Competition Distortions in India – A Dossier

(CDI-32: April–June, 2016)

For earlier Dossiers please see: http://cuts-ccier.org/Competition_Distortions_India.htm

Periodic dossiers look at the interface of policy issues which have an impact on competition in India. Such impact could be negative, positive or mixed, depending on sectors and markets. In these dossiers, news as published is used without verifying its accuracy. The purpose is to flag issues to the layman as well as to the policymakers and specialised regulators, rather than pass any opinion. That would require greater analysis, particularly in terms of cost and benefits.

We are pleased to present to you the Competition Distortion Dossier Edition No: 32 for the quarter April-June 2016. As always, we have attempted to capture interesting stories ranging from trade, anticompetitive practices, reforms and developments in various economic sectors and industries. The stories reflect a mixed bag of both good and bad policies and decisions affecting the economy.

The theme for current issue is level playing field, and its importance. We have selected stories of lack of uneven playing field between: foreign and domestic suppliers; manufacturers of components and final products; products meant for domestic consumption and export; products exported by different countries; different modes of transportation of goods; and domestic and foreign investors.

The justification provided for preferential treatment has been pointed out and potential direct and indirect adverse consequences of consequent reduction in competition have been highlighted. It must be noted that competition is key to promote consumer and producer welfare in any market, and might be suppressed only when overwhelming considerations in public interest exist.

Impact of such competition limiting policies should be periodically studied and these policies should be implemented for a limited time period only. The government should also think of alternative policy options to achieve its objective with minimal adverse impact on competition.

However, at times, other countries might provide unfair incentives to promote their exports. In such cases, providing incentives to domestic industry or imposing duties on imported products might be justified, to create a level playing field.

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A. Trade Policy

1. Government rationalises duty on cellphone components

The Central Board of Excise and Customs (CBEC) has issued a notification amending the import duty on key mobile phone components such as headsets, batteries and chargers to 12.5 percent, bringing it at par with the duty of the full mobile phone package. The Budget 2016 proposals had resulted in duty structure with high duty of 29.44 percent on key parts like batteries, chargers and headsets compared to complete mobiles which were subject to low duty of 12.50 percent.

http://indianexpress.com/article/business/business-others/govt-rationalises-duty-on-cellphone-parts-industry-lauds-move-2788310/

Food For Thought

This is another case of inverted duty regime which the government wishes to clean up. *The 2016 Budget had toyed with the idea of differential import duty regime, with mobile phone components attracting higher duty when compared with full mobile phone package. The objective seemed to be promotion of domestic mobile phone component manufacturing industry. However, such move had the potential to increase the cost of manufacturing of complete mobile phone packages.*

As a result, the government has rolled back its budget proposals and created a level playing field between mobile phone and component manufacturing industry. While such rationalisation will enhance competition within the component industry, such competition should increase efficiency and reduce costs.

It has been suggested that the rationalisation of import duty regime will create the ecosystem for mass manufacturing of both mobile phones and components in a balanced way contributing to Make in India. Economies of scale, reduced cost, and increased efficiency in sector, will benefit consumers of smart phones as well as basic feature phones.

2. Railways removes dual freight for iron ore transport

The Indian Railways has abolished the dual freight rate policy for transportation of iron ore. Currently, transportation of iron ore meant for exports attracts a freight rate that is ₹300 per tonne higher than the rate for domestic use in steel and cement industries.

http://smartinvestor.business-standard.com/market/Marketnews-383300-Marketnewsdet-Railways_abolishes_dual_freight_rate_for_iron_ore_transport.htm#.V39OXtJ97IV

Food For Thought

Currently, transportation of iron ore meant for exports attracts a freight rate that is ₹300 per tonne higher than the rate for domestic use in steel and cement industries. The dual freight rate policy had resulted in diversion of stocks by unscrupulous traders. The Comptroller and Auditor General of India had observed that the government had incurred a loss of ₹29,000 crores due to dual freight rate policy over five years.

The government has decided to abolish the dual freight rate policy and introduce level playing field between iron ore and iron ore pellets meant for exports and domestic use. This is expected to boost freight traffic volumes, introduce transparency and meet the long standing demand of industry for abolition of dual rates.

The abolition of such policy is expected to increase competition between domestic and foreign consumers of iron ore and iron ore pellets. The competition between iron ore producers is also likely to improve and the cost of supervising compliance with the policy is expected to reduce. Consequently, the move is expected to benefit the consumers.

3. Removal of export subsidies on cotton to benefit exports

In the Nairobi Ministerial of World Trade Organisation (WTO), organised in 2015, developed countries made a commitment to immediately eliminate export subsidies. Developing countries were required to do so by January 01, 2017. This is expected to create level playing field between farmers of different countries.

http://articles.economictimes.indiatimes.com/2016-04-28/news/72674924_1_export-subsidies-cotton-level-playing-field

Food for Thought

Export subsidies are usually used by countries to promote international competitiveness of domestic players. While such measures do not distort domestic markets, they often put exports from other countries at a disadvantage.

To avoid such negative impacts, WTO members decided to do away with such measure in the cotton market. While developed countries resolved to immediately cease providing such benefits to local exporters of cotton, developing countries were given a transition period of around two years.

The elimination of export subsidies is expected to create level playing field in the market, enhance efficiency, and thereby boost consumer and producer welfare.

4. Government not considering more steps to check steel import

The Ministry of Commerce & Industry had imposed a minimum import price to check imports of cheap steel in the country. It has clarified that it is not envisaging any additional measure to check such imports.

http://articles.economictimes.indiatimes.com/2016-04-04/news/72041238_1_steel-ministry-certain-steel-products-steel-import

Food for Thought

Minimum import price (MIP) is a measure adopted by governments to protect and promote domestic industry. It disincentivises consumers to rely on imports and encourage shift to domestic suppliers.

The MIP imposed by the government on steel imports is for a limited period of six months. The government does not intend to impose any further restrictions on import. Such moves show the commitment of government to limit the adverse effects of restricting competition. It also highlights government's resolve to create a level playing field between domestic and foreign suppliers of steel. Competitive neutrality in the market is essential to improve efficiency, reduce costs and promote consumer interests.

At the same time, government would have to carefully balance the requirement to promote domestic industry with need to enhance competition and ensure playing field between domestic and foreign market players.

5. Levy anti-dumping duty on imported solar power plant parts

The Indian Solar Power Development Forum (ISPDF) has taken up the cause of promotion of domestic solar power industry and demanded the government to impose anti-dumping duty on the imported solar plant parts. It has also called for exclusive bidding rights for domestic industry for a part of tenders.

http://epaperbeta.timesofindia.com/Article.aspx?eid=31810&articlexml=Levy-anti-dumping-duty-on-imported-solar-plant-15052016005004

Food For Thought

Indian solar power plant industry has been dominated by foreign suppliers from China and Malaysia. Indian manufacturers have not been able to compete with the low priced products offered by their foreign competitors. The WTO dispute settlement panel recently ruled that India cannot discriminate between foreign and domestic suppliers of components for solar panels used by solar power developers in India, and thus it cannot insist on domestic content for setting up of solar power plants.

As a result, the ISPDF has called for imposition of anti-dumping duty on imported solar plant parts and exclusive bidding rights for part of tenders. Anti-dumping duty is typically imposed when other countries provide unfair incentives to promote export of specific products. Such incentives lead to products priced below fair market value, thus creating uneven playing field between such exported products and their local competitors in the target countries.

There is a need to assess if imposition of anti-dumping duty and other similar measures are necessary to enable fair competition between domestic solar power plant manufacturing industry and the foreign competitors.

Achieving of level playing field between domestic and foreign suppliers will be necessary to promote fair competition and efficiency in the market, which eventually will result in producer as well as consumer welfare.

B. Sectoral Reforms

6. Government-funded power projects must use domestic parts

The Central Electricity Authority (CEA) has stated that government funded power projects would be required to use locally made equipment and material procured through domestic competitive bidding. It believes that such move is necessary as domestic manufacturers have invested heavily in technology for creating and expanding manufacturing capacities, manpower and skill development.

http://economictimes.indiatimes.com/industry/energy/power/central-electricity-authority-wants-government-funded-power-projects-to-use-domestic-parts/articleshow/52393092.cms

Food For Thought

Currently, foreign equipment and material has penetrated the Indian electricity sector, with limited scope left for domestic manufactures to utilise their manufacturing capacity. Domestic manufacturing industry has invested heavily in technology, capacity augmentation and skill development but is not getting adequate return on investments. As a result, the government intends to mandate domestic procurement in the power sector.

The government policy seems be guided to protect interests of domestic industry. However, such preferential treatment has the potential to reduce efficiency in the market, and adversely affect consumer welfare. Such policy should be implemented in public interest only if overwhelming reasons exist, with periodic review of impact on market and consumers interest. The government should also think of alternative policy options to promote domestic industry, which are less competition distortionary than discrimination against foreign suppliers.

7. Finally, a level playing field: Changes in Mauritius tax treaty welcome

The government has recently signed a protocol for amending the over-three-decade-old Double Taxation Avoidance Agreement with Mauritius. It plugs the tax leakage and abuses like round-tripping (Indians taking money out of the country and bringing it back via Mauritius) and secures the right to impose capital gains tax on the sale of shares of domestic companies by entities based in Mauritius.

http://www.deccanchronicle.com/opinion/dc-comment/140516/changes-in-mauritius-tax-treaty-welcome.html

Food for Thought

Hitherto, foreign portfolio investors and non-resident Indians based out of Mauritius were exempted from short term capital gains tax, i.e. profits made on sale of shares within a year of purchasing. As a result, nearly 20 percent of foreign portfolio investments in India were made through Mauritius. Between April-December 2015, Rs 39,506 crore has flowed into the country.

Similar benefits were not available to domestic investors, who had to pay short term capital gains tax. This created an uneven playing field between domestic and foreign investors. Such preferential treatment of investors in Mauritius resulted in a practice of round tripping whereby Indians took money out of the country and invested through Mauritius route to avoid taxes. Mauritius is known to provide infrastructure to set up shell companies for investments in countries like India.

To check such abuse, the government signed a protocol for amending over three decade old double taxation avoidance agreement with Mauritius. Such amendment will lead to imposition of capital gains tax on investment from Mauritius, starting 2019-20. For the next two years, the tax will be limited to half the tax rate, or 7.5 percent, provided the Mauritius entity shows expenditure of more than ₹2.7 million to show that it is not a shell company.

This amendment is aimed at creating a level playing field between domestic and foreign investors and preventing tax leakages. However, the government has limited this change only to equities and left out derivatives, debt, mutual funds and other instruments from the purview of capital gains.

8. Time-tabled trains to drive road freight to rail

Aiming at a paradigm shift in the freight operations, Indian Railways will come out with a time table for goods train movement, a first for the public transporter, to attract more loadings and improve the delivery schedule.

http://www.ndtv.com/india-news/railways-to-come-out-with-time-table-for-freight-operation-1205374

Food for Thought

Currently, passenger trains get preference over the movement of freight trains on the busy tracks across the country which causes delay and uncertainty over the time schedule for delivery of goods. Goods trains are kept in loop lines to allow passenger trains to pass as most of the trunk lines face congestion.

The inefficiency and delays in carriage of goods has resulted in railways losing significant market share. The railways used to carry about 80 percent of total goods transported in the country but over time its share got reduced to 36 percent, with the rest shifting to roads.

The shift towards timetable based movement for freight trains is expected to improve performance of passenger as well as goods trains, increase overall railway efficiency and benefit passengers as well as consumers.

This is the first step in the comprehensive menu of reforms planned by Dedicated Freight Corridor Corporation, to improve competition between rail and road transport of goods and create and level field. These reforms include setting up dedicated freight corridors in the country, improving speeds of goods trains, among others.