

# Opinion

SATURDAY, SEPTEMBER 23, 2017

## Rational Expectations

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## Did Modi kill the Indian economy?

Many actions hit GDP but detractors ignore how bad it was in 2014 or that GST is as destabilising as DeMo in short run

**S**O DID PRIME minister Modi kill the economy by following up demonetisation with GST as many suggest? Even if the government does not agree with former prime minister Manmohan Singh's prediction of a DeMo-induced disaster, the fact that it is talking of the need for a stimulus package means it agrees the economy is sluggish and that jobs are not getting created.

There are, however, many caveats. The economy was slowing when Modi took over and with inflation at 9.4% and the fiscal deficit at 4.5% in FY14, India's macros were poor (see graphic). Investment, which was growing at 16% in FY08, fell to 1.6% in FY14, private consumption slowed from 9.4% to 7.3% and government expenditure from 9.6% to 0.6%. Also, India was knee-deep in the twin balance sheet problem—both bank and corporate balance sheets were deeply in red—and getting out of this takes at least 5-6 years as the global experience shows.

None of this is to say Modi didn't make major mistakes, he did. This newspaper has catalogued his wasted three years in fixing telecom, gas-pricing, freeing agriculture—this aggravated the rural crisis, and prolonged the slowdown in a big way—and poor progress in reforming labour laws or genuinely easing business or resolving the Pranab-era retrospective taxes... Indeed, Modi went the other way by imposing more controls in drugs pricing and even cotton-seeds and in creating bigger PSUs instead of privatising them... Even simple solutions such as the apparel package crafted by chief economic advisor Arvind Subramanian took forever to put in place.

Yet, there has been good progress in fixing subsidies other than food, and even in that case, there is some progress. The pro-poor measures like JanDhan accounts, direct benefit transfers and low-cost life/accident/crop insurance are by all accounts a success. And at a time when there were few growth drivers, it was prudent budgeting that saw the government raise petroleum taxes and use the money to dramatically hike government capex in roads/rail—though Suresh Prabhu had to resign due to railway accidents, he began major reforms. In FY14-17, thanks to inflation collapsing, nominal GDP has slowed from 13% to 11% but tax-GDP still rose from 10.1 to 11.2, very unusual in low-growth periods.

While most macros like inflation or the twin deficits improved under Modi, it goes beyond good luck with lower global inflation—by that logic, the go-go years of the UPA were surely influenced by high global growth. Exports growth that averaged 26.4% in FY05-08 played a big role in the average GDP growth of 9.1%—in FY14-17, exports contracted 3.8% on average. The role of RBI in keeping interest rates high—and thereby the rupee getting stronger—is also a big factor in sluggish GDP growth as it restricted local production and encouraged greater imports. Modi is guilty of accepting inflation-targeting (IT) that made RBI have this way, but IT was pushed by the UPA.

There can be little doubt that demonetisation added to the problem by badly hitting supply chains, especially in the informal sector, and it could be years before they revive, if at all—this is Manmohan Singh's point. Demonetisation hit the real estate sector the most since that was a large user of black money, and this has large implications for jobs creation as well—along with the new RERA rules, though, reforming real estate will be a big plus if it makes housing affordable in the medium-term.

But, at a fundamental level, demonetisation and GST are not too different in their impact on the cash-rich informal sector—in both cases, informal sector units have no option but to get into formal chains and start paying taxes and, as happens with greater formalisation, pay higher wages, etc. Bringing in GST so soon after demonetisation surely accelerated the pain but which politician, including Manmohan Singh, has not been pushing for GST for years due to its long-term benefits? And we can quibble about the timing, but GST had to be brought in 2-3 years before the elections so that the pain associated with it was absorbed over time. That is, if DeMo hadn't hit the informal sector, GST would have, albeit at a more gradual and more manageable pace.

Once DeMo or GST were brought in, MSMEs lost their tax-arbitrage-driven USP. The only way to fix this was to raise their efficiency—that requires big reforms in labour rules, tax policies... what are called ease-of-doing-business (EoDB) rules. Modi's failure is that he felt EoDB had been fixed and was unwilling to accept any criticism of this. Nothing cures hubris better than a slowing economy though Modi's 2019 plank will be more money in the hands of the poor and much lower inflation.

## Linking DBT

The ICDS experiment should prompt the govt to replace the inefficient FCI-MSP-PDS system with DBT

**A**NITI AAYOG report points out that leakages and poor-quality food supplements plague the Integrated Child Development Service (ICDS) scheme, eroding its efficacy. Against such a backdrop, the Union women and child development ministry's proposal that take-home rations distributed at *anganwadis* centres be replaced with direct cash transfers makes eminent sense. Under ICDS, some 4.6 children below the age of three years and 1.9 crore pregnant/lactating women get rations to curb child and maternal mortality, child malnutrition and stunting. As per *The Indian Express*, the ministry will mount the pilot in 300 most backward districts. Replacing the rations with cash transfers will not only weed out leakages, it will let beneficiaries pick better supplements from the market. It remains to be seen, though, if the daily entitlement—₹8 for a child, ₹9.30 for a pregnant/lactating woman and ₹12 for a severely malnourished child—proves adequate.

The bigger issue, though, is that of expanding direct benefit transfer (DBT) to public procurement and subsidised distribution of food grains. It has to replace the FCI—minimum support price (MSP) based model, focused mainly on wheat and rice procurement, and that too from largely just Punjab and Haryana. While there is a need to shift to a composite per hectare cash transfer for farm subsidy, the government must also do away with the PDS and give transfers to beneficiaries. Madhya Pradesh's experiment, of transferring cash to farmers to offset the gap between MSP and market prices realised can be eventually direct policy towards shutting down the inefficient FCI-PDS model. Shifting to DBT will save more than ₹40,000 crore a year; that should prod the government to take this political risk.

DOES NCLT HAVE THE POWER TO LOOK INTO TRANSACTIONS BETWEEN CREDITORS, WHEN UNDER THE IBC, IT CAN ONLY LOOK AT QUESTIONS OF PRIORITY OR ANY QUESTION OF LAW?

## First resolution plan throws up points to ponder

**T**HE UNDERLYING OBJECTIVE of the IBC (Insolvency and Bankruptcy Code) is to revive and restore a company or liquidate it. The first insolvency plan approved by the National Company Law Tribunal (NCLT) in the *Synergies Dooray* case, has thrown up some key legal and financial issues. These need to be monitored as they would determine whether the IBC is a success.

Among the key observations of NCLT is that proceedings before it are summary proceedings and, in effect, the NCLT cannot examine the aspect of *mens rea* and see whether the provisions of the IBC have been complied with in the true spirit.

The creditors included Edelweiss Alchemist Asset, MFL (Millennium Finance Limited) and SCL (Synergies Castings Limited). Edelweiss challenged the resolution process, arguing principally that despite being one of the largest financial creditors of Synergies Dooray, its voting rights in the committee of creditors came down drastically because of an assignment agreement entered between SCL and MFL with the alleged ulterior motive of reducing the voting share of Edelweiss.

The IBC provides that a related party to whom a corporate debtor owes a financial debt shall not have any right to representation or vote in a meeting of committee of creditors. Thus, Edelweiss's principle challenge was that SCL being a related party to Synergies Dooray, would not have any right to vote and it entered into an alleged *mala fide* assignment agreement with MFL to transfer all its debts and reduce the voting share of Edelweiss in the committee of creditors. It was further argued that since the debts have been assigned by SCL to MFL, MFL should also be considered as related party for the purpose of IBC.

The NCLT dismissed Edelweiss's claims and noted that the resolution process adopted by the RP (resolution professional) complied with provisions of the IBC and

the assignment agreement was entered following the process of law. The Tribunal also made some interesting observations wherein it noted that proceedings before it, under the IBC, are summary proceedings. Thus, the aspect of *mens rea* cannot be raised before it in an IBC proceeding. It further noted Edelweiss has no *locus standi* to question the various rights which accrued to MFL under the assignment agreement of which it was not a part.

Another interesting observation was that the entire assignment of debts between SCL and MFL can be said to be similar to tax planning rather than tax avoidance. In effect, NCLT has blessed such arrangements between the creditors. However, NCLT, while allowing the resolution plan, passed a direction in relation to payments between SCL and MFL asking them to establish the *bona fide* nature of the transaction between SCL and MFL.

The claims of the financial creditors *qua* the corporate debtor, i.e., Synergies Dooray, were: Alchemist Asset (₹122.06 crore), Edelweiss (₹86.92 crore), MFL (₹673.91 crore) and SCL (₹89.26 crore). While the RP came up with a resolution plan which was approved by 90% of the creditors, the following were the payment amounts to the financial creditors: Alchemist (₹6.86 crore), Edelweiss (₹4.89 crore) and Millennium Finance (₹37.91 crore). These payments are to be made over a period of three years.

Indian companies are generally promoter-driven and the buy-in of the promoters, in the entire resolution process, may become key. Since the vote-share is based on value of debt, there can be situa-

tions wherein the promoter company/related-party transfers a large portion of its debt to a financial creditor with the intent of participating in the creditors meeting while subverting the embargo of the related party put in by the IBC.

The resolution plan approved by the committee of creditors of Synergies Dooray was that the payment to operational creditors would be made on a staggered basis post the completion of payment to the financial creditors.

*Per contra*, the NCLT, while approving the resolution plan, noted the debt owed to operational creditors should be paid first before making payments to other financial creditors considering the quantum of debts involved.

This decision is interesting. An operational creditor does not form part of the committee of creditors (except in a rare case where the corporate debtor does not have any financial creditor). It is plausible that the committee takes care of its interests first before considering the interests of other creditors.

There may be cases where an operational creditor had initiated the action under Section 9 of the IBC but is not a part of the resolution plan. The issue of whether operational creditor is a necessary and proper party in a resolution process will also be tested in the future. In a resolution

plan they are assured of repayments not less than the amount they would have received had the company gone into liquidation under the waterfall mechanism provided under Section 53 of the Act.

The NCLT also noted that the minority creditor cannot super impose or scuttle the process of entire resolution plan. The jurisprudence of the minority creditor in the IBC process will evolve over time especially in cases when the genuineness of the transaction between creditors is called into question.

The key issues would be: does NCLT have the power to look into transactions between creditors especially when under the IBC, the NCLT can only look at questions of priorities or any question of law or facts arising out of insolvency resolution and not any issue emanating from an *inter se* agreement between the creditors? What is the nature of proceedings before NCLT and NCLAT in an IBC proceeding? Can a creditor assail an arrangement between creditors of which it is not a party of, even if it is affected by such arrangement? Can the NCLT/NCLAT look into transaction which involves a related/group company and lift the corporate veil, if required?

In this case, the lenders had to take a staggering haircut of more than 90% on their original outstanding amount. While resolution and restructuring is the key, one must watch to see whether creditors see value in any corporate debtors, especially in cases where the RBI has directed the banks to approach NCLT to resolve the pending dues from loan defaulters to allay the NPA situation. Some of the loans to the said corporate debtors may have turned non-performing despite previous restructuring.

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## LETTERS TO THE EDITOR

### Why the bonus for Railways staff?

Apropos of "Railways staff to get big bonus: Cabinet clears PLB equivalent to 78 days wages; move to cost ₹2,245 cr" (*FE*, September 21), it is ironic that the government of the day is handing out bonuses to 'motivate' the workers of the Indian Railways. Are they not being paid enough to perform their duties? Was there any justification for such generosity on the part of the government? More so when the Railways is under tremendous financial strain and there have been an unprecedented number of train accidents in the space of just days recently? If the Railways staff members were really doing their job efficiently, how come such a large number of train accidents took place in such a short span of time, all attributable to the human errors? One fails to comprehend the rationale behind the government's keenness to grant Railways employees "productivity linked bonus". One is genuinely interested learning what methodology was used for assessing their productivity in the given situation.

—Kumar Gupta, Panchkula

### Stop stubble-burning

This is with reference to the edit 'Cropped solution' (*FE*, September 21). Yet again, there is another proposal to dole out subsidies and incentives to farmers to stop a practice that has its roots in tried and tested, age-old practices of convenience. The proposal of the Punjab CM is flawed because how is the state machinery to keep track of those who did not practice stubble-burning. It would again lead to unchecked subsidies, corruption and worsening of state finances. The state should instead focus on teaching and implementing the usage of newer technologies. Stringent pollution checks should be mandated. The world over, major tech advancements have been made in the field of farming and it is a matter of shame that we are struggling with stubble-burning.

—Gaurav Gupta, Hyderabad

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## FM FLAGS NPAs AS CORE CONCERN

Finance minister Arun Jaitley

The major challenge of the banking sector has been the increasing number of stressed assets. I think it is this which is really the core area of concern today

## NPA RESOLUTION

**ABIR ROY**

Partner  
Lakshmikumaran & Sridharan



## Merkel's bold vision for Germany can wait

There's a German philosophy to Merkel's lack of vision, and that, as much as Germany's economic prosperity, will win her the polls on Sept 24

**GERMAN CHANCELLOR ANGELA** Merkel is often accused of refusing to lead. Many inside and outside her country would like her to be the leader of the free world, to suggest bold concepts and make decisive moves. But there's a strong, very German philosophy to Merkel's lack of vision, and that, as much as Germany's economic prosperity, is winning her the September 24 election.

"Whoever has visions should go see a doctor," Helmut Schmidt, a revered German chancellor, said in 1980, though he later described the phrase as "pompous". It can be argued that postwar German leaders, despite their country's reduced global standing, often had grand visions. Schmidt himself dreamed of a nuke-free world. Willy Brandt thought he had figured out peaceful coexistence with the Communists world. Helmut Kohl worked tirelessly toward German reunification. Merkel has had her visionary moments, too, with Germany's determined move to non-nuclear sustainable energy and with the decision to let in more than a million asylum seekers in 2015. But in the 2017 campaign, Merkel appeared to act out Schmidt's maxim. She offered no bold scenario for the future, no aspirational goal.

Perhaps the closest she came to setting out a vision was a year ago, as she presented this year's budget in parliament. Germany, she said, has seen a lot of change since World War II, and "change isn't a bad thing". But she also vowed to defend the status quo in the broadest sense of the term: "Germany will remain Germany, with all that we love and hold dear about it."

This promise was made at the height of the country's panic about the mass immigration. But it reflected a more complicated conviction: In Germany, the more things change, the more they stay the same. Merkel seized upon that feeling for her campaign slogan, too: "For a Germany in which we live well and love living."

The campaign was fuelled by an uncharacteristic nationalism. Unlike in pre-

vious elections, Merkel's Christian Democratic Party (CDU in German) used the colours of the German flag in election posters. Merkel and another prominent CDU politician, interior minister Thomas de Maiziere, published their takes on the German identity in the nation's most popular tabloid, *Bild*. It is tempting to write this off as a tactical move meant to prevent the far-right party, Alternative for Germany (AfD in German), from occupying the nationalist ground. But Merkel bases her take on identity politics in a strikingly different way.

The AfD's version of patriotism is closely related to the notion of *Vaterland*, which students of the German national identity Elizabeth Boa and Rachel Palfreyman described as the masculine idea of homeland, the country for which soldiers die in a foreign field. "Courage for Germany" is one of the party's slogans. One of the AfD's lead candidates, Alexander Gauland, recently asserted a "right to non-nuclear sustainable energy and with the decision to let in more than a million asylum seekers in 2015. But in the 2017 campaign, Merkel appeared to act out Schmidt's maxim. She offered no bold scenario for the future, no aspirational goal.

But the "stunning historical persistence" noted by researchers Davide Cantonmi, Felix Hagemeyer and Mark Westcott in the AfD voting patterns speaks to Merkel's point: The more things change, the more they stay the same. Merkel's subtle counterweight to the *Vaterland* patriotism of the AfD is what Boa and Palfreyman interpreted as the feminine version of German identity, *Heimat*, the nurturing place one calls home.

Merkel doesn't use the word in speeches: It became tainted during the Nazi era, when the official propaganda equated it to *Vaterland*. But the way she

sees Germany is in line with that notion. That's obvious from the ABC of all things German she published in *Bild*. *Heimat* is deeply regional and local (the Nazis misused the term when they applied it to the country as a whole), and Merkel's list is full of the joys of local life—regional festivals, small-town newspapers, garden plots. The flag, the military and the constitution are there, too—how could they not be—but most of the list consists of what makes Germany a place of comfort.

The original philosophy of the *Heimat* notion, developed in the 1920s (before it got commingled with ethnic nationalism) allowed for people to find a new *Heimat* to embrace in a deeply personal way. That is an important part of the CDU approach to immigration: Newcomers are supposed to accept the German *Leitkultur*, or "leading culture".

The consensus about the current election campaign is that Merkel ran it in a minimalist style to avoid obvious errors, hoping to coast to victory on the tide of good feelings about the economy. There's a lot of truth to that. If you ask Germans whether there is a local version of the American dream, they may refer self-deprecatingly to an old ad for the Sparkasse, the network of savings banks: "My house. My car. My boat. My wife." But there's a non-economic side to this desire for comfort—the pride in the land that provides it. Merkel made a subtle appeal to a different version of German patriotism than the one espoused by AfD. It is conservative and seemingly unambitious, but if it were otherwise, it probably would not have been such a perfect alternative to the radicalism of the far right.

In her quiet way, Merkel is winning an ideological battle, not just exploiting prosperity. It may not mean much for the outside world, but it's important domestically. Bold vision would have gotten in the way this year. There will be time for it later.

**LEONID BERSHIDSKY**

Bloomberg



● THE STATE OF DEMOCRACY

# Why we need political parties

Almost a decade since the start of the financial crisis, economies are on the mend—but politics are not

**MOISÉS NAÍM**  
NYT

**IN LESS THAN A DECADE**, the world went from worrying about financial crashes to worrying about crashing democracies. Starting in 2008, we were distressed over which economy would topple next, or whether the next banking crisis would wipe out people's savings. Yet the Great Recession was not as prolonged as we feared—the hardest-hit economies have recovered, or are in the process of doing so.

What has not returned to pre-crisis mode is politics. Today political parties—essential to strong democratic systems—are becoming something of an endangered species.

The aftermath of the economic downturn paved the way for the success of non-traditional political leaders like Donald Trump and made viable some once-unimaginable ideas, like Brexit.

Long-standing trends also took a stronger hold in the West. As salaries stagnated, or even declined in the United States, Britain and other economically advanced democracies, the embattled middle class blamed automation and globalisation. Immigration and international trade were seen as costly downsides to international integration.

Surprisingly, even emerging markets with fast-growing economies and stellar records of lifting people out of poverty, like Brazil, faced challenges from angry populations disappointed with their governments and empowered by social media and other new technologies.

In developing countries, it is common for people's expectations to grow at a faster pace than the capacity of the state to meet them. Money is always short, and public institutions are often ineffective. So even though the lives of hundreds of millions of people in Asia, Latin America and Africa are improving, that doesn't mean that people are content. And it has become clear that economic progress and prosperity do not always buy political stability.

The global wave of political anger sweeping many rich and poor countries alike is also fed by a new-found impatience with corruption.

In the last decade, societies in which corruption used to be treated as a fact of

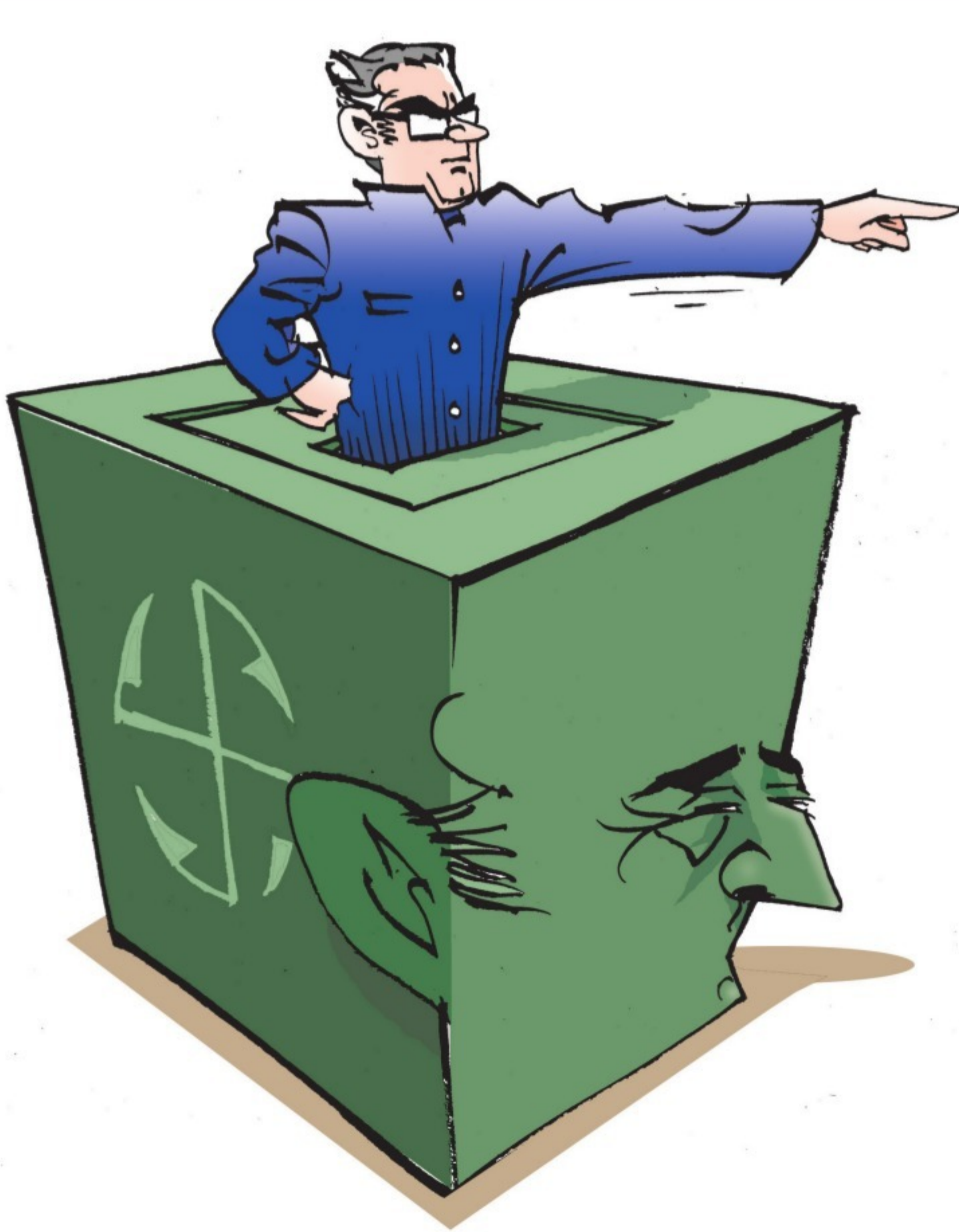


ILLUSTRATION: ROHNIT PHORE

life developed a strong intolerance to official thievery and ousted once-untouchable politicians. In Brazil and India, Russia and Spain, people took to the streets to denounce corruption by the powerful.

And too often those in power were also leaders of traditional political parties. When such leaders are caught stealing, it becomes another stain on parties, whose prestige and allure have been steadily waning. These days, political parties are seen not as natural habitats for idealists but for fast-talking and often hypocritical opportunists and careerists.

The disdain for politics as usual—and therefore for parties locked in the status quo—is intense, widespread, global. This is why anti-politics, the rejection of traditional politics and its practitioners, is such a popular instinct today.

The case of Tiririca vividly illustrates why. In 2010 Fiver Silva, known professionally as Tiririca the clown, ran for a congressional seat in Brazil, campaigning in costume. His message was honest and straightforward: "I don't know what a representative in Congress does, but if you send me there I will tell you." He also explained that his goal was "to help people in need in this country ... but especially my family."

At the time, it was easy to dismiss Tiririca's run as an extreme anti-political gesture that could happen only in a rowdy young democracy like Brazil's. But not for long. The sentiment that propelled Tiririca to victory is similar to that which drove the political success of the comedian Beppe Grillo in Italy, or that of Mr Trump, a reality TV show host.

Both men were able to undermine the power of dominant parties. While Mr Grillo's Five Star Movement sought to displace Italy's political machine by positioning himself as a radical outsider, Mr Trump took on traditional politics as a radical insider, staging a hostile takeover of the Republican Party.

Mr Trump's appeal to "drain the swamp" in Washington. Mr Grillo's scorching denunciation of the "caste" that in his view ran Italy to the ground. Demonstrators' banners in Brazil imploring voters to "throw them all out." These

examples resonate in similar ways.

These days, calls for a new political order usually require the ouster of political parties and elected leaders, and in many cases that is the correct call. Corrupt and ineffectual organisations need to be replaced by effective ones.

Yet many activists harbour the misconception that the answer lies in non-governmental organisations, or in loose, non-hierarchical movements.

Democracies, however, need political parties. We need permanent organisations that earn political power and govern, that are forced to articulate disparate interests and viewpoints, that can recruit and develop future government leaders and that monitor those already in power.

Political leaders need to have a stance on preschool education and nuclear weapons, healthcare and agriculture, and

have well-articulated views on fighting terrorism and regulating banks, among myriad other policy issues. And political parties are the training camps of these leaders.

To survive, political parties must regain the ability to inspire and mobilise people—especially the young—who might otherwise disdain politics or prefer to channel whatever political energy they have through single-issue groups. Parties must be willing to overhaul their structures, mindsets and methods to adapt to a new world. We also need to bring party renewal to the foreground in our discussion of contemporary politics.

In the decade since the financial crisis, almost everything we do—eating, reading, shopping, dating, travelling and communicating—was disrupted by new technologies and innovation. Everything, that is, except the way we govern ourselves.

We need a disruptive innovation that pulls democratic parties into the 21st century.

*(Moisés Naim is a distinguished fellow at the Carnegie Endowment for International Peace, Venezuela's former minister of trade and industry, and an author, most recently, of The End of Power: From Boardrooms to Battlefields and Churches to States, Why Being in Charge Isn't What It Used to Be.)*

**Political parties are becoming an endangered species. In fact, the aftermath of the economic downturn paved the way for the success of non-traditional political leaders like Donald Trump and made viable some once-unimaginable ideas, like Brexit**

DATA DRIVE

## Burning question

**EVEN THOUGH GLOBAL OIL PRICES** have halved since June 2014, retail prices of petrol and diesel in India have remained more or less unchanged since then. High central and state taxes have offset any easing of prices that could have been possible because of the reduction in crude prices.

For instance, in Delhi, the central excise duties and state VATs comprise around 52% of the retail price of petrol and around 44% of diesel's. VAT rates vary across states, from 20% in Mizoram to as much as 48% in Maharashtra on petrol. In case of diesel, it varies between 12% in Mizoram and 38% in Madhya Pradesh.

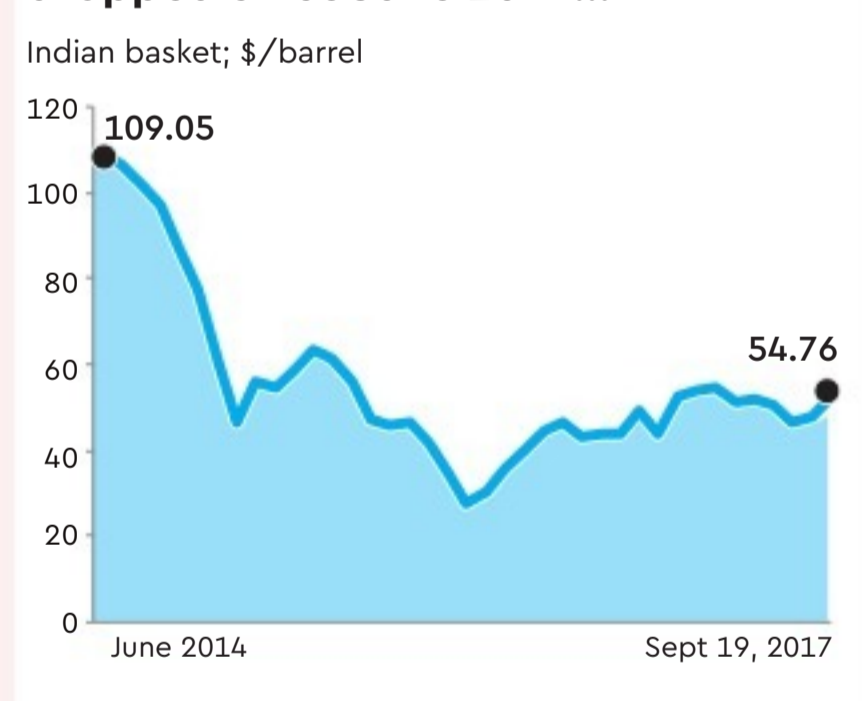
While the central taxes are on the basis of

"per litre (specific)", state taxes are ad valorem and would tend to increase the final retail price when the base crude oil price changes. At a time when the economy is slowing, part of the money collected by the government via taxing petro products is being utilised to fund capital expenditure, especially for building roads and welfare projects in the country.

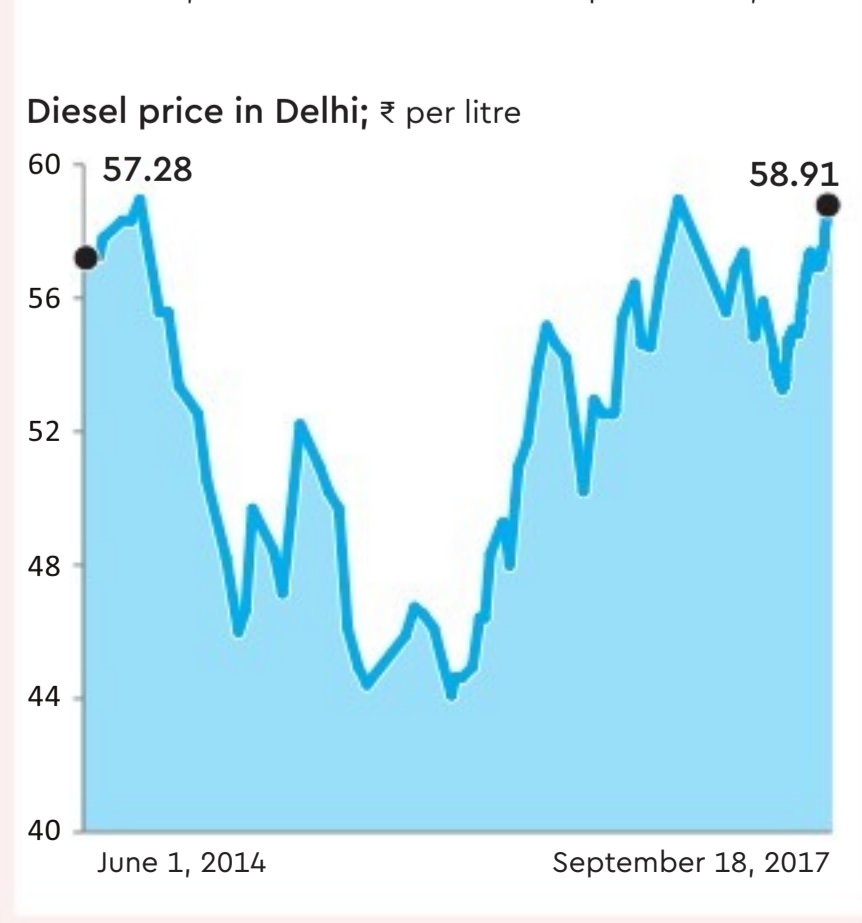
A uniform, pan-India tax mechanism will benefit people. In fact, oil minister Dharmendra Pradhan has requested the ministry of finance to bring petroleum products under the ambit of the Goods and Services Tax (GST). At present, only petro-products like LPG, naphtha, butane/propane, petroleum coke have been brought under GST.



### While global oil prices have dropped since June 2014...



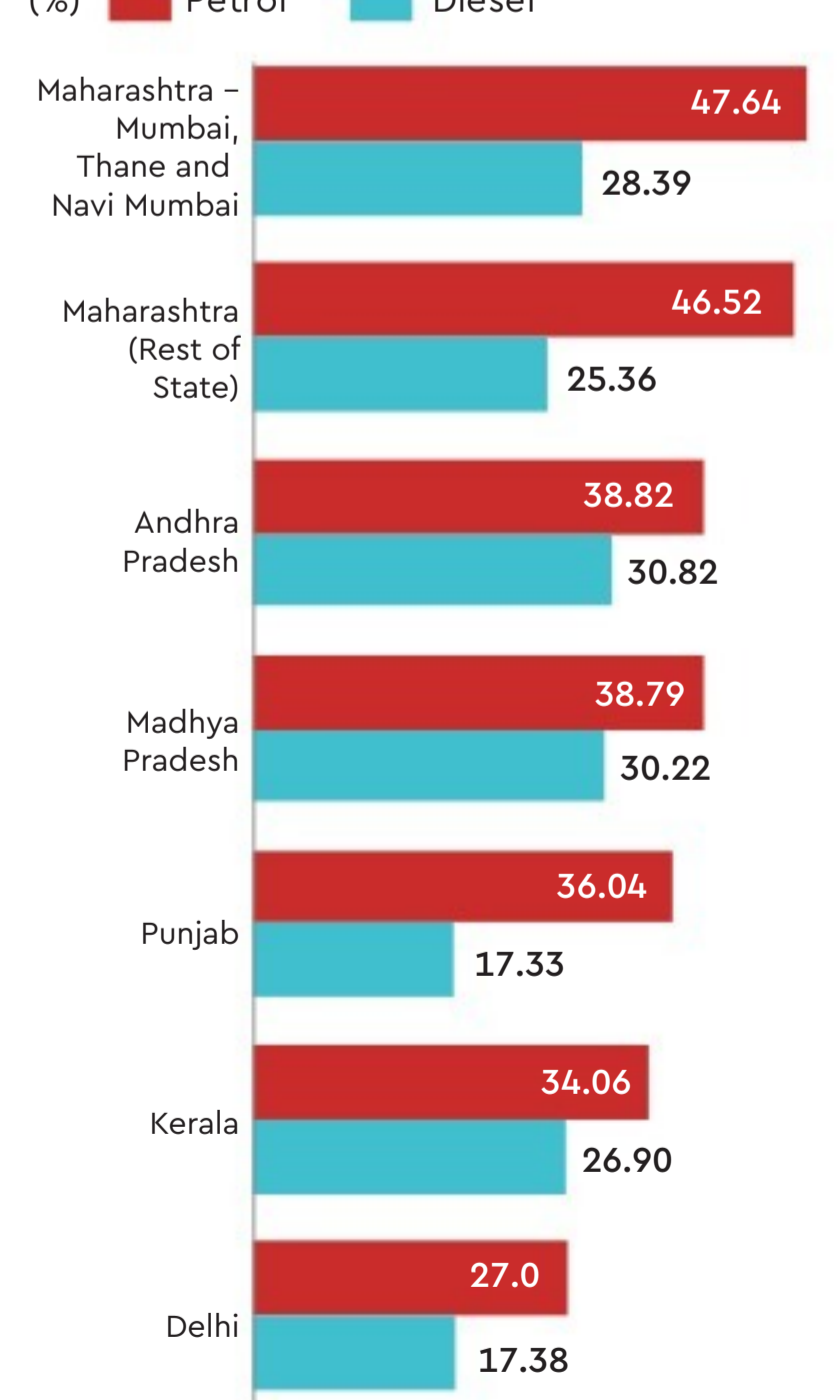
### ... retail prices of petrol, diesel have risen in India



### Taxes add to the price of oil in the country

Category	Price Range (₹/litre)
Central taxes	
Petrol	₹21.5 - 22.7
Diesel	₹17.3 - 19.7

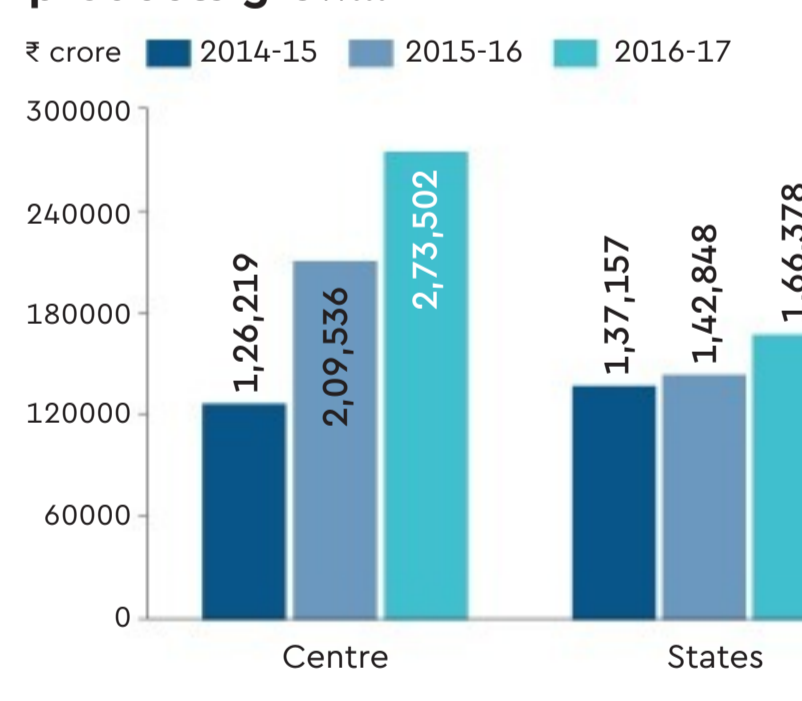
### State sales tax



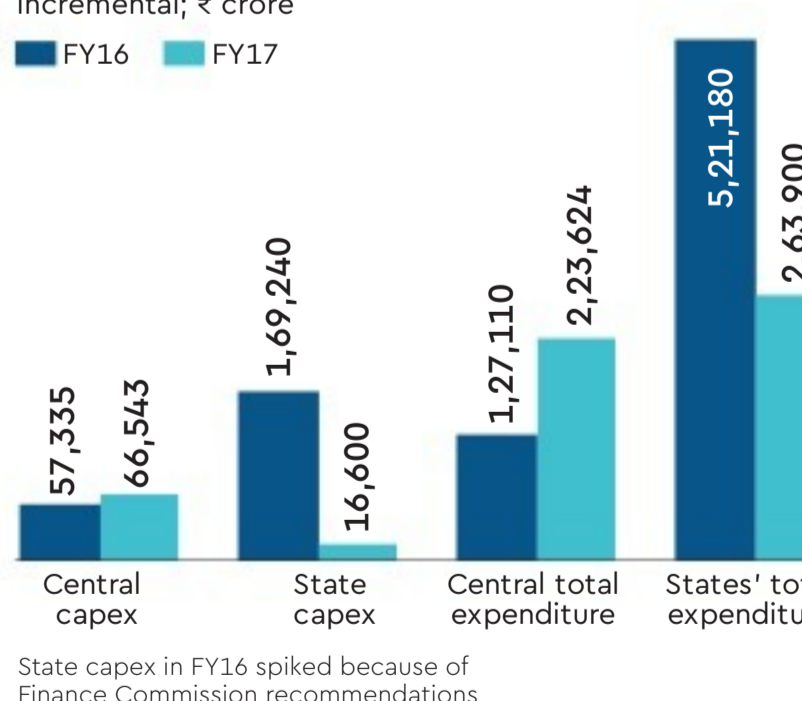
### Price build-up for petrol in Delhi

Trade parity landed cost	27.61
Marketing, freight, margin	2.8
<b>Price to dealers</b>	<b>30.41</b>
Excise	21.48
Dealer commission	3.57
VAT in Delhi at 27%	14.97
<b>Final price</b>	<b>70.43</b>

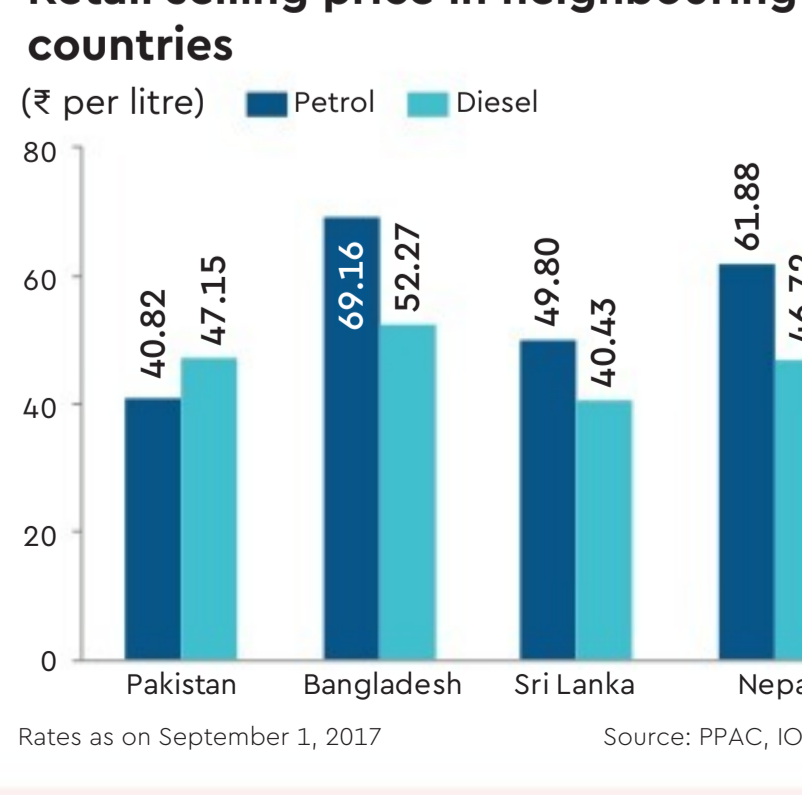
### While tax collections on petro-products grew...



### ...govt used a part of it in capex



### Retail selling price in neighbouring countries



Rates as on September 1, 2017. Source: PPAC, IOC