



Status of Competition and Regulation in India, 2007

"This is a very timely Report, which takes stock of the regulatory regime in the country, in order to tell us in the government, about what we had promised to do when we came to power, and what we have not been able to do. It shows the way forward to the government to implement its mandate more effectively".

–*Kamal Nath*

Minister for Commerce & Industry, India

The Indian economy had been characterised by significant government involvement marked with the dominance of large state-owned public enterprises (SOEs). There existed lacunae in the older laws and policies, which needed corrections as India moved ahead in creating a sound economic regulatory regime aimed at delivering higher growth, creating more employment and ensuring distributional justice to all. In order to realise this, India embarked on the path of economic reforms during 1990s by shifting to market-driven economic policies.

This Briefing Paper brief evaluates the significance of competition policies and regulatory regimes, including the government policies that impeded competition. It also examines the competition-related issues and sectoral dimensions citing examples of selected sectors. It recommends, among others, adoption of a National Competition Policy, so that a better regulatory regime can be realised in the country.

1. Introduction

In India, the importance of competition policy and related regulatory regimes has increased greatly since 1991 when a massive wave of liberalisation eliminated many controls on investment, capital market, foreign trade and prices. Prior to 1991, the public interest was sought to be served more through direct regulations that required the prior approval of government for many commercial decisions. Post-1991, in most sectors of the economy, the protection of public interest objectives rests with the laws governing competition and the regulatory regimes that have been set up for "natural" monopolies and network industries (where the production patterns of one producer are linked to that of others).

Competition, though seen as a means of attaining efficiency and fairness, might not have necessarily promoted these objectives unless it has dealt with trade-offs in its objectives and instruments. This concern led to a shift from a structural to a behavioural approach in drafting a new competition regime. After all, in a fiercely competitive market, even a duopoly can produce an outcome that a perfectly competitive market generates. Thus, it may not be necessary to have a highly-competitive

market structure provided appropriate rules of the game are designed and enforced so that the market players behave in a competitive manner.

This approach may, however, become ineffective when competition in natural monopolies cannot be ensured as such. Situations can also arise where there may be a number of players in the market but the market itself is so segmented that individual players become monopolists. The only way to get 'competitive outcomes' in such markets is to put effective regulation in place. Thus, regulation in different sectors becomes an integral component of competition policy.

In principle, India is at an early stage in developing a strong competition and regulation regime. Since new authorities have been set up, many of them are struggling to find their feet firm on the ground. The Competition Commission of India (CCI) is not yet operational in a meaningful sense. There are questions about jurisdiction and shortage of qualified staff as well. Thus, for the competition regime to work effectively, India needs a continuing debate on the economics of competition and regulatory policy.

2. Policies *vis-à-vis* Competition

In India, the thrust of reforms has been to allow for more competition and for government to play the role of a facilitator rather than a controller. However, many anticompetitive outcomes often arise due to government policies that are not in line with market principles. Even though the government is committed to introduce competition based on market principles, the outcome is generally the opposite. Mostly, this happens because of futile efforts borne out of ignorance to reconcile with too many conflicting objectives. And too many good intentions often result in bad outcomes. Moreover, increasing cronyism has also been responsible for such efforts.

2.1 Policies/practices that impede the market process

Trade policy-related distortions: Recently, there have been significant relaxations in quantitative restrictions, reduction in tariffs and ease of the exchange control regime. Despite this, the operation of key elements of the trade policy regime has several anticompetitive dimensions, including policies *vis-à-vis* the operation of anti-dumping measures, inverted duty structure, etc.

Procurement-related distortions: The government is continuing with a discriminatory policy in favour of the public sector, albeit recent moves to extend the purchase preference policy for central public sector enterprises for another three years is an example. Quite often government procurement rules, which otherwise do not have any such preference clause, result in anticompetitive outcomes because of the way they are implemented.

Pricing-related distortions: The government continues to intervene in the pricing of several commodities that distorts competition. For example, the current system of pricing coal weakens incentives for delivering better quality coal or the implementation of a minimum support price system distorts prices of food grains in the open market.

Distortions created by rules and regulations: Many anticompetitive outcomes emanate from Government rules and regulations. For instance, the Essential Commodities Act, which applies to any commodity declared as 'essential' by the Central Government that provides for instruments such as licences, permits, regulations and orders for price control, storage, movement of produce, distribution, compulsory purchase by the government and sale (levy) to the government. The Act vests much discretionary power with government officials, which has led to excessive control and intervention in the functioning of the market.

Some of the state government policies too create anticompetitive outcomes. Many of the policies, rules and regulations adopted by state governments have become obsolete in the present economic environment that adversely affect the competition culture in the country.

Several states have some orders or regulations in place giving preferential treatment in the matter of purchase to units situated within the state borders; they, therefore, encourage government protected cartels. The construction

Box 1: The 'Nine Principles' of Competition Policy

- Foster competitive neutrality between public and private sector enterprises;
- Ensure access to essential facilities;
- Facilitate easy movement of goods and services;
- Separate policy-making, regulation and operation functions;
- Ensure free and fair market process;
- Balance competition and intellectual property rights (IPRs);
- Ensure transparent, predictable and participatory regulatory environment;
- Notify and publicly justify deviation from competition principles; and
- Respect for international obligations.

sector, for instance, is scandalously infested with collusive bidding. Box 1 lists 'Nine principles of Competition Policy', which if observed rightly, can enhance the process of deregulation, liberalisation and competition necessary for sustaining growth and innovation.

3. Competition Related Issues

3.1 Abuse of Dominance

The thrust of Indian Competition Act, 2002 (Amended in 2007: CA 07) is not so much on dominance but on its abuse. It seeks to check the behavioural issues of market practices, rather than the structural ones because 'bigness' or scales are no longer as important as they used to be. This is one reason why the new law, in its treatment of mergers and acquisitions (M&As), has kept a high threshold for regulation. Another critical departure from the old competition law is the way abuses resulting from IPRs, another form of dominance, are treated. The Monopolies and Restrictive Trade Practices Act (MRTPA) was barred from exercising its jurisdiction over any practices sanctioned under an IPR law, while CA 07 can examine any 'unreasonable exercise' of any IPRs if they cause an adverse effect on competition under the provision of 'abuse of dominance' in the new law.

The MRTPA dealt with abuse of dominance in various cases under the windows of 'monopolistic practice' and 'restrictive trade practice', but there was no clear definition on 'abuse of dominance'. Neither was there a clear definition of 'cartels', which, as a collusive action by several parties, could also lead to collective abuse of dominance. The CA 07 defines them better.

3.2 Cartels

Cartels, in India as well as elsewhere, are found to be the most common practice in markets particularly in the intermediate products, i.e. cement, tyres, steel etc., that are processed and that form input costs all along several stages of the supply chain with fairly sophisticated customers. Thus, a cement cartel may result in a distributor being overcharged, which is then passed on in higher prices from the distributor to a builder, and finally the householder.

The Monopolies and Restrictive Trade Practices Commission (MRTPC), in its 30-odd year history, has been able to act successfully against a very few cartels in the domestic market, let alone in the global market, because the law was just not adequate to deal with them. One of its actions was against a cement cartel in India in 1990. But, no significant result has been achieved.

The CA 07 possesses effective provisions to combat cartels, which are based on the best international practices. But how the new law will operate depends on how the provisions are used by the new competition authority. Taking some cues from the successful regimes to enable it to bust cartels, CA 07 contains provisions that encourage whistle-blowing and leniency. This is because cartel 'agreements' are always oral and not documented, which makes it very difficult for an agency to prosecute them even if the circumstantial evidence is corroborative.

With the availability of a leniency programme, powers to impose fines against cartel members, explicit provisions to exercise jurisdiction in respect of actions taken place outside India (with an effect in India), and provisions to enter into co-operation agreement with overseas competition agencies, the CCI has been better empowered to tackle cartel cases than its predecessor.

4. Sectoral Dimensions

4.1 Local Regulation Required

In a big country like India, it is not possible for regulatory actions to be taken up *only* in the national capital. Regulated entities are so many, and often so small in size, that a central body is unable to police them. Therefore, state governments should establish their own regulatory agencies, covering a variety of services under an omnibus/hybrid law and regulatory agency. The constitutional framework allows the state to regulate certain trade practices, which are being followed either on an *ad hoc* basis or not at all, and in many cases without any scientific approach. The state agency can look after sectors that are a part of the state or under the Concurrent list in the Constitution.

4.2 Telecommunications and Electricity

Telecommunication

The telecom sector presents a curious paradox. On one hand, it seems there is enough competition in the sector and compared with regulation in other industries, the decade-old telecom regulatory regime stands apart. On the other, many argue the industry is too fragmented to survive in its current form. Apart from the obvious longer tenure, the telecom regulatory regime (with more than a little prodding from the country's courts) has introduced competition in most areas of telecom (some notable exceptions remain) while the electricity regulatory regime struggles to initiate one.

Political barriers are quite evident in the sector's regulatory regime, as relation between the government and the Telecom Regulatory Authority of India (TRAI) has been a roller-coaster ride. While the previous Government accepted the TRAI's recommendations immediately, the

present Government announced a major change in policy on long distance and internet telephony without even seeking the mandatory TRAI recommendation. As part of the political economy of the country, the Telecom Policy has been changed at least twice to accommodate a big business house.

Electricity

The impact of regulation and the development of competition in the electricity sector have not been effective. The reason for this has been the steadfast refusal by the political class to view electricity as a private good and therefore empower the regulators properly. The very concept of independent regulation has still not been fully accepted. Given the importance of the government role in the electricity market, it is not easy to identify the impact of the regulators. So what we get at best is a fragmented view.

The Government has striven hard to improve access, as can be seen from a large number of programmes. As has been pointed out by experts there has never been an explicit mention of Universal Service Obligation (USO) in connection with electricity.

The Electricity Act, 2003 has tried to make amends by seeking stand-alone systems for rural areas and non-conventional energy systems, and a national policy on electrification and local distribution in rural areas. The Act has further increased the challenges, it sought to change in pricing and tariffs, and unbundling has been made mandatory for all utilities, separation of transmission and systems, etc., such that the past electricity monopolies can be replaced with a more competitive framework.

Regulators are in place in the states and have issued a series of regulatory orders, which are beginning to reduce the wide dispersion in electricity tariffs that have existed traditionally, and to contain tariffs charged for industries.

4.3 Social Sector Regulation

Healthcare and education are critical soft infrastructural issues for economic growth. The healthcare sector is plagued with anticompetitive practices, which are mostly found at local level and need local solutions by way of local regulatory agencies supported by vigilant consumer activism. Strict regulation of all healthcare services, is the need of the hour. Fee structures at private healthcare centres need to be formalised and monitored to prevent exploitation of patients.

The education sector requires a paradigm shift in regulation and the debate has only just begun. The National Knowledge Commission has highlighted the extreme barriers to entry that exist in the field of higher education. This has resulted in an increase in the size and deterioration in the quality of existing universities, as there is no competition. Besides, it does not promote autonomy and accountability. The education sector requires two transformations: state must invest heavily to increase access to higher education and it should respect the autonomy of the institutions, so that a diversity of methods finds expression; and institutions should be allowed to have the flexibility so that talent can be retained in the country.

5. The Way Forward

There is a strong need to promote a culture of competition in India and to enable the consumer movement through resourcing and capacity building. Strengthening and resourcing the consumer movement will go a long way in promoting effective markets and good governance in India at substantially lower costs than similar efforts put into governmental or quasi-governmental initiatives. The challenge is to reach out to the political elite in India to see the benefits of an effective competition law and policy.

Some people think that a competition law is a 'First World luxury'. They are mistaken. It can be applicable in a poor country as much in a rich one, but it will need to be adapted to the local scenario, and innovative ways will have to be evolved to design and implement an effective competition law. Moreover, we need a committed polity, dedicated consumer movement and an honest bureaucracy to effectively implement the laws.

5.1 Future Agenda and Recommendations

Adopt and implement a National Competition Policy

National competition policy is desirable to promote economic development and inclusive growth. Such a policy is the motherboard for designing good policies and practices on economic governance. The economic reforms undertaken by the Government have been generally on a sector-by-sector basis and progress across sectors has not been uniform. So, a broad-based, overarching national competition policy will promote coherence in the reforms and establish uniform competition principles across sectors.

Implement regulatory reforms

There is a need to implement regulatory reforms in order to adopt the best practices in the regulatory architecture, so that India can attract a high order of investment in infrastructure and promote consumer satisfaction to the best extent possible. Predictability of the regulatory framework is an essential pre-requisite to attract investment.

Recommendations

- ◆ Provide a clear distinction between 'policy' and 'non-policy' issues;
- ◆ Make regulatory agencies autonomous by legislation so that undue interference by the line ministry is curbed;
- ◆ Establish a Parliamentary Committee on Regulation and Competition as the reporting authority for all regulatory agencies; and
- ◆ Constitute multi-sectoral regulators to reduce the possibility of regulatory capture by the regulated sector and line ministry.

Implement competition rules

One of the principles of a national competition policy is to proactively promote competition rules through the competition and regulatory laws and remove the repugnant anticompetitive provisions which have a direct and negative bearing on the functioning of a healthy market. The implementation of competition rules is an ongoing exercise. However, there are areas – both macro/cross-cutting and micro – on which the CCI needs to work.

Address systemic issues coherently

The first cross-cutting issue is the quality of personnel – both members and staff – in the regulatory authorities. A common (rhetorical) refrain that is often heard is how one can get Members/Chairmen at a peon's salary. Only retired civil servants or judges are available at such low salaries. Thus, there has been a tendency in recent years to appoint retired bureaucrats and judges as heads of regulatory bodies without ascertaining their suitability. This unhealthy practice needs to be curbed.

Recommendations

- ◆ Standing Committee of eminent people should be constituted to select and/or remove regulators from various regulatory agencies at the central and state level;
- ◆ Regulators should be given a fixed tenure of five years with a maximum age limit of 60 years for appointment, with the reasons for any exceptions defended in writing;
- ◆ Provisions in regulatory laws that deter people from business/non-government sector to move to regulatory bodies should be removed and the prevailing practice of sinecure needs to be discouraged; and
- ◆ The Department of Personnel should be designated as the administrative ministry for regulatory bodies, responsible for release of appointment orders and other administrative matters.

Develop capacity building solutions

Capacity building programmes need to be developed for devising methods and coping strategies to ensure effective implementation of the competition regime within a given environment. Sectors like power, water supply and sanitation, urban infrastructure, transport infrastructure, oil and gas and telecommunications demand greater capacity building efforts. India has now adopted a new competition law, which will be in line with the changed economic scenario. However, there is very little expertise in the country. Thus, there is a huge capacity building agenda.

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