Hormuz has driven crude oil prices higher, forcing India's state-run Oil Marketing Companies into mounting under-recoveries while the government hesitates on full pass-through; price controls are fiscally and macroeconomically unsustainable, and targeted, time-bound subsidy support — not blanket price suppression — is the right policy response.



SUPPORTING

- India imports about 85% of its crude oil; the FY25 oil import bill was approximately \$137 billion, making domestic petrol-diesel prices structurally exposed to external crude shocks and to currency movements against the US dollar.
- The Strait of Hormuz carries roughly 20% of global oil trade and 25% of global LNG trade; disruption to this chokepoint following the June 2025 Iran-Israel war episode has intensified India's vulnerability and pushed OMCs (IOC, BPCL, HPCL) into under-recovery territory on petrol and diesel sales in recent quarters.
- India's dynamic pricing regime introduced in June 2017 has been repeatedly suspended in practice around elections (2018-19, 2022, 2024), creating implicit fiscal liabilities through OMC balance sheets and reviving the discredited oil-bonds mechanism in fiscal effect if not in form.
- Strategic Petroleum Reserve coverage stands at roughly 75 days when strategic plus commercial reserves are combined, against the International Energy Agency-recommended 90-day import-cover norm; Padur Phase II and the new Bikaner-Bina SPR additions, alongside Russian discounted crude (which has risen to roughly 30%+ of India's basket from under 2% pre-2022) and ethanol blending (E20 standard achieved in 2025 and E30 notified in May 2026), are the structural hedges India is building.

COUNTER

Full and immediate pass-through during an external shock can be inflationary, regressive in distributional effect, and politically costly, particularly for lower-income households dependent on diesel-priced transport and LPG cooking fuel; a careful sequencing of pass-through with PMUY-style targeted subsidy support and a transparent price-band mechanism is preferable to either extreme of full freeze or full liberalisation.

WAY FORWARD

Adopt phased pass-through with simultaneous PMUY-style targeted LPG subsidy for vulnerable households; introduce a transparent price-band mechanism with a defined adjustment corridor like China's; accelerate Strategic Petroleum Reserve expansion toward the IEA 90-day norm (Padur Phase II, Bikaner-Bina); diversify crude sourcing further beyond West Asia; deepen ethanol blending (E30 notified May 2026), green hydrogen and EV adoption; mandate transparent OMC disclosure of under-recoveries to end the era of implicit balance-sheet subsidies.

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MAINS ANSWER FRAMEWORK
QUESTION

"Iran-conflict disruption in the Strait of Hormuz has driven crude higher while India's state-run Oil Marketing Companies absorb under-recoveries through implicit subsidies." Examine the case for greater pass-through alongside targeted, time-bound subsidy support and accelerated SPR expansion. (250 words)

INTRODUCTION

Business Standard argues that India's hybrid fuel-pricing regime — formally dynamic since June 2017 but de facto frozen during electoral cycles and external shocks — has reached a fiscal and macroeconomic breaking point following the Iran-Israel war's disruption of the Strait of Hormuz, and that greater pass-through alongside targeted, time-bound subsidy support is unavoidable.

BODY

India imports about 85% of its crude oil; the FY25 oil import bill stood at roughly \$137 billion, leaving domestic petrol and diesel prices structurally exposed to external crude shocks and to currency movements against the US dollar. The Strait of Hormuz, which carries roughly 20% of global oil and 25% of global LNG trade, is the chokepoint whose disruption following the June 2025 Iran-Israel war has driven crude higher and forced OMCs (Indian Oil Corporation, Bharat Petroleum, Hindustan Petroleum) into under-recovery territory on petrol and diesel sales.

India's response has involved alternative supply lines — Saudi Arabia's East-West Petroline, the UAE's Habshan-Fujairah pipeline and the Iraqi Strategic Pipeline reduce but do not eliminate Hormuz dependence — and a striking pivot to Russian discounted crude, which has grown from under 2% of India's basket pre-2022 to roughly 30%+ at current levels, alongside continued sanctions-impacted China-Iran oil flows in the wider market. The fuel-pricing regime itself is the structural problem.

Dynamic pricing was introduced in June 2017 with daily revisions by OMCs; in practice, prices have been frozen around elections (2018-19, 2022, 2024), creating implicit fiscal liabilities through OMC balance sheets — a return in substance, if not in form, to the discredited oil-bonds mechanism (~₹1.5 lakh crore through the UPA era). Central excise duties were heavily increased between 2014 and 2020 and partially rolled back in 2021-22; State VAT continues to create wide inter-state retail price variation. PMUY expanded LPG coverage and absorbed part of the cooking fuel subsidy burden in 2024-25. Cross-country comparison is instructive: China operates a state-controlled pricing band with adjustment within defined limits (and a ceiling around \$130/bbl); the UK and Germany pass-through fully with carbon tax additionality; the US runs a free market.

India's Strategic Petroleum Reserve coverage of about 75 days falls short of the IEA-recommended 90 days; Padur Phase II and the new Bikaner-Bina additions are the response. On the demand side, ethanol blending hit E20 in 2025 and E30 has been notified in May 2026; EVs and green hydrogen extend the structural hedge.

CONCLUSION

Price suppression is not a strategy. The right sequencing is phased pass-through with simultaneous PMUY-style targeted LPG subsidy for vulnerable households, a transparent price-band mechanism, accelerated SPR expansion toward the IEA norm, deeper crude diversification, and sustained investment in ethanol, green hydrogen and electric mobility — converting an external shock into a forcing function for the structural energy transition that India's import dependence has long demanded.

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