COMPETITION DISTORTIONS IN INDIA – A CUTS DOSSIER

(CDI-44: April to June, 2019)

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. 44 for the quarter of April-June 2019. In this edition, we cover stories of attempts to provide a fillip to the domestic solar manufacturers as well as the withdrawal of India's GSP benefits by the US. Further, we cover initiatives that could contribute positively to competition in the country. These include the interoperability framework launched by BSE followed by the report on Digital Payments by the RBI powered Nandan Nilekani Committee. As for policies that may negatively impact competition in the economy, we discuss the pain points in the aviation sector as well as the drawback of infusing cash to revive the Public Sector Banks.

Contents

Trade Policies

India Revises Solar Manufacturing Tender to Attract Investors[1]

More than a year and 10 extensions later, the Union Government has revised the tender specifications for the first solar manufacturing-linked power plant project in the country. Hoping to attract more domestic investors, the tariff cap has been set at Rs 2.75/unit. This will be for setting up 6 GW (per annum) of solar power plants linked to 2 GW of solar manufacturing plant. Introducing an interesting amendment, Solar Energy Corporation of India (SECI) has allowed using imported solar modules at the power plant and not necessarily the ones manufactured at the linked unit set up by the company. Earlier, this was mandatory.

Food for Thought

In an attempt to boost domestic solar module manufacturing in the country, the Indian government has sweetened the terms and conditions of the manufacturing-linked solar scheme.[2] While India leads as the producer of solar energy, it takes the backseat as the manufacturer of solar panels.[3] Its share of all manufacturing in gross domestic product (GDP) has remained stagnant at 16 percent from 1991-2017.[4] Indian solar manufacturers are losing foothold in the domestic market due to continuous solar imports as even after the imposition of safeguard duty, imported solar equipment are cheaper than domestically manufactured equipment.[5]

In 2017, 90 percent of the solar imports came from China due to the competitive low prices offered by Chinese manufacturers.[6] China's solar panel manufacturing growth is largely driven by three factors, namely (i) technological know-how; (ii) low cost of capital; and (iii) subsidised land acquisition, raw material and labour, all of which are backed by the Chinese government.[7] Meanwhile, it has also adopted an aggressive approach to match the growing demand of solar power in India. In 2018, China cut financial support to developers and halted approval for new solar projects.[8] As a result,

[1] www.financialexpress.com/economy/seci-tweaks-conditions-for-manufacturing-linked-solar-scheme/1620371/
[2] https://qz.com/india/1546930/why-indias-latest-push-for-solar-panel-manufacturing-may-not-be-strong-enough/
[3] www.financialexpress.com/industry/india-is-cheapest-solar-energy-producer-beats-china-uk-us-among-others/1618546/
[4] www.thehindu.com/opinion/op-ed/india-needs-a-solar-manufacturing-strategy/article27526839.ece
[5] www.pv-magazine-india.com/2019/07/19/lets-compete-on-quality-and-innovation-vikram-solar-cfo/
[6] Supra Note 3
[7] *Ibid*
[8] *Ibid*

Chinese producers cut their prices of export to India to sustain their manufacturing plant capacity utilisation. These low cost Chinese imports have led to India's poor performance in solar panel manufacturing.

While the government's intent to promote domestic manufacturing of renewable energy equipment is visible, should there be a robust manufacturing policy for the Indian solar industry to successfully satisfy in-country demand for greener environment? Are the current government incentives and subsidies enough to make the solar modules cost competitive with the foreign suppliers?

Perhaps the Indian government needs to learn its lessons from China and take concrete measures to develop the entire solar supply chain capacity within India so as to reduce its dependence on other nations and become a global leader of solar power. There should be a higher focus on innovation and quality/performance improvement of solar equipment.[9] *Alongside this, penetration in the untapped and emerging solar markets globally will also support domestic solar manufacturers to generate revenue.*[10]

Withdrawal of India's GSP Benefits by US[11]

The US has withdrawn India's Generalised System of Preferences (GSP) benefits from June 05, 2019. These are unilateral, non-reciprocal and non-discriminatory benefits extended by some developed countries to developing ones. India, as part of our bilateral trade discussions, had offered resolution on significant US requests in an effort to find a mutually acceptable way forward. It is unfortunate that this did not find acceptance by the US. India, like the US and other nations, shall always uphold its national interest in these matters.

Food for Thought

The GSP, established by the Trade Act of 1974, is the largest and oldest US trade preference programme. The US intends to promote economic development by eliminating duties on some products it imports from the 120 countries designated as beneficiaries.

[9] Supra Note 4
[10] *Ibid*
[11] http://pib.nic.in/newsite/PrintRelease.aspx?relid=190203

Not only does it help benefitting countries in increasing and diversifying their trade with the US, but also boosts US' competitiveness by reducing the costs of imported inputs used by US companies. Withdrawal of such benefits puts India at a disadvantage with other competitors that enjoy them as the landed price of goods exported from India has to be the same as it was before the GSP was removed. If not, consumers of those products in the US would gravitate to producers that enjoy the GSP benefits and hence are able to offer lower prices. As for India, it responded to US' withdrawal of the GSP benefits by imposing its long pending retaliatory tariffs of US$235mn on import of 29 US products worth US$1.4bn.

The series of protectionist measures taken by two governments has strained the relations between these strategic partners. While the US has been urging India to open its markets to foreign players, the Indian government has been inclining toward protectionist towards foreign firms in the fast growing e-commerce market to help foster domestic companies and create jobs for millions of youth. With the ongoing talks between US and India to provide impetus to bilateral trade and commercial ties, the two countries should aim at achieving mutually beneficial outcomes that furthers their growing economic relationship. Meanwhile, on a national front, India should focus on providing breather to producers suffering losses from the GSP removal, by offering fiscal benefits to the affected sectors.

Policies Promoting Competition

BSE Launches Interoperability Framework[12]

The Bombay Stock Exchange (BSE) has gone live with the implementation of the interoperability framework among clearing corporations. The Securities and Exchange Board of India (SEBI) laid down the broad guidelines for operationalising the interoperability framework among clearing corporations in November 2018. The interoperability framework allows traders to settle their dealings in any of the exchanges irrespective of the exchange on which the transaction took place.

[12] www.thehindubusinessline.com/markets/bse-launches-interoperability-framework/article27428230.ece

Food for Thought

As the stock exchanges commence the implementation of SEBI's interoperability framework, it comes with far reaching benefits for traders and investors. Not only is it expected to reduce the overall cost of compliance and trading for participants, but will also promote competition amongst clearing corporations and strengthen the risk management system of exchanges.[13]

- ***Promote Competition***

  Interoperability will open opportunities for trade in different instruments across exchanges for an investor. The trading members will now be able to clear trades through a clearing corporation of their choice instead of going through the clearing corporation owned by a particular exchange. This will expose clearing corporations to more competition thereby offering better services to consumers.

- ***Enhance efficiency in capital deployment***

  An investor trading through the same broker across exchanges will be eligible for netting the benefits of his trades through any clearing across the exchanges.

- ***Reduce compliance and trading costs***

  By allowing the brokers to use any of the clearing corporations to settle the trades, interoperability would lower the compliance cost for market intermediaries, which in turn would lower the trading cost for investors.

- ***Strengthen risk management***

  By separating execution risk from settlement risk interoperability would provide safety and security to participants in the event of shutting down of a particular exchange or its clearing platform due to technical glitch, cyber-attack etc.

[13] www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-interoperability/article27765847.ece

Nandan Nilekani Committee Submits a Report on Payments to RBI[14]

Nandan Nilekani led High-Level Committee on Deepening Digital Payments submitted its report to the Reserve Bank of India (RBI). The five-member team was formed in January 2019 by the RBI to consult various stakeholders of the payments ecosystem and deliberate on solutions to further strengthen the industry.

Food for Thought

Recently, the five-member panel made its recommendations to the RBI through a comprehensive report that provides a medium-term strategy for deepening of digital payments. The Committee estimates that there are about 100 million monthly active users of digital payments in India and the number is expected to increase three-folds by 2021. The figure only reinforces the relevance of boosting digital payments in the country while promoting competition and safeguarding innovation.

- ***Conducting periodic user surveys on attitude to digital payments to get a better pulse of local issues***

  Consumers form the bedrock of competition law and policy in any economy. It is pertinent to gauge consumer preferences and perspectives not only to advance digital payments but also to promote competition. It will also pave way for evidence-based reforms which will thereby facilitate optimal competition and regulation of digital payments.

- ***Encouraging non-banks to participate in the payments system***

  The Committee encourages banks and non-banks to continue to compete, innovate and grow the ecosystem. It recommends payment schemes be allowed to induct non-banks as associate members to encourage acceptance of digital payments. In order to facilitate effective competition, there is a need to encourage level playing field by treating similarly placed entities similarly, and dissimilarly placed entities dissimilarly. With more and more consumers adopting digital payments, there should be an enhanced role of non-banks in access to and operations of retail payments systems.

[14] https://economictimes.indiatimes.com/industry/banking/finance/banking/nandan-nilekani-committee-submits-report-on-payments-to-rbi/articleshow/69376839.cms

- ***Incorporating risk based light touch regulation enabling the regulated players to serve consumers in a viable manner***

  Banking constitutes diverse activities like deposits, payments and credit, each of which pose different risks and can be differently regulated. There is a need to reform disproportionate entity-based regulation and move towards proportionate risk-based regulation to promote competition and innovation.

  Going forward, the regulators have their task cut out. After coming up with several policy initiatives on paper, it is time for the RBI to take action and implement them on the ground. Even the tall promises of a truly Digital India will be put to test with the recommendations laid out by the Nandan Nilekani panel. The report leaves the readers with certain thought-provoking questions:

  - *Will the broad base recommendations hinder their effective implementation?*
  - *With India being an overwhelmingly cash heavy economy, what will it take for a true transition to a digital society?*
  - *Why is the report silent on the formation of a separate body to govern the digital payments ecosystem, as also suggested by the Inter-Ministerial Committee for Finalisation of Amendments to the Payments and Settlements System Act?*

Policies Inhibiting Competition

Policymakers partly blamed for Jet Failure[15]

The failure of Jet Airways should be a 'wake-up call' for the aviation industry and at least part of the blame should be at the doorstep of the policymakers as the cost structure is high, SpiceJet Chief Ajay Singh said. Indian aviation sector has high growth potential, but airlines have been flagging concerns about high costs, especially for aviation turbine fuel (ATF) that accounts for over 40 percent of an airline's operational expenses.

[15] www.businesstoday.in/sectors/aviation/failure-jet-airways-wake-up-call-industry-policymakers-partly-blamed-spicejet-chief-ajay-singh/story/353654.html

Food for Thought

The aviation sector in India has witnessed the rise and fall of many airlines over the course of past decade. In 1992, the government opened the skies for private players to operate as scheduled airlines enabling the entry of Jet Airways, ModiLuft, Damania Airways, Air Sahara, and East-West Airlines etc. in the civil aviation industry. Other than having airplanes in common, all these players also shared financial and operational troubles. Each of them either eventually ceased their operations or was acquired owing to being crushed under the massive weight of debts and not being able to sustain operations.

One of the commonly flagged reasons behind the prolonged financial crisis of airlines is high tax on ATF. ATF, also known as jet fuel, accounts for over 40 percent of an airline's operational expenses. Tax imposed on this fuel in India is among the highest in the world. Domestic carriers pay 11 percent excise duty on jet fuel, but do not get credit for it in the final tax liability on airfare charged to the consumer in the form of Goods and Services Tax (GST) as both are different streams of indirect taxation.[16] Thus, domestic airlines suffer from an uneven level playing field as compared to their international counterparts with respect to tax levied on jet fuel leading to high operational cost structures.

As per the Economic Survey 2019, unpredictable changes in global crude oil prices were compounded by high domestic tax regime on jet fuel in 2018-19 for the airlines industry.[17] In order to compete increasingly with global carriers, the service providers have urged for a competitive cost structure with international airlines.[18] This has led to the demand from airline carriers to bring the fuel within the ambit of GST with input tax credit in order to create a level playing field for them vis-à-vis international carriers.[19]

India's aviation sector contributes significantly to the economy by enabling trade, creating jobs and facilitating connectivity. As India progresses towards establishing its mark as a global leader in various sectors, its aviation sector cannot be neglected. It deserves the attention of regulators particularly at the present state of affairs with a

[16] https://m.economictimes.com/industry/transportation/airlines-/-aviation/government-cuts-excise-duty-on-aviation-turbine-fuel-to-11-percent-from-14-per-cent/articleshow/66152693.cms
[17] www.deccanherald.com/business/budget-2019/economic-survey-flags-high-tax-regime-for-jet-fuel-744994.html
[18] Supra Note 5
[19] www.moneycontrol.com/news/business/economy/taxation-imbalances-in-indian-aviation-sector-need-to-be-corrected-says-spicejet-chief-ajay-singh-4077981.html

beleaguered private airline (Jet Airways) and the only public airlines (Air India) on life-support. Perhaps the need of the hour is to undertake targeted policy interventions to ensure sustainable growth of the industry.

FinMin to Review Capital Needs of PSU Banks[20]

The Finance Ministry will review the capital infusion requirements of public sector undertaking (PSU) banks after September and there will be separate allocation for recapitalisation in the general Budget likely to be presented in July 2019. According to official sources, by September 2019, the capital position with regard to the regulatory requirements and growth of all the PSU banks, which received funds in 2018-19, will be clear.

Food for Thought

The feeble state of Public Sector Banks (PSBs) in India is well known. As of December 2018, the overall bad loans, i.e. loans that went unpaid for 90 days or more accounted for Rs 8.64tn.[21] Just in the last quarter of the current financial year, public banks reported a collective loss of Rs 30,940 crores.[22] Majority of PSBs have found a place under the RBI's prompt corrective action programme with government infusing capital to keep them afloat.[23]

At a time, when the country is marred with lack of capital inflow in the domestic market, there is an expectation to boost the banking sector for capital formation and consumption. However, such efforts have been unidirectional. The government's inclination towards favouring the state-owned enterprises (SOEs), such as the PSBs in this case, comes at the cost of neglecting the private players, which occupy a larger market share in the Indian banking industry, thereby leading to an uneven playing field. More recently, private as well as non-banks have gained prominence in the economy when PSBs have been burdened with bad loans.

As for PSBs, recently there was a three-way merger between Vijaya Bank, Dena Bank and Bank of Baroda to create the second largest lender in the country after the State

[20] www.livemint.com/news/india/finmin-to-take-call-on-psu-banks-capital-infusion-requirements-after-september-1556882845992.html; As a recent development, the 2019 budget announced a cash infusion of Rs 70,000 crores in PSBs.

[21] www.livemint.com/industry/banking/how-private-banks-are-taking-over-indian-banking-1560706195840.html

[22] *Ibid*

[23] www.businesstoday.in/opinion/perspective/are-weak-public-sector-banks-discouraging-term-deposits/story/357205.html

Bank of India. Pursuant to this merger, suggestions have been made to merge smaller banks with big lenders to create institutes of global scale and size.[24] *Also, competition should be used as a tool to determine which PSBs need to be supported.*[25] *Further, creation of a Bank Investment Company, as in Singapore, which creates a layer between the government and banks could also offer respite to woes of Indian PSBs.*[26]

The case of PSBs in India leaves many questions unanswered. Should the government take lessons from sectors such as telecom and airlines where SOEs are struggling to survive as private companies are flourishing? With the private sector banks capturing lion's share of the market, should the government continue to infuse cash in PSUs to revive them? Should such financial injections be backed with a solid roadmap for growth? Is the nationalisation of banks justifiable in the present economy?

[24] www.bloombergquint.com/business/50-years-of-bank-nationalisation-can-india-follow-singapores-example-in-psu-bank-reform
[25] www.bloombergquint.com/business/dont-allow-public-sector-banks-to-whither-away-says-yv-reddy
[26] Supra Notes 14 and 15