Competition Distortions in India – A Dossier

(CDI-11: January-March 2011)

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

This periodic dossier produced by CUTS looks at the interface of policy issues having an impact, both negative and positive, on competition in India. The dossier relies on published news from reputed sources but at the same time CUTS does not guarantee its accuracy. The purpose is to flag issues to the layman as well as to the specialised policymakers and regulators, rather than be judgmental about them. Judgments would require greater analysis particularly in terms of cost and benefits therewith.

This is the 11th volume of the quarterly dossier that highlights several trade and non-trade related issues that may run contrary to the spirit of competition policy and thus adversely impact the overall welfare of a nation. It also educates about some of the welcome initiatives of the government that promote competition.

We have always taken a view that competition is the best restorative force in the market which, eventually, ensures consumer and business welfare. This is highlighted in a recent case study on private bus operators on Naathdwara-Choti Sadri Route in Rajasthan that brings to light the existing loopholes in legislative provisions which give rise to anti-competitive outcomes.

The Motor Vehicles Act, 1988 under Section 99 provides for monopoly rights to state transport undertakings to ply on inter city routes. This is contrary to the deregulation and liberalisation policies of the government.

In a recent case study done by CUTS, we found that commuters on the above mentioned route were not being serviced by either a private operator or the Rajasthan State Road Transport Corporation (RSRTC), which had multiple outcomes: unsafe travel in illegal means such as overloaded jeeps; loss of revenue to the State by way of taxes which would have been paid by legal operators. Please see CUTS Policy Options Note #1/2011 for more (http://www.cuts-ccier.org/pdf/Anticompetitive_Provisions_in_the_Motor_Vehicles_2011.pdf).

Such instances have been mentioned as a ubiquitous feature across the country due the legal provisions. Given that private bus operators are unscrupulous, there is a need to deregulate the services like the airline sector and have an effective road transport regulator to oversee all bus operators, public or private.

This dossier draws attention to other instances of competition distortions in India from news culled out from newspapers that have direct bearing on consumer welfare.

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A. Trade Issues

1. India's market barriers will limit FDI

The US Commerce Secretary, Gary Locke expressed concern over India's 'tariff and non-tariff barriers'.

He said these 'market barriers' of India may protect some domestic industries in the short term, but in the long term will limit foreign direct investment (FDI) and imports that can enhance innovation within Indian partner companies, and increase the standard of living for India's people.

"Even though India has made tremendous strides to open up its economy, there is much work left to be done", he said.

Speaking at a CII conference, Locke said joining him on this trip are 24 leading American companies.

…American firms can provide technologies to modernise India's power sector and deliver electricity to millions of rural Indians, Locke added that US companies could help India build the world's best planes, roads, rail lines etc.

…However, he said, for this to happen, New Delhi should address US businesses' concerns including India's tariffs of 19 percent on civil aviation aircraft, 30 on pistachios, 26 on X ray film and 50 percent on apples.

http://www.thehindubusinessline.com/industry-and-economy/government-and-policy/article1165071.ece

Food for Thought

High tariffs are not merely a barrier to trade and limit FDI but are potentially distortive of competition by restricting the entry of new players into the domestic market. The objective of competition policy is to ease entry and exit conditions by removing some of the government erected barriers such as trade restrictions which could be one of the main institutional barriers to domestic competition. The need to lower tariffs and the need for liberalising the domestic investment regime have been discussed at various WTO Ministerial Meetings.

It is often argued that such policies or protectionist measures are in line with the industrial policy necessary to protect the domestic industries and promote economic growth of a country. The purpose of industrial policy is to establish a course of action to support the achievement of development goals that depend upon the performance of the domestic manufacturing and industrial sectors. Industrial policy is usually justified on the grounds that market failures impede the proper functioning of free markets and thus prevent the ability of countries to attain development targets thus calling for government intervention to overcome such market failures. However, too much government intervention may hinder competition by creating barriers to entry as mentioned above and also promote inefficiencies and have an adverse impact on consumer welfare.

A balanced approach towards promoting domestic industrial growth while staying committed to multilateral obligations is required.

2. BHEL seeks duty on Chinese import

Bharat Heavy Electricals Ltd. (BHEL) has asked the government to ensure level-playing filed *vis-à-vis* Chinese players by imposing import duty on the equipment to ensure equality among all players in the power sector.

Admitting competition emerging from across the border, BHEL Chairman & Managing Director BP Rao said, "Competition is bound to happen when there is huge opportunity. We are not worried about competition. But we are (domestic players) facing disadvantage factors. We need level-playing field. We have moved the Plan Panel and hope the government will impose import duty on power equipment".

"We expect the government to look into the matter seriously and hope in the forthcoming Budget, the government will take some decision on this issue", he said.

On the Chinese threat, he said: "The cost is no more an issue now as the Chinese companies sell the equipment more or less on the same price that of ours. We do not see competition as we are an end-to-end player in the Indian market. We do not supply equipment alone. We will ensure that BHEL continues to maintain and grow its market share and will be at high competitive edge".

"More than 90 percent of those who have gone for Chinese equipment are coming back to us for their second set of equipment and we have nothing to lose as the market throws huge opportunities for us", he said adding "Given the order book size of ₹1,54,000 crore and continuous demand from number of customers, BHEL expects to cross the ₹45,000-crore turnover by 2011-12 and will further grow substantially", he said.

Meanwhile, BHEL is planning to float a non-banking finance company to fund power equipment, power projects among other things.

http://www.financialexpress.com/news/seeks-duty-on-chinese-import/734282/2

Food for Thought

Equipment imports from China help bridge the gap in demand and supply from domestic manufacturers, but may also be seen to create a situation in which foreign manufacturers gain an advantage over Indian companies. The import duty aims to create a level playing field which is the main objective of a trade-related competition policy principle. However, some Indian companies in the power sector are of the view that import duties will increase project costs for power generation companies that are working on financial closure based on less expensive Chinese equipment. The private producers have warned the government that higher import duties would increase project costs, consequently increasing power tariffs for consumers and derailing the government's crucial plans to increase India's power generating capacity. Some other apprehensions are with respect to continued dependence on imported equipment which may prevent development of local component and spare-parts vendors, which will be detrimental to national interest.

Experience shared with people who have used Chinese power generation equipment is very good. It has been said by one person that the erection costs are about one third of BHEL's equipment. BHEL admits that prices are not a problem.

Can BHEL not enter into collaboration with some of the Chinese manufacturers to build and assemble their equipment in India and also elsewhere where demand is growing?

3. Latex users seek import duty cut

After price of RSS-4 – the premium grade rubber sheet – got glued to the ₹200-plus price territory, both the rubber consuming industry and growers are eyeing the potential of trading in liquid rubber latex.

Indian latex-using industry – includes condoms, medical gloves, toy balloons, etc. – has demanded customs duty cut from the present level of 70 percent, to ease latex imports. In a letter to Ministry of Finance, All India Rubber Industries Association (AIRIA) has also sought permission for immediate import of 5,000 tonnes at zero-duty.

The domestic latex industry has asked for immediate correction in inverted duty structure on natural rubber latex on the lines of natural rubber done recently. Another demand is for fixing the minimum and maximum price of latex.

…The domestic latex price has been heating up over the last two years. What AIRIA argues is that the import duty on latex stands at a significant 70 percent while that on finished product it is less than 7.5 percent. The price of latex has gone up from around ₹55 a kg in January 2009 to ₹117 currently, touching ₹148 recently. AIRIA has urged for the social consideration due to small industry. It is mostly micro and small enterprise (MSE) units, making items like balloons, hot water bottles, feeding bottles, foam mattresses, medical and surgical articles and some sports goods, who use rubber latex.

The association points out that these small units cannot afford to pass on the price increase to the end-consumers.

Vinod Simon, President AIRIA, says that the industry had been expecting some solace in the recent Budget. "On the contrary, the import duty on latex has been gradually enhanced from 25 percent in 1999-2000 to 70 percent currently while those on finished goods have been reduced from 40 to less than 7.5 percent during the same period. This is even against the government's avowed policy of enhancing domestic value addition", he adds.

So far, the Union Government had been looking at natural rubber and rubber latex as substitutable products. Liquid rubber latex is the first stage output of the rubber tree. This is processed to yield natural rubber. For natural rubber, a prescribed quantity of imports had been allowed at just 7.5 percent duty till March 2011 end. But rubber latex did not get this treatment. In effect, according to AIRIA, where natural rubber takes ₹20 per kg duty, latex has to deal with duty to the tune of ₹100 per kg.

http://www.financialexpress.com/news/latex-users-seek-import-duty-cut/764515/

http://www.thehindubusinessline.com/industry-and-economy/agri biz/article1550860.ece?homepage=true

Food for Thought

The demand for customs duty cut from the present 70 percent to ease latex imports should be welcomed as reducing the duty will promote competition in latex by lowering the barriers to entry and cost to the users. Secondly, if the Union Government treats natural rubber and latex rubber as substitutable, it should provide a level playing field in its treatment of both which it failed to do by allowing a prescribed quantity of import of natural rubber at a duty as low as 7.5 percent till March 2011 end.

Furthermore, a significant problem prevalent in the rubber industry is the inverted duty structure. An inverted duty structure is a situation where the duty on the finished product is lower than that on the raw materials. Economically, the inverted duty structure results in increased cost of funding, making local manufacturing economically less competitive against *imports and effectively putting the importer of inputs for manufacturing of goods in the country at a disadvantage.*

The domestic manufacturing industries have been highlighting this to the government and seeking relief. The import duty on rubber latex is as high as 70 percent while the duty on the finished product is as low as less than 7.5 percent. This is a typical example of inverted duty structure where the rate of customs duty on manufactured product is significantly lower than the rate of customs duty on import of raw material used in manufacture of the finished products. Thus, an inverted duty structure runs contrary to the objective of competition by hurting the small and medium domestic manufacturing industries while promoting imports.

In the backdrop of growing demand and rising prices of domestic latex, it is necessary to correct the distortions that exist in this industry along with exploring possibilities for a regular/steady flow of exports.

B. Other Issues

1. Milking freight to please passengers

How much does the Indian Railways' earnings from freight subsidise what it gets from transporting passengers? One way to look at it is by comparing unit revenues from freight with that from passenger fares. During the current fiscal, the Railways' average income from hauling one tonne of goods over a one-km distance – what is technically called revenue per net tonne-km – is estimated at ₹1.02.

…over the last 10 years, the unit revenue from freight has gone up by nearly 30 paise, whereas the corresponding revenue per passenger-km has risen by a mere 3 paise.

As a result, the passenger fare-to-freight ratio, which stood at 0.30:1 in 2001-02, is set to fall to 0.25:1 in the revised estimates for 2010-11. That is way below the corresponding average of 1.4:1 for Korea, 1.3:1 for France, 1.2:1 for China, 0.9:1 for Malaysia and Indonesia, and 0.7:1 for Thailand.

What it means is that whereas passenger fares in India are a fourth of freight charges, in other countries, commuters pay 1.2-1.4 times more than those transporting goods.

The extent of cross-subsidisation is even more, if one goes by the revelation in the 'White Paper on Indian Railways' – tabled in December 2009 by the Rail Minister – that passenger trains utilise nearly 60 percent of the Railways' network capacity.

While using up 60 percent of the network, passenger revenues are, however, budgeted to contribute only ₹30,456 crore or 28.7 percent of the Railways' gross tariff receipts of ₹1,06,239 crore during 2011-12, with the share of freight being ₹68,620 crore.

Moreover, there is a large element of cross-subsidisation even within the passenger segment, with AC commuters being over-charged relative to second class travellers – to the extent of driving away premium rail traffic to airlines.

Thus, while the average revenue per passenger-km for 2011-12 is budgeted at about 28 paise, it ranges from as low as 14.75 paise for ordinary second class to ₹1.05 for AC-3 Tier and ₹2.53 for AC First Class.

http://www.thehindubusinessline.com/industry-and-economy/logistics/article1490279.ece

Food for Thought

Railways are a natural monopoly and due to their importance for economic development and enormous market power, they have been state owned in India where railways were first founded in 1853 as a system of 42 rail systems and nationalised into one unit in 1951.

Indian railways enjoy a monopoly with the ability to use that power to cross-subsidise the prices/fares of passengers and freight as well as fares within the passenger sector. Such an abuse of monopoly of over pricing one sector (freight sector) to compensate for the loss suffered by the passenger sector is contrary to the spirit of competition which aims at establishing a level playing field for all competing players in a given market.

The problem of cross-subsidisation in rail pricing has been a notorious issue for many years and continues to be an agenda before the Planning Commission which has been advocating the need for the establishment of a Rail Tariff Regulatory Authority that would decide on passenger fares and freight fairly. Of course such a proposal that rightly aims at targeting a competition distortive practice and the use of monopolistic power to manipulate passenger and freight fares through price cross-subsidisation has not been entertained much by the Railway Ministry that is not yet ready to lose its monopoly of manipulating fares in a manner that would earn them some favour among the electorate.

2. Closure of vaccine units not justified

Taking a critical view of the manner in which the manufacturing licences of three public-sector vaccine producing units were suspended, a Parliamentary panel said it was abundantly clear that the decision was based on a major misconception and due to the misinterpretation of certain unclear signals in the communication from the World Health Organisation (WHO).

…Surprisingly, it was not clarified in spite of the matter having surfaced five times in internal notes at various levels in the Ministry. The Ministry's decision to recommend the closure of the three vaccine-producing public sector undertakings (PSUs) was not only myopic but also exposed the nation to an unacceptable risk in vaccine security, even as several states were reeling under vaccine shortages, according to the department-related Parliamentary Committee on Health and Family Welfare.

The three units in question are the Central Research Institute at Kasauli, the Pasteur Institute of India at Coonoor and the BCG Vaccine Laboratory at Chennai.

As was discussed in the earlier reports of the Committee, in the absence of the supply of vaccines from the public sector, the cost of vaccines in the domestic market appreciated by 50-70 percent within two years from the closure of the these units. The Committee had observed that it was 'high time' that the role and *locus standi* of the National Regulatory Authority (Drugs Controller-General of India) *vis-a-vis* WHO were made clear. In the absence of any clear-cut boundary in the matter, it was left to the subjective interpretation of the officials at the helm at any point of time.

According to the Committee, such a precarious situation left ample scope for such cases to recur. Hence, it strongly recommended that the Ministry, which was the prime intermediary between WHO and the National Regulatory Authority, take up the matter with WHO and clarify its position at the earliest.

The Committee also focused on the issue of the Ministry's treatment of the compliance of good manufacturing practices (GMP) norms by the three PSUs. From the outset, the department, while justifying its decision to suspend the manufacturing licences of the PSUs, said that they had failed to comply with the GMP norms specified under the Drugs & Cosmetics Act and Rules. However, as the vaccines produced by the PSUs conformed to the standards of safety, efficacy and quality – a fact admitted by the then Secretary during the course of her deposition before the Committee on October 26, 2009 – the Committee stressed that the decision to close these PSUs on the grounds of non-compliance lacked justification.

The Committee was, therefore, perturbed to note that the Ministry, rather than admit the fallacy of the decision earlier taken by them, continued to harp on the lack of compliance with GMP norms. The Committee further said that the Ministry, the office of the Directorate-General of Health Services and the Drug Controller-General of India could not evade having to take responsibility for the manner in which the case was dealt with.

The Committee found unacceptable the tenor of the action, which was inclined towards absolving the top authorities of the responsibility for singling out the three PSUs while sparing the private players.

http://www.thehindu.com/news/states/other-states/article1509881.ece?service=mobile

Food For Thought

This is another case of lack of competitive neutrality against the public sector, somewhat like the airline sector where private players have been encouraged in India while the public sector Air India has bled.

The market for healthcare services is quite distinct in its functioning with asymmetries of information and market power prevailing in the industry. Besides these structural complexities, India has been struggling with bridging the growing gap between the demand and supply of vaccines. Under such circumstances, one of the main objectives of India's national strategy to meet its vaccine needs is to increase the decisive intervention of the government and strengthening the public sector to make safe and effective vaccines available at reasonable prices. Instead, in the face of a shortened supply, the Ministry's decision to close three PSUs for allegedly not complying with the GMP norms has not only exposed the country to an unacceptable risk in vaccine security but also stifled competition in the healthcare sector leading to a hike in the cost of vaccines in the domestic market by 50-70 percent within two years from the closure. With the closing down of these units, the government has been procuring vaccines required for the country's national immunisation programme from the private vaccine companies at high prices thereby leading to a substantial increase in the expenditure on universal immunisation programme.

Evidence has shown that private players offered vaccines at competitive prices prior to closing down of PSUs after which the government has been to seen to steadily pay higher prices for procuring vaccines from them to this day.

Instead of buying vaccines only from private players, the closure of the three PSUs must be re-visited. This may be a significant step towards lowering the cost of vaccines in the domestic market by generating healthy competition.

3. Coal Ministry to renew privatisation push

At a time when severe environmental challenges are impeding the growth of the coal sector, the Union Coal Ministry has decided to renew a decade-old proposal of opening up the sector for private investors.

'Facilitating the removal of entry barriers in coal mining for opening up the sector' has been identified as a 'high priority' area by Coal Minister Sriprakash Jaiswal, in the Ministry's latest 'Strategic Plan' formulated for the next five years.

Opening up coal mining to the private sector, along with setting up an independent coal regulator and other such proposals, is a part of the broader 'blueprint' for reforms the United Progressive Alliance (UPA) government wants to bring in the coal sector.

The move to allow private companies to mine will also help India to reduce its import dependence on coal. While the proposal has already been cleared by the Union Cabinet, a bill in this regard, introduced in the Rajya Sabha by the National Democratic Alliance government in 2000, is still pending. This time, however, the Ministry seems to have adopted a determined approach for implementing the proposal. It is building what it is being called a 'detailed implementation plan to pursue the clearance of Coal Mines (Nationalisation) Amendment Bill 2000 in Parliament', including a quarterly review of the progress on the proposal at the joint secretary level.

"The Ministry fully intends to push this subject. We will definitely like to do it as soon as possible. In fact, a separate Group of Ministers (GoM) has been set up to look into the matter which speaks of the government's intention," said a senior official from the Coal Ministry. The GoM was set up in 2010 to deliberate on various aspects of the controversial proposal of opening up the sector. However, it has not met once so far.

While the Ministry is confident of making a breakthrough this time, insiders believe that the path to privatisation in coal mining is still a distant dream. "Allowing private companies to mine coal is not going to be easy. There are major political repercussions associated with the move. The main reason why the government has not been able to do it is because it had Left parties' support. Even now, with the support gone, there is strong opposition from the unions who think that the move would lead to privatisation of Coal India Ltd and the workers would lose jobs", said a senior official close to the development. The CPI (M) had withdrawn support from the first UPA in July 2008 over the India-US nuclear deal issue.

…A Parliamentary Standing Committee had earlier recommended the government to have detailed discussions with stakeholders before making a final move. The Coal Ministry's latest strategy paper, however, identifies the 'opposition from various quarters to the opening up of coal sector to private investment for commercial mining' as a 'threat that will impede speedier growth of the sector'.

http://www.business-standard.com/india/news/coal-min-to-renew-privatisation-push/427703/

Food for Thought

1970s was a dark period in India's dirigisme history to nationalise various sectors such as banking, insurance etc. Coal mining was nationalised in 1973. The motive was political as Prime Minister Indira Gandhi wanted her dominance on all economic issues. Consequently, there were both positive and negative outcomes of such policies.

Coal accounts for over 50 percent of India's primary energy consumption. Major factors deterring competition in this sector are the absence of deregulation, dominance of public sector monopoly and restrictions on commercial mining. In the absence of competition, the sector is a breeding ground for inefficiency where the production has been seen to suffer. It is important that drawing from the positive experiences of oil and gas sectors, the government should open up the coal sector to competition by private players. But the idea of a coal regulator is anachronistic, when the Competition Commission of India is there to check market abuses.

Competition would not only boost investments but also production to meet the growing demands along with reducing India's import reliance for coal. Removing entry barriers by opening the coal mining sector to private investors is therefore a welcome move. The implementation of the plan, would however, run into some difficulties as are being witnessed *now through strikes and protests by workers and other stakeholders that might not view such a development in their favour.*

A final decision taken by the government must take into account the wishes of the interested players guided by the overall objective of competition and efficiency gains in providing a level playing field for private sector participation by amending various discriminatory provisions against the private players within the current legal and policy framework as well as establishing a regulatory body for the sector.

4. Apex court asks TRAI to evolve new norms for mobile interconnectivity

The Supreme Court, on February 03, 2011, directed the Telecom Regulatory Authority of India (TRAI) to evolve a new set of revenue-sharing norms and other regulations on interconnectivity among operators for carrying calls of one network through others.

A Bench, comprising Chief Justice S H Kapadia, asked the TRAI to bring the new Interconnect Regulation on Mobile termination charges and carriage charges within four months after consulting various stakeholders.

…The apex court gave its direction on a petition by TRAI challenging the Telecom Disputes Settlement & Appellate Tribunal (TDSAT) order, which had set aside on September 29, 2010 the TRAI's Interconnection Usage Charges (Regulation), 2009 and asked the telecom regulator to bring out fresh interconnection norms and regulations in consultations with various stakeholders.

The TDSAT had set aside TRAI's 2009 Interconnect Usage Charge (IUC) regulation on a host of petitions by various mobile service-providers objecting to the telecom regulator's order.

…In its 2009 IUC regulation, TRAI had fixed a mobile termination charge (MTC) at 20 paise per minute for all local and national long-distance charges.

It had also raised the MTC for incoming international calls to 40 paise per minute from 30 paise, while putting a ceiling on carriage fee of 65 paise per minute for domestic long-distance calls.

TRAI's IUC regulation was widely opposed by state-run *Bharat Sanchar Nigam Limited* and private operators – Bharti, Vodafone, Idea, Aircel, Etisalat DB and CDMA lobby group Association of Unified Telecom Service Providers of India – which had filed several petitions before TDSAT.

BSNL wanted termination charges for the fixed wire-line services to be fixed by the regulator on the data supplied by it on actual-cost basis.

It also wanted the MTC for incoming ISD calls to be fixed through mutual negotiation between operators. Alternatively, it wanted an MTC in the ₹3-4 range instead of 30 paise, which TRAI had fixed.

GSM operators including Airtel and Vodafone, on the other hand, wanted an MTC of 35 paise instead of 20 paise and had requested TDSAT to direct TRAI for a fresh consultation on this issue.

Opposing all these, TRAI submitted before the Supreme Court that it had fixed the MTC in such a way so that the commercial interests of the exiting big operators and small operators could be balanced.

"While establishing the IUC regime, the impact on the competition, prices, quality, incentives and investment in fixed and mobile network has to be seen. The service providers need to be fairly compensated for the investments and operational expenses through IUC to drive growth of the telecom sector", TRAI said in its petition.

http://www.thehindubusinessline.com/industry-and-economy/info-tech/article1156449.ece

Food for Thought

With so many operators in the sector, it is a challenging task for TRAI to come up with an IUC regulation that pleases everyone. Often existing operators may be seen to abuse their market power and create difficult conditions for new entrants to compete by refusing to interconnect or offering the same at higher prices and/or unreasonable terms. Although a reduction in charges would lead to lower tariffs for consumers, it might dent the profitability of the existing operators while new GSM players might stand to gain from such a reduction.
Establishing an IUC regime would need an evaluation of its impact on various factors such as price, quality, incentive, investment, competition and the overall growth of the sector. After consultations with all stakeholders, TRAI should come up with such a regime (in a timely fashion) that would balance the interests of the consumers, the small and big operators.

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