COMPETITION DISTORTIONS IN INDIA – A CUTS DOSSIER

(CDI-40: April to June, 2018)

For earlier Dossiers please see: http://www.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 utilised without verifying its accuracy, but ensuring its veracity.

The purpose is to flag issues and provide food for thought to the layman as well as to the policymakers and regulators. A detailed analysis has not been undertaken as it would require deeper examination of the issues, particularly in terms of cost and benefits.

We are pleased to present to you the CUTS Competition Distortion Dossier Edition No: 40 for the quarter of April-June 2018.

In this edition, we continue where we left off earlier, by highlighting the long-term adverse effects of retaliatory trade measures and possible trade wars on domestic competition. Furthermore, the unattractiveness of the terms of the sale for the debt-ridden Air India has featured again in this edition and we highlight the distortionary issues that still loom large.

Coming to the contemporary issues *vis-à-vis* the digital economy, we explain the possible negative effects of the latest notification, especially on start-ups, small and medium sized enterprises (SMEs) by the Reserve Bank of India (RBI) mandating data localisation for payment systems.

Positive developments in the energy sector, particularly regarding the opening up of coal auctions to the steel and power sectors and the possible splitting up of the GAIL (India) Ltd. have also been featured.

Contents

A. Trade Policies

1. India Hits back at US Tariffs

India raised tariffs on a slew of items in retaliation for the US imposing higher levies on some products shipped from the country, echoing steps taken by China, the European Union and other trading partners. The import duty on chickpeas and Bengal gram has been increased to 60 percent, while that on lentils has been hiked to 30 percent. Other products on which duties have been hiked include certain kind of nuts, iron and steel products, apples, pears, flat rolled products of stainless steel, other alloy steel, tube and pipe fittings, and screws, bolts and rivets.

Source: www.hindustantimes.com/business-news/india-raises-import-duties-on-agri-steel-products-to-protest-us-tariff-hike/story-fung5wX88UshIfORNCwPBK.html

Food For Thought

The US is one of India's largest trading partners. India enjoys a trade surplus of US$24bn with the US.[1] *This figure represents gross trade balance while one should look at the other side also, i.e. trade balance in terms of value added. According to the Organisation for Economic Cooperation and Development (OECD) Trade in Value Added (TiVA) database, India's trade surplus (in terms of value added) with the US has declined from US$8.2bn in 2003 to US$4.8bn in 2011.*[2] *Thus, data on the two sides of trade balance reflect that as compared to India's exports to the US, there is much more domestic value addition in US exports to India. This implies that India's exports to the US comprise of mainly primary or low value added finished products while US exports to India include high-value technology intensive products. Noteworthy, India's share in total goods trade deficit of the US is less than three percent in 2017.*[3]

However, in order to reduce its trade deficit and protect American industries, the US levied 25 percent tariff on steel and 10 percent tariff on aluminium imported from all countries except Canada and Mexico in March 2018.[4] *This move affected steel and*

[1] www.thehindubusinessline.com/economy/policy/us-moves-to-bridge-24billion-trade-deficit-with-india/article9663443.ece

[2] See CUTS-WDC Policy Note #1/2018, India-United States Bilateral Trade Deficit: Myth and Reality. Available at http://cuts-wdc.org/pdf/CUTS-WDC_Policy_Note-1-India_United_States_Bilateral_Trade_Deficit.pdf

[3] Calculated from www.census.gov

[4] www.thehindubusinessline.com/news/world/trump-imposes-heavy-tariffs-on-steel-and-aluminium-imports-into-us/article22992419.ece

aluminium exports from India to the US worth US$198.6mn and US$42.4mn, respectively. Such measures have an adverse impact on consumers in the importing country and result in retaliatory action, thereby hampering the precedents of bilateral trade between both countries.

Although such measures taken by the Indian authorities may be justifiable in short term to protect the interests of the domestic industry and from a political economy perspective, emerging trade wars between the US and India would negatively impact consumers and competition in both the nations in the long-run.[5] *Specifically in the Indian context, there is a possibility that such trade wars would hamper the global competitiveness of Indian firms, especially those that export products, such as steel and aluminium.*

From this follows the need to check distortionary measures,[6] *bearing in mind the intended growth prospects and competitiveness of industries such as steel in both the countries. Apart from strengthening the political ties, bilateral trade between both the countries has historically proven to be economically beneficial in terms of growing foreign direct investments (FDIs), and has, in turn, promoted competition and served consumers' interests.*[7] *This precedent is worth preserving and trade related distortionary measures should always remain an exception.*

2. 10% Duty to Curb Aluminium Dumping

Faced with 123 percent growth in imports over last seven years, the aluminium industry has sought government intervention by way of higher import duty of 10 percent on scrap and metal to protect domestic production. The industry fears the ongoing US-China trade war will cause further dumping of surplus metal and scrap from countries like the US, China and Russia, which would affect domestic producers.

Source: http://mydigitalfc.com/plan-and-policy/10-duty-sought-curb-aluminium-dumping

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[5] See effect of tariffs on prices of goods in the US, available at www.washingtonpost.com/graphics/2018/business/trump-tariff-trade-war/?noredirect=on&utm_term=.f2fba4ccea28

[6] By use of tools like competition impact assessment, available at: www.cuts-ccier.org/Compeg/pdf/CUTS_Competition_Impact_Assessment_Toolkit-A_Framework_to_Assess_Competition_Distortions_Induced_by_Government_Policies_in_the_Developing_World.pdf

[7] See www.brookings.edu/blog/up-front/2017/06/22/growing-the-u-s-india-economic-relationship-the-only-way-forward/ and www.cnbc.com/2018/07/13/india-execs-raise-concerns-about-potential-trade-war-with-us.html

Food For Thought

Annually, India consumes three million tonnes of aluminium and simultaneously has a production capacity of four million tonnes. This means that India is potentially self-sufficient in terms of production of aluminium. However, despite this self-sufficiency, the country meets nearly 50 percent of its demand through imports, mainly from China as it diverts its surplus to other countries and offers rock-bottom prices. As mentioned before, imports have risen by 123 percent and domestic producers have advocated for an increase in import duty in order to curb imports.

With threat of China-US trade wars and the concurrent possibility of surplus dumping in India, protecting the interests of domestic producers seems to be a valid concern. However, the argument in favour of anti-dumping measures, led by primary producers of aluminium, seems to be protectionist. It is likely to distort competition downstream as secondary and tertiary industries would bear the brunt of increased prices. The domestic producers need to analyse the reasons for their inability to face competition in the domestic and export markets.

As pointed out by the Metal Recycling Association of India (MRAI), this move would 'restrict the availability of scrap for recycled aluminium for more than 5,000 units in the country'.[8] As a result, it would have an adverse impact on SMEs, especially those that 'make products such as alloys by recycling, as it will shoot up their input cost'.[9] As a result, the decision of whether or not to impose the duty would ideally require a more detailed cost-benefit analysis keeping in mind the possibly distortionary impact on competition in the downstream industry (especially SMEs) and on the end consumer. Moreover, policy distortions, if any, which hinder domestic producers to effectively compete with foreign producers need to be rationalised.

B. Policies Inhibiting Competition

3. Air India Sale Faces Serious Turbulence

With two major domestic carriers IndiGo and Jet Airways pulling out of the race for Air India and the Tata Group reported to be disinclined to bid, there is a growing chorus for 'serious corrections' to the terms of sale laid out by the government. The

[8] See www.thehindubusinessline.com/economy/secondary-aluminium-industry-players-urge-govt-to-remove-duty-on-scrap-import/article24449952.ece

[9] *Ibid*

key challenges are the huge Rs 33,000-crore debt burden, which needs to be written off completely, government stake of 24 percent, which could be reduced to just a single golden share, and full transfer of Air India staff.

Source: www.thehindu.com/business/markets/centre-should-make-serious-corrections-in-ais-sale-terms/article23505495.ece?utm_source=email&utm_medium=Email&utm_campaign=Newsletter

Food For Thought

In the previous edition of the CDD (edition 39), we had highlighted the unattractiveness of the terms of the sale and the unpredictability of the process of disinvestment of the debt ridden Air India and stated, 'such an approach in totality might end up distorting the process of privatisation and as a result might defeat the objective of the exercise, i.e. to increase the competitiveness of the debt-ridden airline and bringing in efficiencies through disinvestment'. This has in fact materialised. The proposed sale of Air India has failed to attract any bids and the Civil Aviation Ministry informed that it had received no response for the expression of interest floated by it.[10]

The various contentious pain-points that led to a no-show include: the requirement from the bidder to operate Air India at arm's length from its other businesses; mandatory IPO; and freezing bidder's shareholding structure at the Expression of Interest stage. These and other conditionalities have jeopardised the privatisation exercise and failed to create an attractive environment for potential bidders. It is evident that the window of opportunity to infuse economic efficiencies through privatisation of the debt-ridden national carrier is closing, that will naturally negatively impact the possibility of further improving competition in the robust Indian aviation industry.

4. RBI Mandates Data Localisation for Payment Systems

The RBI, India's central bank and the regulator for payment systems in India, in its press release dated April 05, 2018, mandated data localisation for payment systems. The notification states *inter alia* that all system providers shall ensure that the entire

[10] See https://twitter.com/MoCA_GoI/status/1002161580652580866?ref_src=twsrc%5Etfw%7Ctwcamp%5Etweetembed%7Ctwterm%5E1002161580652580866&ref_url=https%3A%2F%2Ftimesofindia.indiatimes.com%2Fbusiness%2Findia-business%2Fno-takers-for-maharaja-air-india-auction-fails%2Farticleshow%2F64401806.cms

data relating to payment systems operated by them are stored in a system only in India. This data should include the full end-to-end transaction details/information collected/carried/processed as part of the message/payment instruction. For the foreign leg of the transaction, if any, the data can also be stored in the foreign country, if required.

Source: www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11244&Mode=0

Food For Thought

The RBI justified its exclusive data localisation requirement on the pretext of better monitoring and supervision of market players. The condition is likely to increase cost of doing business disincentivising market players to make additional investments in safety and security. Effective monitoring and supervision, along with access to data by law enforcement agencies, are legitimate government objectives. However, there is no reason why such objectives cannot be met when data is stored at location of choice of businesses, which may be outside the country. Moreover, it is not certain if such objectives will be met if the data is mandatorily stored within the country.

Data localisation requirements are likely to create competition distortions as its impact on differently situated companies (difference may be geographical as well as related to resource availability) might create an unlevel-playing field. While large domestic companies having data centres in the country are likely to support such requirements, large multinationals are not. Even small and medium sized companies, including start-ups, are likely to witness increase in cost as companies operating data centres are likely to pass them on.[11]

The recently released draft of the Personal Data Protection Bill, 2018, also requires storage of at least one serving copy of the personal data on a server or data centre in India. It further mandates that critical personal data shall only be processed in India.[12] *Localised data processing may fail to benefit from global standards and capabilities of data processing, safety, security, and fraud detection, thus impeding interests of consumers and small local businesses. These are unlikely to be replicated at local data centres.*

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[11] https://inc42.com/buzz/paytm-continues-to-support-data-localisation-mirroring-data-not-the-solution/
[12] http://meity.gov.in/writereaddata/files/Personal_Data_Protection_Bill%2C2018_0.pdf

The legitimate objectives of the government can be met be improving regulatory capacity, reforming mutual legal assistance treaties, strengthening global cooperation on data protection, designing model codes for data requests. Competition distortionary policies might not be the best solution in this regard.

C. Good News: Policies Promoting Competition

5. Government to Open Coal Auctions to Steel, Power Sectors

Union Minister Piyush Goyal said the government was looking at opening auctions of coal mines to steel and power sectors, and that a robust framework was being worked out for commercial mining. Goyal, who runs coal and railway ministries said different proposals were underway with respect to mines auctioning, and added the banking secretary would be meeting all stakeholders.

On power sector he said, "within that framework, if there is a way to work with the power sector players and bankers in consultation and under the advice and guidance of the RBI, we will try to find a solution in the best interest of the country."

Source: www.cnbctv18.com/economy/government-looking-at-opening-coal-auctions-to-steel-power-sectors-says-piyush-goyal-124603.htm

Food For Thought

In February 2018, the Cabinet Committee on Economic Affairs opened up commercial coal mining for private players, putting an end to Coal India's monopoly in mining and selling coal. Opening the auctions of coal mines to the steel and power sectors is likely to induce competition, promote efficiency and aid in better price discovery.

The true potential of coal sector can only be realised by adopting transparency and competition reforms. The government is also considering revamp of coal auction rules, to make them more business-friendly. Some of the suggested reforms include allowing bidding on revenue share basis, allowing captive mines to sell part of the output in the market, easing of bank guarantees, and linking the value of to-be-auctioned blocks with a proposed monthly coal index.[13]

These reforms are likely to promote competition and induce efficiency in the sector.

[13] https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/revamp-of-coal-auction-rules-business-friendly-reforms-on-cards/articleshow/65001261.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

6. India Aims to Split GAIL to Open up Gas Sector

India plans to split state-run gas utility GAIL by March 2019 to create two companies: one marketing gas, and another operating pipeline that can be used by consumers who buy direct from producers. By splitting GAIL, the regulator of India's oil and gas sector hopes to increase the number of gas consumers and attract billions of dollars needed to expand the pipeline network and build more liquefied natural gas (LNG) terminals.

Source: https://in.reuters.com/article/india-gas/india-aims-to-split-gail-within-a-year-to-open-up-gas-sector-idINKBN1HY12Q?utm_source=Twitter&utm_medium=Social

Food For Thought

GAIL (India) Ltd is the country's biggest gas marketing and trading firm and owns most of the nation's pipelines, giving it a stranglehold on the market for fuel. By unbundling GAIL and opening the sector, the government hopes to increase usage of fuel and meet its objective of raising the share of a cleaner, cheaper fuel as a part of the energy mix to 15 from 6.2 percent, in the next 12 years. This will be possible as different sectors are likely to be thrown open for private sector investment with government run operator just being one of companies competing for market share.

GAIL owns more than two-thirds of India's existing 15,000 km (940 miles) of pipelines, but the government wants to more than double the network to expand gas deliveries. While the new pipeline company created by the division of GAIL would be expected to lead the way, other companies are likely to be in a position to bid for rights to build and operate pipelines. It has been estimated that investment of nearly US$20bn would be needed over the next several years for laying pipelines. Attracting of private sector capital by unbundling of the sector and allow competition is the right way forward.