Competition Distortions in India
– A Dossier

(CDI - 4: October – November, 2009)

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.

LIST OF CONTENTS

A. Trade issues

1. Coastal trade could be sealed for foreign shipping firms

Considering the plea of the Indian National Shipping Association (INSA), the Shipping Ministry, along with the Ministries of Law & Commerce, is set to draft a paper, in full compliance with WTO provisions, to direct shipping trade opportunities towards Indian companies.

The possibility of terrorist threats arising from the sea route is being offered as a justification for an official ban on foreign vessels. Notably, the Merchant Shipping Act, 1958 facilitates the entry of foreign vessels; however, the tender process for the same is often more friendly towards foreign vessels than Indian.
http://www.financialexpress.com/news/coastal-trade-could-be-sealed-for-foreign-shipping-firms/523981/

Food for Thought
It is important to understand whether potential threats from terrorist activities constitute valid grounds for the shipping trade to be directed towards Indian companies only. Such research should also try to examine if and how effective safeguards can be implemented to facilitate the entry of foreign shipping interests into the shipping trade sector.

Only if research rules out viable safeguards against terrorist risks in the event of foreign entry, can the ban be defended as a practice that is not aimed at distorting competition. However, in certain cases, distortion of competition may be allowed to serve significant public interest. The onus then lies with the ministries to establish the significance of public interests after identifying these.

2. Steel companies seek duty wall to stop Chinese import surge

Indian markets have been flooded with cheaply produced Chinese steel imports, causing a serious threat to domestic steel manufacturers. A proposal to levy safeguard duty on Chinese steel was initially rejected by the Government as it could not determine impairment to local industry by the same.

Indian manufacturers are urging policy makers to pursue protectionist measures and revive the previously levied 5% safeguard duty on Chinese imported steel products to shield the domestic steel industry.
http://economictimes.indiatimes.com/News/News-By-Industry/Indl-Goods-/-Svs/Steel/Steel-cos-seek-duty-wall-to-stop-Chinese-import-surge/articleshow/5121888.cms

Food for Thought
The moot question which should be answered through research is whether Chinese price advantage is an outcome of higher efficiency. If that is indeed the case then the levy of safeguard duty constitutes an act of neutralisation of fair competitive advantage or in effect a distortion of competition.

Whether such distortion of competition is warranted would in turn depend on the positives associated with safeguards i.e. the welfare gains from protection of employment and generation of growth possibilities. It is, however, possible that such safeguard duties deter the attainment of efficiency by domestic industry and may in the long run represent an obstacle to its development rather than a catalyst.

3. Urea imports may be freed to promote private plea

The agricultural ministry is keen to introduce Open General Licenses (OGL) for urea imports. The resulting boost in imports would be associated with a reduction in the subsidy bill as consumption based on subsidised domestic production would decrease. The ministry thus aims to reduce the fiscal deficit through the OGL move. The OGL proposal is awaiting inter-ministerial as well as cabinet approvals.

Notably, the government plans to remove the direct subsidy from its agenda in the near future and channel the cash directly to the farmers via smart cards.
http://economictimes.indiatimes.com/news/economy/policy/Urea-imports-may- be-freed-to-promote-private-play/articleshow/5125570.cms

Food for Thought
The freeing of urea imports should be seen as a measure to free up competition in this sector by negating anti-competitive tendencies. The key question that research needs to answer is whether the positive effects of the introduction of greater competition are offset by negative effects such as a fall in revenue.

The impact on price and consumption on the one hand and revenue collections on the other should be studied and compared. Such study can serve as a useful guide for removal of distortions in other sectors, especially where the product in question has the same characteristics as urea i.e. that of an essential input with significant implications for productivity in the supply chain.

4. Lessons from India's port privatization

Leading port operator PSA-Sical Terminals Ltd. is operating a terminal, under its 30-year contract, which handles 450,000 standard containers per year. The Chennai High Court did not entertain the Tariff Authority of Major Ports (TAMP) order to slash rates of Tuticorin port by 15% in 2002 and 50% in 2006. Soon after quashing TAMP's 2007 order, the Court decided that the matter should be revisited by TAMP and finally the regulator slashed rates by 34% in December 2008.

The royalty paid by PSA-Sical to the government owned port for container handling is currently at Rs. 1,641 per container, but shall compound to Rs. 5,178 by 2029. PSA-Sical currently charges Rs. 2,300 for single container handling.

Notably, the royalty so paid is anticipated to cross the revenue levels of the operators soon, as royalties are poised to increase every year in mid-July. PSA-Sical offered surprisingly non-viable royalty figures during the contracting phase; it has no room to exit these obligations.

The tariff that existed in 1999 incorporated the paid royalty as an input to cost but in mid 2003 this changed. Subsequently, when the terminals of private firms turned commercially unworkable, the shipping ministry decided to consider royalty as a partial cost measure, but only up to the level of the second highest bidder's quote. However, PSA-Sical desires that the tariff should reflect the entire royalty paid.
http://www.livemint.com/2009/11/12204900/Lessons-from-India8217s-por.html?h=B

Food for Thought
The royalty paid to the port by the firm undertaking container handling should be set at levels which conform to international standards and not treated as monopoly rent subject to bidding by competitors.

In the case of bidding determining royalty levels, the impact of higher royalties will be felt by the shipping sector in the form of higher tariffs for container handling which in effect is a distortion of competition. Efficiency gains would not result in tariff gains as these would be captured through higher royalties. Careful research should go into determining what these international standards/benchmarks are.

B. Other Issues

1. Brands erect roadblocks on the air to get ahead of competitors

MTV India, affiliated to media giant Viacom 18, has inked a road block advertising deal with FMCG (Fast Moving Consumer Goods) players such as Nokia India Pvt. Ltd. & ITC Ltd. to offer them commercial time on the channel for a specific duration on exclusive basis.

Also in the same league is the Zee Network, which under a deal anticipated to be worth Rs. 10 crore, is all set to exclusively air the commercials of Hindustan Unilever Ltd. (HUL) products such as Surf Excel, Dove, Rin & Axe. HUL has also struck a similar deal worth Rs. 8 crore with Star India Pvt. Ltd. for exclusively buying time on 10 of its channels.

Industry experts opine that the advertising expenditure of FMCG firms increased by 30% to 40% in Q3 2009 and is poised to rise further.
http://www.livemint.com/2009/09/22214524/Brands-erect-roadblocks-on-the.html

Food for Thought
The important question to consider is whether such exclusive time slots can be construed as refusal to deal with other players which in effect is a violation of competition law. However, the counterargument which can be offered in this case is that the provision of exclusive time slots is based on a transparent bidding process.

Thus, the onus is on the investigator to determine the transparency of bidding, if at all such bidding has taken place. In the absence of a transparent bidding process, the act of providing exclusive time slots can be deemed anti-competitive and collusive.

2. IOC seeks freedom to set retail fuel prices

The Indian Oil Corp., (IOC) along with Navratna oil entities, is seeking relief from government intervention in setting retail prices for fuel, appointing and reallocating portfolios of Directors & Independent Directors and fixing compensation and performance incentives.

It has also appealed in its Annual Performance Memorandum which it inks regularly with the Petroleum Ministry, that the Navratna oil enterprises should be the ultimate decision makers in determining terms relating to retail tariffs of LNG, petrol, diesel, domestic LPG & kerosene. IOC claims to be losing Rs. 3.63/litre of petrol, Rs. 2.33/litre of diesel & Rs. 17.15/litre of kerosene and. Rs. 158.55 per standard (14.2kg) domestic LPG cylinder.

The Government currently does not allow oil enterprises to increase prices at a rate higher than that of cost appreciation in order to keep a check on inflation in the economy. However, IOC maintains that pricing autonomy is crucial as it will let IOC create a revenue surplus which can be pumped into strategic initiatives and also

used to offset the significant loss (Rs. 23,510 crore) incurred in petrol, diesel and domestic LPG sales (as for 2009-10).
http://www.financialexpress.com/news/ioc-seeks-freedom-to-fix-fuel-rates/521538/

Food for Thought

Allowing firms to set their own prices in the presence of competitors actually encourages competitive forces in the economy as the forces of competition ensure that prices get reined in. However, in the case of a government monopoly, freedom to set prices is a negation of competition even to the limited extent that it can be simulated by fixing of prices at competitive levels by an external authority/regulator. In other words, while freedom to set prices is pro competition in the case of free entry, in the case of a virtual monopoly it can be seen as destroying the possibilities of simulated competition.

3. ISPs dial up competition panel on Net telephony

Despite the indication by the telecom regulator, TRAI that increased choice would soon be made available to consumers, the Department of Telecom (DoT) is unwilling as of now to allow the entry of Internet Service Providers (ISPs) to the telephony sector and offer net telephony for domestic calls. The DoT is firm in its stance that such entry will create an uneven playing field as unified license holders (ULHs) and ISPs pay differing proportions (6%-10% and 6% respectively) of their incomes as license fee.

Moreover, DoT reasons that ISPs have an advantage over ULHs as the former can offer two services at one go (conventional net surfing and telephony). The exploitation of this possibility can leave telecom players in a fragile state. ISPs in turn have retaliated saying that the DoT is acting dominantly to marginalise them. The ISPs are of the opinion that access to the IT sector can boost their revenues and at the same time help the common man maximise his utility from the internet.

Labelling the DoT's move as anti-competitive, the Internet Service Providers Association of India (ISPAI) has forwarded the case to the Competition Commission of India (CCI), which is, however, yet to accept their petition.
http://www.thehindubusinessline.com/2009/11/03/stories/2009110351860100.htm

Food for Thought

All dimensions of competition should be allowed to evolve – quality, price or technological – as long as such competition is fair. The ISP's ability to offer two services at one go should be seen as natural evolution of the telephony sector through competition in the technology space. Its stifling would be anti-competitive. The argument can of course be made that ISPs and ULHs pay different proportions of their income as license fees but these should be brought on parity through suitable legislation. The scope for bringing about such legislation needs to be investigated immediately.

4. States put the ball in Centre's court on capacity addition woes

The Central Government has been asked by the States to speed up the process of giving clearances in regard to fuel supply and matters relating to forest & environment. In order to meet its capacity addition goal of 26,783MW of the total of 78,700MW targeted in the 11th Plan, the Government also needs to foster competition in the power equipments market rather than promote lethargic state-run BHEL's uncompetitive acts.

The Centre has, however, made clear that generation of only 62,000 MW would be possible by the end of the 11th Plan period. The States have in response drawn attention to their power deficit of around 9% and energy shortfall of 10%.

Although market players like L&T, JSW, Toshiba and Alstom have initiated activities to compete against BHEL in the plant equipments markets, it will still require 4 to 5 years for them to begin actual supply. The privileged treatment accorded to BHEL by the Government is detrimental to the free market environment as their policy making mechanism is solely focused towards the state run monopolist.

Notably, equipments such as boilers, turbines and generators are vital to power generation cost and electricity tariffs – costly power plants built by BHEL result in high average per unit electricity cost in India. The cost per unit in India is almost double that of China, making the Indian market very uncompetitive.
http://in.biz.yahoo.com/091115/50/baul1e.html
http://www.hardnewsmedia.com/2009/05/2887

Food for Thought
There is a need to ascertain the quality of power equipment produced by the private competitors of BHEL. If these indeed satisfy admissible quality standards, these should be allowed to compete in the market for power generation equipment.

Not allowing such power equipment to enter the market when quality standards are being adhered to would be anti-competitive and stunt the enhancement of efficiency in this sector and its growth.

If BHEL's monopoly is being promoted on flimsy public interest grounds then the welfare implications of such promotion should be made clear and offset against the negative ones resulting from decreased competition. Only if the net benefit from promotion of monopoly is positive can it be undertaken.

C. News & Views

1. Banking, Shipping may be kept out of Competition Commission's purview

The Ministry of Corporate Affairs (MCA) is considering the exemption of shipping from the Competition Commission of India's vigilance in response to the demands of Indian National Ship Owners' Association (INSA). The Ministry is planning to examine cases from other countries which have similar arrangements in this regard.

The Ministry, under Sections 54 and 55 of the Competition Act, 2002, is empowered to set free certain sectors or enterprises from the purview of competition law.

Notably, the Reserve Bank of India (RBI) has also communicated its intention to the Finance Ministry to exempt banking mergers and acquisitions (M&A) from the obligation of the Competition Act 2002. M&A investigation powers of the CCI pursuant to Sections 5 & 6 are still to be notified by the Government.
http://www.transportweekly.com/pages/en/news/articles/66126/

Food for Thought
The exemption of certain sectors and certain practices within sectors from competition law can be defended on public grounds. Such exemption however should not be provided on an adhoc basis but on the basis of a list of admissible matters of public interest.

Moreover, the decision to make an exemption should be based on an objective assessment of the losses from sacrificing competition objectives and the gain facilitated from promotion of the public interest objective.

2. Free ATM era ends tomorrow

Reserve Bank of India's (RBI) directive dated 1st April, 2009 to introduce free ATM transactions from third party facilities has come to a conclusion. The new decision effective from 13th October, 2009, stipulates that ATM users will be offered 5 free third party withdrawals each month with a limit of Rs. 10.000, while from the 6th third party transaction onwards, a charge of Rs. 20 shall be levied as proposed by the Indian Bankers Association (IBA).

The RBI reasons that the free third party ATM regime put an unnecessary burden on banks to process such transactions. Banks have also clarified that these have been informing customers of the proposed move in advance via quarterly statements and commercials at ATMs & branches.

However, Axis Bank has unilaterally set out a plan to waive such charges to churn out more Current Account & Savings Account (CASA) customers.
http://www.business-standard.com/india/storypage.php?autono=372943

Food for Thought
The situation can be compared to that of interconnect agreements in the telecom sector i.e. these agreements facilitate unrestricted roaming and thus rule out dominance by large players.

In the case of ATMs, the mentioned restrictions are being introduced ostensibly to reduce additional processing burdens but the exact financial and human capital implications of this additional processing burden need to be worked out and offset against the losses from diluted competition. Under the new scenario, large banks with ATMs all over the country will gain at the expense of banks with ATMs only in certain regions.

3. Govt companies may be kept out of coal block bid

Government owned coal entities such as Coal India and NTPC along with state owned mining corporations would probably be exempted from the competitive bidding process for allocation of captive coal blocks. These public entities would be allowed access to supplies of coal at lower than market prices to prevent higher prices of coal for consumers in steel, power and cement sectors.

The proposal is integrated in the new draft legislation, *Mines & Minerals (Scientific Development and Regulation) Act,* which is pending the Cabinet's consent.
http://www.projectstoday.com/News/NewsDetails.aspx?nid=28294
http://economictimes.indiatimes.com/News/News-By-Industry/Indl-Goods-/-Svs/Metals-Mining/Firms-planning-investments-to-get-advantage-in-coal-bids/articleshow/5099696.cms

Food for Thought
Coal has many uses – one of the prominent ones being the production of power. Allowing NTPC access to coal at concessional rates amounts to discrimination against private players in the power sector. This would deter entry into the power sector as players such as NTPC would have a head start. Thus, the expansion of the power sector would be jeopardised.

The question which needs to be answered in this case is whether coal's use as an intermediate input into steel and cement is more important than its function as a source of power. Only if that is true can the government's decision be justified. But that is a tall claim which needs to be backed by rigorous research.

4. Telecom operators want lock-in policy relaxed

The domestic telecom operators have requested TRAI to ease laws relating to mergers and acquisitions (M&A) as the current standard of a three-year lock-in hinders consolidation in the telecom sector. The present M&A criteria oblige each of the two operators to wait till three years from the expiry of its license to enter into any combinations.

Most importantly, the current clause of lock-in within the Universal Access Service Licence (UASL) agreement constitutes a high exit barrier for promoters and thus hinders optimal consolidation. Experts opine that under such a condition, the industry will not be sustainable enough to maintain global investor confidence and thus possibility of industry fragmentation will also increase.

Lessons from global jurisdictions such as US, China, Italy and France specify that M&A's bring an end to the miseries of unprofitable and sub-scale operators as such combinations leave only 3 to 4 players in the market. In contrast, the Indian market accounts for 12 operators in every circle with frozen possibilities for consolidation.
http://www.blonnet.com/2009/11/16/stories/2009111650860200.htm
http://www.business-standard.com/india/news/%5Cdo-we-neednew-spectrum-policy%5C/376776/

Food for Thought
Apparently such a policy is to prevent rent seeking by new players who have obtained a license and are then selling it off at a premium to another player through a merger or takeover. This can be dealt with under clear conditionality of setting off the premium against higher revenue to the government on a case to case basis.

In general allowing mergers and acquisitions, the potential economies of scale have to be weighed against the possibilities of increase in the scope for abuse of dominance. Indeed detailed competition analysis needs to precede the approval/disapproval of any potential merger. Market shares need to be worked out and the implications for concentration and the scope for abuse of dominance generated.

Even if the possibility of a highly concentrated industry exists, the merger might still be allowed if it is perceived that one of the firms is sick and would not be able to survive in the market on its own; the past track record of players shows that these are unlikely to indulge in abuse of dominance etc. In other words, it is important to bear in mind that mere dominance does not lead to its abuse – moreover, any abuse of dominance facilitated by a merger can be penalised post the merger.