



MACRO ECONOMICS

How fuel prices are set

What goes into the price of a litre of petrol or diesel, and why tax is the government's main lever now

Tax rates and rules as on 16 October 2026

For training and education only. Not investment advice.

Oil firms formally set pump prices from the market; government taxes it; prices can be held for long spells.

So a pump price has two big parts: a base price that moves with global crude oil and the rupee, and taxes set by the Centre and the state. Dealer commission is a smaller third part.

What makes up the pump price



Base price

What the oil company pays for the fuel: refining, margin and freight. It tracks global crude and the rupee.



Central excise

A fixed duty in rupees per litre, set by the Centre. It is the same across the country and does not move with the price.



State VAT

A tax charged by the state as a percentage, so it rises when the base price and excise rise. Rates differ by state.



Dealer commission

What the fuel station earns per litre. The smallest of the four parts, usually a few rupees.

Excise and VAT together make up a large share of the pump price, and that share changes over time.

Source: PRS Legislative Research; HPCL published petrol price build-up (Delhi).

A litre of petrol, built up

ASSUMED FIGURES

A worked build-up for one litre of petrol.

All figures are assumed and rounded, to show the method. None is a current rate.

- 1 Base price (refining, margin, freight): ₹55.00 a litre. This is the part that moves with crude oil and the rupee.
- 2 Add central excise ₹13.00 (assumed) and dealer commission ₹4.00: ₹72.00.
- 3 Add state VAT at an assumed 20%: 20% of ₹72.00 = ₹14.40. VAT falls on the base, the excise and the commission.
- 4 Pump price = ₹72.00 + ₹14.40 = ₹86.40. Here the two taxes, ₹13.00 + ₹14.40 = ₹27.40, are nearly a third of it.

Change the tax rates or the base price and the pump price changes. Most of the movement comes from those.

Illustration: every figure here (base, excise, commission, VAT rate) is assumed, not a current rate.

From fixed prices to daily market prices

1

Administered pricing

For years the government set retail prices and shielded buyers from global swings. Oil companies absorbed much of the gap.

2

Petrol freed in 2010

Petrol was made market-determined in 2010, so oil companies, not the government, set its price.

3

Diesel freed in 2014

Diesel followed in October 2014. Both prices now move with global crude oil and the rupee.

4

Daily revision since 2017

Since 16 June 2017 prices are reviewed daily, but they can stay unchanged for long spells.

Sources: PRS Legislative Research, 'What impacts petroleum prices'; Cabinet decision deregulating diesel, 18 October 2014 (contemporary reports).

Two taxes, and why GST is not one



Central excise

Set by the Centre as a fixed amount per litre. Its special additional duty was cut ₹10 a litre in March 2026, to ₹3 on petrol and nil on diesel.



State VAT

Each state sets its own VAT as a percentage. As a percentage, the rupee amount rises when the base price and excise rise, and rates differ by state.



Outside GST

Petrol, diesel, crude, natural gas and aviation fuel are kept out of GST for now. The GST Council has set no date to include them.

The two taxes are set separately, so pump prices differ a lot between states.

Sources: MoF Notification 05/2026-Central Excise, 26 March 2026; PRS Legislative Research, on petroleum and GST.

Oil bonds: a piece of history

Older material talks a lot about 'oil bonds'. Here is what they were and why they no longer matter today.

1

What they were

Under administered pricing the government owed oil companies for selling below cost. Some of this was paid not in cash but in bonds — the 'oil bonds'.

2

When

They were issued between 2005 and 2010. About ₹1.4 lakh crore was issued; roughly ₹1.3 lakh crore stayed outstanding for years.

3

Now repaid

The last of these bonds were due to mature by 29 March 2026. The Budgets for 2025-26 and 2026-27 list none left, so they no longer sit on prices.

Sources: Union Budget 2025-26 and 2026-27, Receipt Budget, Annexure 6 (bonds due for discharge); BOOM fact-check of the 2005-10 issue.

Where things stand

Tax rules and status as on 16 October 2026. These change when the Centre, the states or the GST Council act.

EXCISE (SAED),
PETROL

₹3/1

Cut from ₹13 on 26 March 2026. Other duties apply.

EXCISE (SAED), DIESEL

Nil

Cut from ₹10 on 26 March 2026. Other duties apply.

GST ON FUEL

None

Kept out of GST; the Council has set no date to include it.

OIL BONDS (2005-10)

Repaid

Last matured by March 2026. None left in the 2026-27 Budget.

Sources: MoF Notification 05/2026-Central Excise; PRS on GST; Union Budget 2025-26 and 2026-27 receipts (oil bonds).

If you learnt this from older material

What older decks say

- The government fixes the pump price.
- Oil companies are paid in oil bonds, not cash.
- Oil bonds keep prices high for years.
- Prices change every fortnight.

What holds now

- Oil companies set prices: petrol 2010, diesel 2014.
- Administered pricing has ended.
- The oil bonds were fully repaid by March 2026.
- Prices are revised daily, since 16 June 2017.

The framework changed: market pricing, daily revision, and oil bonds now history.

Sources: PRS Legislative Research explainer; Union Budget 2026-27 receipts.

Four things people get wrong



'The government sets the pump price.'

Not formally since petrol was freed in 2010 and diesel in 2014. Oil companies set prices; the government's main lever is tax.



'Oil bonds still keep fuel prices high.'

The oil bonds of 2005-2010 were fully repaid by March 2026. They are no longer a cost sitting on today's price.



'A price rollback is a free win.'

If a price is held below cost, someone bears the gap: the oil companies, or the government through lower tax revenue.



'Petrol and diesel are taxed alike.'

Central excise differs by fuel (SAED: ₹3 petrol, nil diesel) and every state sets its own VAT, so prices differ.

Check yourself

Q1

A litre of petrol has a base price of ₹50, central excise of ₹13, dealer commission of ₹3, and state VAT of 20% on the rest. What is the pump price?

Q2

Who sets the retail price of petrol and diesel today, and since when?

Q3

What were 'oil bonds', and do they still affect fuel prices?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Petrol made market-determined in 2010, diesel in October 2014, daily revision since 16 June 2017: PRS Legislative Research, 'What impacts petroleum prices'.
- SAED on petrol cut from ₹13 to ₹3 and on diesel from ₹10 to nil, 26 March 2026: MoF Notification 05/2026-Central Excise (it had risen ₹2 in April 2025).
- Petrol, diesel, crude, natural gas and ATF kept outside GST, no date set by the GST Council: PRS explainer; Finance Minister's reply in Parliament, March 2021.
- Oil bonds of about ₹1.4 lakh crore issued to oil marketing companies, 2005-06 to 2009-10; about ₹1.3 lakh crore outstanding for years: contemporary fact-checks (BOOM, Scroll, Factly).
- Last oil-company special bonds due 29 March 2026; none due in 2026-27: Union Budget 2025-26 and 2026-27, Receipt Budget, Annexure 6.
- The petrol build-up on slide 4 and the quiz use assumed, rounded figures; none is a current rate.

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