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Iran-US & Israel War: Economic Implications for Pakistan

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Global Oil Market Dynamics & Petroleum Pricing Mechanisms

The POL (Petroleum, Oil and Lubricants) prices for end-consumers are usually announced every 15 days by the OGRA (Oil and Gas Regulatory Authority) and the Ministry of Energy (Petroleum Division). Calculations are made through a formula used by the government, which mainly takes into account international oil prices (usually Arab Gulf, at port), exchange rate (on which transactions are made), all taxes (at import stage and sale), transport cost, and dealers' margins. Landed prices include FOB price (international market price of petrol/diesel), freight, insurance, and port-handling charges. Then, the domestic Inland Freight Equalization Margin (IFEM), the Petroleum levy (currently, domestic sales tax is zero), and finally, the margins of the Oil Marketing Company (OMC) and dealer. These are normal adjustments in POL prices.

Impact of the Iran–US & Israel War on Petroleum Prices

In this extraordinary situation, the government has taken a preemptive decision to pass on the impact of the upcoming hike in international prices. The government has taken an anticipated benchmark of USD 130 per barrel to scale up the price by Rs. 55 per liter, which was the highest-ever single increase. However, contrary to the government's expectations, crude prices reached a maximum of USD 120 per barrel for a brief interval and fell back to USD 87 per barrel on March 10, 2026. Now, the question is whether this price increase was justified, or whether there were ways and means available for the government within the confines of the fiscal situation and the IMF program?

Critical Assessment of Pakistan's Petroleum Price Adjustment

First, in the aftermath of the US-Iran-Israel conflict and the blockage of a major global trade route, the global prices were expected to overshoot, as markets normally overreact. In all previous such incidents, market corrections have also been the norm, and it was evident in the last few days. Responsible governments carefully review elements of price overshooting, demand and supply, and the impact on other economic variables, and come up with the measures needed to respond to the situation.

In this extraordinary situation, the adjustment in fuel prices was inevitable. However, while passing on the huge impact to the consumers, the package must be accompanied by other adjustment measures. The absorptive capacity of the economy has to take primacy. Pakistan is the only country that passes on the entire impact immediately to end consumers, without using a cushion available in the taxation measure. The country has the capacity to store more than 45 days' worth of reserves with ease; however, it has already reduced the storage to 30 days. As of March 06, 2026, Pakistan had sufficient stocks to sustain the consumption for a few more weeks, and the price hike could have been delayed. Moreover, reportedly, OGRA has already moved a summary for another increase of Rs. 50 per liter, which seems to be based on misinformed calculations, even when the oil prices are already trending downward and have reached USD 87.

Alternative Policy Approaches to Price Management

The government of Pakistan has not packaged the adjustment among various economic agents, and the ruling elite should be seen as cognizant of the situation through its actions. The government delayed the austerity package with insignificant measures for many days, which shows an indifferent attitude. The package expects savings of Rs. 200 billion from all measures, which seems ambitious. The government has not worked out the depth and breadth of the magnitude of impact and has not explored the available cushion in the system.

The government has not evaluated its repercussions on the economy. Given the fiscal situation, a pass-through was inevitable, but only after exploring some space available in the petroleum levy. Petroleum Development Levy's (PDL) target for the current fiscal year is Rs. 1468 billion, and it is already ahead of the target as it collected Rs. 823 billion in the first half (July-Dec), providing an option to the government not to pass on the international price hike to consumers.

Economic Repercussions for Pakistan if the Conflict Prolongs

Pakistan is one of the most vulnerable countries in the region to such shocks, as its growth had just started to get strengthened after three years. Its remittance inflows are more than its exports, and more than half of them originate from the Middle East. If war is prolonged, we risk massive layoffs in the Middle East, which might result in up to a USD 3-4 billion hit to the current account. Inflation has reached 7%, even before the start of the war, and might touch double digits due to a significant price hike. Exports, which already started feeling the heat of the Afghan situation, are likely to face a severe impact, and higher POL imports may trigger an external sector crisis. Exchange rate stability is also at risk. The import-dependent power sector is facing another risk of a shortage of imported fuel supplies. This time, the shock to the economy may be greater than COVID-19 in terms of intensity and breadth.

Strategic Long-Term Options for Economic Resilience

Pakistan should consider diversifying its sources of crude oil supply beyond the Middle East, such as Russia or Uzbekistan, via the Wakhan corridor through China. Another opportunity is to consider a barter window at the Iranian border. In the future, Pakistan will have to shift demand for fuel to electricity on the pattern of China, where all two- and three-wheelers operate on electricity, and a significant portion of cars and buses have shifted to electricity.

Almost all conservation policies have failed in Pakistan in the past. The government is required to motivate civil society, opinion makers, the media, and the public at large for an effective conservation strategy. The transport sector usually consumes 50-60% of petroleum products in Pakistan, and strategies where collaboration is required are public transport expansion, carpooling and ride-sharing, fuel-efficient vehicles, shifting buses and two- and three-wheelers to electricity, as well as stringent fuel economy regulations for all types of vehicles. A social campaign for ride-sharing, especially during office hours, may be helpful to some extent. In Urban areas, the weak transport system is also an impediment. The media has to allocate time for public service messages on conservation.