COMPETITION DISTORTIONS IN INDIA – A CUTS DOSSIER

(CDI-39: January to March, 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: 39 for the quarter of January to March 2018. In this edition, we have a dedicated Trade Policy Section highlighting the possible distortionary impact of India's rising protectionist tendencies, with special reference to India-U.S. trade relations. In the trade policy section, the thematic issues revolve around the divergent impact of import substitution and export promotion policies.

Apart from this, we have intended to capture interesting stories having an impact on competition, in sectors such as agriculture, energy, civil aviation, digital payments, retail and telecommunications. Subsequently, the distortionary effect of entity-based regulation on competition has been highlighted with respect to the India's digital payments industry. In the same vein, the government's indication to investors about possible retention of stakes in the national carrier, Air India and its impact has been discussed. Conversely, there have been several positive developments in the telecom and energy sector, where the government has proposed big-ticket reforms which will expectedly have a positive impact on the competitive structure of relevant the industries.

Contents

A. Trade Policies

1. India's protectionist tendencies

India's Union Budget 2018-19 substantially raised tariffs across a range of sectors, thereby reversing a 20-year trend. As a result, on imported mobile phones, the applicable rate jumps from 15% to 20%, in addition to a 15% tariff on certain components of mobile phones and television sets. According to the Finance Minister, the explicit rationale for this move is to increase value addition in domestic manufacturing which is tied to the 'Make in India' scheme. Moreover, the move is also aimed at generating employment.

Source: https://www.livemint.com/Opinion/TjhwiyIuWRAjVma8IsneKI/Indias-protectionist-folly.html

Food For Thought

The traditional rationale behind inward-looking policies has been the replacement of foreign imports with domestic production. This is basically done by implementing policies which promote import substitution. Industrialisation led by import substitution strategies helped nations in the past to build supply chains from scratch (Baldwin, 2012).[1] However, with the emergence of global value chains (GVCs) and rapid technological advancements, such strategies have proven to be no longer worth pursuing. Ironically, the same rationale seems to be one of the driving forces behind the implementation of the 'Make in India' initiative, through which the government wishes to raise the global competitiveness of the Indian manufacturing sector.

Conceptually, the laudability and clarity of the initiative cannot be challenged. There has been a lot of debate on what can be considered as 'fair competition' in this regard (whether enterprises in developing nations such as India need protection to grow or not).[2] While import substitution might unduly favour domestic industries, dropping import duties might invariably disproportionately benefit foreign industries operating from position of strength.

Besides, in order to truly add value to the already existing GVCs across sectors and to generate revenue through exports, one of the most crucial prerequisites is to have open borders. Although import substitution and tariff increase might seem inviting in the short-run, it could turn out to be counterproductive in the long run. In the long-run, increasing tariffs in select

[1] http://graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/Baldwin/Publications/Chapters/Globalization/__PROOF_MS_ch5_RichardBaldwin_p306-392.pdf

[2] For more, see https://www.livemint.com/Opinion/X85hbGZDg28XPaEudP8SLJ/Trade-in-an-increasingly-protectionist-world.html and https://www.livemint.com/Opinion/38V3FaVxTKjLODGRs1lOYL/Indian-enterprises-need-protection-to-grow.html

sectors could in fact translate into uncompetitive global exports (as the cost of domestic production rises) and unsustainable growth of domestic firms.

This is because firms which are at the lower rung of the GVC (in select sectors), will only be able to add real value by addressing and focussing on their foundational innovation constraints, not by receiving policy protection from global competition. In this regard, the government has a crucial role to play in terms of inter alia building firm level innovation capacities and generating core competencies in sectors which are lagging behind. To encourage this, an inward facing policy outlook might not suffice.

Another implication of raising trade barriers (or threatening to do so) is that it might directly distort economic ties with potential allies. For instance, one such consequence has been the threat of reciprocal action from the US and the rising trade friction between India and the US.[3] *Both governments run the risk of negatively affecting competition in select sectors which have previously proven to be profitable and have brought in substantial dividends. Furthermore, reciprocal retaliatory action can negatively impact export competitiveness of firms in the long run. Reportedly, India currently ranks ninth on the list of trading partners that run a trade surplus with the U.S., which means India exports more to the U.S. than what it imports.*[4] *Moreover, bilateral trade between India and the U.S. has grown to about USD 115 billion in 2016 from $20 billion in 2001*[5]*. Hence, raising trade restrictions might ruin this lucrative relationship, adversely affecting competition in key sectors, thereby eventually rendering it a self-defeating exercise for both countries.*[6]

2. Draft policy seeks stable regime for agriculture exports

The Department of Commerce recently circulated a draft 'Agriculture-Export Policy' which provides a broader policy framework to promote agriculture exports and to integrate Indian farmers with the global markets. The policy aims to "double farmer's income and increase the share of agricultural exports from present US$ 30 Billion to US$ 60 Billion by 2022".

Reforms in the *Agricultural Produce Marketing Committee (*APMC Act), streamlining of mandi fee and liberalisation of land leasing norms are among the raft of measures suggested in the draft policy, formulated by the commerce ministry aimed at helping to realise the government's goal of doubling farmers' income by 2022.

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[3] https://in.reuters.com/article/us-india-usa-trade-exclusive/exclusive-u-s-tells-india-to-cut-tariffs-as-trade-friction-heats-up-idINKCN1G70J3
[4] https://www.bloombergquint.com/business/2018/03/05/trade-war-us-metal-tariffs-impact-on-india
[5] https://in.reuters.com/article/us-india-usa-trade-exclusive/exclusive-u-s-tells-india-to-cut-tariffs-as-trade-friction-heats-up-idINKCN1G70J3
[6] https://www.ft.com/content/25900f14-1564-11e8-9c33-02f893d608c2

Source:
http://commerce.gov.in/writereaddata/uploadedfile/MOC_636571617294118126_Draft_Agr_Export_Policy.pdf

Food For Thought

The draft Agriculture Export Policy has a forward looking agenda, which has linkages with numerous other policies of various ministries and departments. It basically suggests inter alia the removal of restrictions on export and provides an assurance that processed agricultural products or organic products will not be subject to export restrictions such as Minimum Export Price (MEP), duty on exports and bans, etc. The draft policy also highlights the possible distortionary impact of providing protection to domestic players. Furthermore, the draft rightly recognises that utilising trade policy as a means to attain short-term goals through levying export restrictions might negatively affect India's image as a reliable supplier.

In totality, it seems that the policy is a step in the right direction. However, as it stands, it missies out on the opportunity to propose reforms which might help reduce entry barriers from the perspective of farmers. There is also scope for the policy to introduce one major concept, i.e. promoting the farmers (agriculturists) to move up in the global agriculture value chains. From the definition of "agriculturists" in the Agricultural Produce Marketing Committee (APMC) Laws (including the latest Model Agricultural Produce and Livestock Marketing (Promotion and Facilitating) Act, 2017 and the Model Contract Farming Act, 2018), it can be inferred that the vision of policy makers for farmers has been to restrict their roles till harvest. As per these (model) laws, anything beyond harvest comes under the domain of 'marketing'. "Value addition at farm gate" is a must for farmers to climb up the value chain and to gain more remunerative prices for their value-added produce.

The draft policy also recommends reform in the Agricultural Produce Marketing Committee (APMC) Act, which noticeably suffers from several competition distortions including the constitution of market committee in a manner which practically escalates the possibility of collusion and anti-competitive conduct and a clear conflict of interest of the APMC, which in effect promotes monopolistic tendencies and abuse of dominance. However, a proper strategy needs to be formulated to advocate for APMC reforms at state level. Regulatory impact assessment and competition impact assessment could be part of such a strategy.[7]

B. Policies Inhibiting Competition

3. KYC norms for e-wallets made mandatory from March 1

As per a Reserve Bank of India (RBI) directive, users of prepaid payment instruments (PPIs) such as mobile wallets will have to complete the Know Your Customer (KYC)

[7] For details, see CUTS submission of comments on the draft Model APMC Act, 2016 here: http://www.cuts-ccier.org/pdf/Advocacy-Submission_of_Comments_on_the_Draft_Model_APMC_Act2016.pdf

requirements by February 28. The RBI has refused to extend the deadline any further. Those who do not comply with the KYC norms will not be allowed to load money into their respective wallet accounts or carry out remittance-based transactions. They will also not be allowed to transfer the cash in the wallet account to their bank accounts. However, users will be allowed to use the balance amount in their respective wallets to pay for goods and services. Once the balance is exhausted, the user will not be able to load cash again until the KYC norms are complied with.

Source: https://www.thehindubusinessline.com/economy/kyc-norms-for-e-wallets-made-made-mandatory-from-march-1/article22859974.ece

Food For Thought

The RBI, as per the Master Direction on Issuance and Operation of Prepaid Payment Instruments (updated on 29th December 2017) mandated all PPIs to ensure compliance with full KYC norms by February 2018.[8] This has led to an industry wide outcry. This is primarily because the PPI issuers, especially those that are non-banking financial companies (NBFCs) consider this as a cumbersome precondition, which can shrink the competitive space for digital payments.[9] It has been estimated that this rule could result in a business loss which is worth Rs. 12000 crores for the entire sector.[10]

Consumers would simply shift back to cash rather than go through the process of KYC themselves. Notably, 80 per cent of the wallet transactions are at risk of reverting to cash.[11] Besides, it has been reported by one PPI issuer that, "as on March 1, 2018 merely 40% to 45% of the customers have completed the full KYC compliance process".[12]

This policy step also fails to acknowledge the intrinsic distortionary impact on innovation and competition and ignores the benefits of implementing a risk-based regulatory framework. A risk-based framework could balance the public interest (safety/security concerns) with competition and innovation in a better manner. Besides, risk-based regulation would remain sensitive to consumer demand. The demand might practically be to store fewer amounts in wallets, which reduces the risk considerably (also, given that cash-ins are not allowed, the risks are anyways less as money trail is there). Although it might be argued that the intention of the provision is to make sure that the PPI ecosystem is safe and secure, the corresponding costs still remain immense. So much so that it significantly reduces the motivation of consumers to remain attached to such payment platforms and might actually result in a less robust and less competitive space for digital payments in India, thereby rendering the government's policy shift from cash heavy to a less cash society a mere pipe dream.

[8] Notification available at https://rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=11142
[9] https://inc42.com/buzz/rbi-digital-payments-kyc/
[10] https://www.moneycontrol.com/news/business/startup/rbis-full-kyc-rule-puts-rs-12000-crore-online-wallet-business-at-risk-2516663.html
[11] https://www.moneycontrol.com/news/business/startup/rbis-full-kyc-rule-puts-rs-12000-crore-online-wallet-business-at-risk-2516663.html
[12] https://inc42.com/buzz/rbi-digital-payments-kyc/

4. Govt to retain 24% stake in Air India, Air India Express

The government has decided to retain a 24 per cent stake in Air India and Air India Express, as part of its divestment in the state-owned airline. The government is also proposing divesting 50 per cent of its stake in Air India Sats Airport Services. The divestment is to be carried out through an open competitive bidding process. The government is proposing a strategic divestment of the airline by transferring management control and sale of 76 per cent of its equity share capital in Air India.

Source: https://www.thehindubusinessline.com/economy/govt-to-divest-76-stake-in-air-india-air-india-express/article23366791.ece

Food For Thought

After considering all its options regarding the disinvestment of State Owned Enterprise (SOE), Air India, the government has decided against complete privatisation. Earlier in May, 2017, the NITI Aayog cited various international instances wherein total privatisation of national carriers was carried out and in consonance, suggested that the government should sell its entire stake in Air India.[13] *Another report by a think tank, CAPA India proposed that the government should ideally not hold any stake in the national carrier. The reasoning was that, "any level of equity retention would raise concerns about the prospect of government interference after privatisation."*[14] *The chief of the International Air Transport Association (IATA), Alexandre de Juniac also held a similar view and highlighted that the government should not own a stake in the carrier and it should aim to create "competitive conditions to give Air India the right weapons to compete against others".*[15]

The government's decision seemed to have diluted investors' interests and might even negatively affect the rationale of the entire exercise. A leading IndiGo representative had flagged this concern by stating that, "Our view is that a joint ownership with the government is, at best, a very difficult proposition and we would not go down that path". [16] *Moreover, the fact that the government has changed its mind multiple times (initially started with indicating complete privatisation and is now considering retention of stakes) seems to have brought in a sense of uncertainty in the minds of potential investors. The conditions for purchase of stake appear to be too stringent and this might be the reason why two major potential investors have decided not to participate in the disinvestment*

13 https://economictimes.indiatimes.com/news/economy/policy/niti-aayog-proposes-total-privatisation-of-air-india/articleshow/58916909.cms

14 https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/government-should-exit-air-india-says-report/articleshow/61038368.cms

15 https://mediaindia.eu/aviation/air-indias-fate-to-be-sealed/

16 http://www.business-standard.com/article/companies/centre-may-completely-exit-air-india-sell-its-residual-stake-to-lic-118040500040_1.html

process.[17] Evidently, 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.

C. Policies Promoting Competition

5. Telecom Regulatory Authority of India releases inputs for formulation of National Telecom policy - 2018

Based on preliminary discussions with various stakeholders including telecom service providers, telecom equipment manufacturers, industry associations, consulting firms, and cloud service providers etc.; the Telecom Regulatory Authority of India (TRAI) has prepared inputs for formulating the National Telecom Policy – 2018 in line with the technological advancements in the sector and customer aspirations for digital services. Besides an investment of $100 billion, TRAI intends to generate 20 lakh additional jobs in the Information and Communication Technologies (ICT) industry.

Source: http://www.trai.gov.in/sites/default/files/Recommendation_NTP_2018_02022018.pdf

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TRAI has put forth the following broad vision, through the draft policy document: "To develop a competitive, sustainable, and investor-friendly ICT market for rollout of state-of-the-art ubiquitous digital communication infrastructure to provide resilient, reliable, affordable, and consumer friendly products and services to meet local as well as global needs; and in the process, transform India's knowledge economy, support inclusive development, foster innovation, and stimulate job creation."

To achieve this vision, several strategies have been proposed, which includes reforms vis-à-vis *enhancing ease of doing business; achieving 'unique mobile subscriber density'; enabling access for wireline and wireless broadband services at affordable prices; enabling access for Internet of Things (IoT) and establishing India as a global hub for research and development and innovation etc. Nevertheless, industry experts have suggested that there is scope for improvements and the NTP should focus on infrastructure sharing, including complete*

[17] https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/jet-airways-rules-out-air-india-bid/articleshow/63694403.cms?utm_source=newsletter&utm_medium=email&utm_campaign=Dailynewsletter&ncode=fecd2253fcaf0ca6c39eb1cb2a919b7c

networks and capacities to deal will the challenges being currently faced by the industry.[18] *Others have argued that the NTP should also address quality of services issues.*[19]

Going forward, the strategies related to improving access to core telecom infrastructure and building innovation capacities of local firms will particularly play a leading role in providing impetus to competition. This is because telecom is no longer a vertically integrated sector, but in fact acts as a multipurpose foundational base for other industries to grow upon. The robustness and ubiquity of the telecom network (ranging from development of essential infrastructure to provision of services to end-consumers) will determine its horizontal range and vertical diffusion. This in turn will (a) infuse business efficiencies and create novel business opportunities (b) benefit the consumer through increased choice and better quality of services and products and (c) fix some of the prevalent distortions to competition such as sub-optimal framework of spectrum licensing. In this regard, implementing the policy in a manner which (a) facilitates creation of processes and industry structures which are competitive and (b) balances public interests with innovation incentives will be crucial.

6. Commercial coal mining opened for private sector

Opening up commercial coal mining for Indian and foreign companies in the private sector, the Cabinet Committee on Economic Affairs (CCEA) approved the methodology for auction of coal mines/blocks for sale of the commodity.

The government described the move as the most ambitious reform of the sector since its nationalisation in 1973. The auction — on an online transparent platform — will be an ascending forward auction whereby the bid parameter will be the price offer in rupees per tonne, which will be paid to the State government on the actual production of coal. There shall be no restriction on the sale and/or utilisation of coal from the mine, an official statement said on the decision.

Source: http://www.thehindu.com/business/Industry/government-clears-opening-up-of-commercial-coal-mining-to-private-firms/article22806187.ece

Food For Thought

Coal continues to cater to a major chunk of India's electricity requirements.[20] *Despite a recent increase in coal production, India continues to meet one-fifth of its coal requirement through imports, which reportedly costs the exchequer INR 1 lakh crore annually (approx. USD 15 Billion).*[21] *Since the last four decades, the process of commercial coal mining has been led*

18 https://economictimes.indiatimes.com/news/economy/policy/new-national-telecom-policy-should-focus-on-infra-sharing-says-akhil-gupta/articleshow/63412464.cms

19 https://www.thehindubusinessline.com/opinion/national-telecom-policy-2018-must-focus-on-quality-of-service/article23295433.ece

20 http://www.thehindu.com/opinion/op-ed/meeting-indias-electricity-needs/article23325382.ece

21 https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/commercial-coal-mining-can-cut-import-bill-by-rs-30000-crore-crisil/articleshow/63186935.cms

primarily by State Owned Enterprises (SOEs), such as Coal India Limited (CIL) and Singareni Collieries Company Limited (SCCL). CIL presently enjoys a dominant market position with a market share of approximately 80 per cent and is one of the global leaders when it comes to coal mining.

The CCEAs move to open up commercial mining to the private sector has several benefits in store. The direct benefit is more competition, as it allows direct entry of private players into the market. This in turn would positively shape the competitive structure of the mining sector, which is virtually now a monopoly. The move is expected to "bring in competition along with private investment, technology adoption and international best practices".[22] Moreover, the proposed online auction methodology will bring in increased transparency and put a substantial competitive pressure on the SOEs' performance. Economic efficiencies, including production, mining efficiencies and optimal capacity utilisation are natural consequences, which in effect will also help to reduce the current import dependence of the nation. Reportedly, participation by private players can reduce dependence by 50 per cent in the non-coking coal category, as India has substantial reserves which can substitute its import.[23]

7. Cabinet approves 100% FDI in single-brand retail via automatic route

The Union cabinet allowed 100 per cent foreign direct investment (FDI) in single-brand retail without prior government approval and liberalized local sourcing norms. Although 100 per cent FDI is already permitted in single-brand retail, only up to 49 per cent was allowed through the so-called automatic route and investment above that needed government approval. The cabinet further eased the local sourcing rule for foreign single-brand retailers; such entities are not required to meet the 30% target for local sourcing by their Indian units for five years if they are already doing so for their global operations.

Source: https://www.livemint.com/Industry/e1EE0Bn93jqlRnkElATPHI/100-FDI-in-singlebrand-retail-via-automatic-route-gets-cab.html

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Single-brand retail basically entails brands which sell its products under one brand (such as IKEA and Starbucks).[24] Before the present policy relaxation, potential foreign investors could enjoy equity of 49 per cent in single-brand retail chains and in order to attain the remaining 51

[22] https://www.brookings.edu/blog/planetpolicy/2018/03/01/commercial-coal-mining-in-india-a-possible-but-not-irrefutable-game-changer/
[23] https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/commercial-coal-mining-can-cut-import-bill-by-rs-30000-crore-crisil/articleshow/63186935.cms
[24] Ibid.

per cent, permission from the Department of Industrial Policy and Promotion (DIPP) was required.[25] Notably, FDI is still capped at 51 per cent in cases of multi-brand retail.

Be that as it may, now that entry in the Indian market has been made more streamlined, foreign single-brand retailers are expected to make the most of the opportunity. Not having to apply for permissions and being exempted from the erstwhile local sourcing requirements means that the government has eased business opportunities and opened up the retail sector to more competition, especially from large global retailers. This move would expectedly reinvigorate the will and efforts of foreign retailers to enter the Indian market and will also challenge the domestic competitors to improve their efficiency and performance. At the same time however, the potential of multi-brand retail remains untapped and the industry expects further liberalisation therein.[26]

25 https://www.thehindubusinessline.com/opinion/columns/slate/all-you-want-to-know-about-fdi-in-singlebrand-retail/article10033495.ece

26 http://www.ey.com/in/en/newsroom/news-releases/published-editorial---endless-wait-for-fdi-in-multi-brand-retail