POLICY DISTORTIONS HURT COMPETITION AND GROWTH IN INDIA

A CUTS RESEARCH REPORT

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30 1983 2012 CUTS International

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Published by

CUTS International

D-217, Bhaskar Marg, Bani Park
Jaipur 302016, India
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Email: cuts@cuts.org
Web site: www.cuts-international.org

ISBN 978-81-8257-192-1

Printed in India by Jaipur Printers Private Limited, Jaipur

#1317

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Abbreviations

AEFI	Adverse Effects After Immunisation
AIDA	Antiretroviral Drugs
AIRIA	All India Rubber Industries Association
CAR	Civil Aviation Requirement
CCI	Competition Commission of India
CST	Central Sales Tax
DAP	Di-ammonium Phosphate
DFID	Department for International Development
EGoM	Empowered Group of Ministers
GDP	Gross Domestic Product
GMP	Good Manufacturing Practices
HPCL	Haldia Petrochemical Corporation Ltd
MoP	Muriate of Potash
NCP	National Competition Policy
OECD	Organisation for Economic Co-operation and Development
OFT	Office of Fair Trading

PPP	Private-Public Partnership
PSUs	Public Sector Undertakings
RBI	Reserve Bank of India
RIICO	Rajasthan State Industrial Development and Investment Corporation Ltd
RIL	Reliance Industries Ltd
RSRTC	Rajasthan State Road Transport Corporation
SEBI	Securities and Exchange Board of India
SMEs	Small and Medium Enterprises
SoEs	State-owned Enterprises
UPA	United Progressive Alliance
WTO	World Trade Organisation

Executive Summary

Effective competition is the instrument for attaining economic growth through enhanced innovation, efficiency and productivity as well as ensuring social gains by overall poverty reduction and greater consumer welfare. This is why, in his book, the Power of Productivity, author William Lewis argues that if countries eliminated the policies that distort competition, they could grow rapidly. Competition is distorted by factors such as anti-competitive practices of enterprises as well as policies and regulations adopted and implemented by the government that have anti-competitive outcomes. Of the two types of distortions, this paper focuses on the latter.

Addressing the distortions induced by government policies and statutes may be challenging especially for two main reasons. Firstly, in such policies the distortive component may be accompanied with some justifications which are difficult to assess and are also often not transparently determined or notified.

A second challenge posed by such policies is that there is no mechanism or a comprehensive policy in the existing competition regime of India which ensures that policies are formulated in a manner that their anti-competitive outcomes are minimised as a result of which, they are least competition restrictive. This is different from certain practices of firms such as mergers, cartels, price-fixing etc. which if seen to cause appreciable adverse effect or have the potential to cause appreciable adverse effect on competition in the relevant market can directly be challenged under the competition law of India. Fortunately, currently, there is a draft National Competition Policy that would address such challenges when implemented, that awaits approval from the Empowered Group of Ministers (EGoM).

The distortions caused by government policies, statutes and regulations may be broadly seen to be emanating from various policies and praxis in the areas of trade, procurement, subsidies and aids and other policies such as industrial, fiscal and transport etc., that are sometimes seen to favour public players and distort competitive neutrality (the reverse is also true).

Regional trade agreements that the government enters into have often been seen to cause an anomaly leading to an inverted duty structure where the import duty on finished products is much lower than that on the intermediate goods and raw materials. Some instances of this have been observed in many sectors and have the effect of harming domestic manufacturers while favouring foreign imports. Specific instances in the rubber and cement industry are highlighted in this paper.

Trade remedial measures such as duties on anti-dumping and safeguards to remedy the injury suffered by domestic industries at the hands of foreign competitors are useful to some extent. However, they need to be closely scrutinised as there is potential of them being abused by market players to block entry of foreign competitors and such duties levied over longer time span may also become breeding grounds of inefficiency for domestic firms.

Subsidies/state aids may be granted both by the central and the state governments as part of the economic policy of the country. However, they may be misused by recipients for indulging in anti-competitive practices by giving them an unfair advantage over their rivals. They also promote inefficiencies and create soft budget constraints for the beneficiaries adding to the fiscal drain. Section 107 of the Treaty of Functioning of European regulates state aid and provides for a balancing test to assess its overall impact before approving such a grant. Anti-competitive concerns also arise from certain industrial policies. For example, regulations regarding Civil Aviation (Section 3, Part II and III) exhibit high costs for entrants which raises the barrier to entry in this sector. In the case of coal industry, the legislation restricts entry and confers exclusive rights by statutorily limiting the production of coal to government company (Coal India Ltd.) Similarly, in the infrastructure sector, the legislation is hindering the *level-playing field* and creating competition distortions witnessed in a recent case study on road transport by CUTS International[1] where the license application of a private player was turned down on a ground that the route has been reserved for Rajasthan State Transport Corporation under Section 68-C of the Motor Vehicles Act, 1939 despite the fact that state buses were not plying on that route.

Competitive neutrality may be distorted through many policies in the way they are formulated or in the manner that they are implemented that advantages the public sector over the private players. As mentioned earlier, there are also instances of reverse competitive neutrality when the private players are seen to be favoured by the government over the public sector. Such practical instances in the current Indian context have been discussed. A good example of both these types of distortions exists in the civil aviation sector. For many years public sector airlines have been trying in vain to procure aircraft to expand their fleet. As a result, a lot of unused bilateral traffic rights have been allocated to those private airlines that have been allowed to operate international services. Instead of giving Air India the permission to buy aircraft, the ministry allowed Jet Airways to open international services that operated only on commercial routes already serviced by Air India. It may be concluded that the state-owned airlines appear to have been deliberately dumped to allow the private sector to consolidate. Evidently, governance deficit was present in this quirky action.

Procurement policies formulated and implemented by the government have been seen to favour some specific companies or a specific sector by way of preference clauses or alternatively in a manner that they are implemented that has the effect of raising entry barriers by making the process tedious or limited in number or too expensive that in effect keeps many players out. Some of these policies are also seen to distort competitive neutrality i.e. the level-playing field between public and private market players. The paper highlights some instances of such distortions that take place in India.

Due to the anti-competitive outcomes in the formulation and implementation of many such government policies, as seen in the previous sections, there is a need to scrutinise and assess them on the touchstone of competition and the impediments they are likely to cause to the market process. Often social, environmental, defence or security objectives can override economic interests in terms of determining public or national interest, as highlighted at different points in this paper.

Intervention in markets to achieve such objectives can be entirely appropriate. It is necessary, however, that such deviations are justified and implemented in a transparent manner and the objectives clearly spelt out. A review of such policies and regulations need to be done through competition impact assessment.

The Competition Assessment Framework developed by Department For International Development (DFID)[2] and the Competition Assessment Toolkit by Organisation For Economic Co-operation and Development (OECD)[3] serve as effective reference tools especially for developing countries and have been discussed in the paper. Regulatory Impact Assessment as undertaken by several OECD countries as a standing policy whenever a new law or regulation is proposed also serves as a good model.

Revisiting the need for a framework by which distortions induced by government policies, statutes and regulations may be addressed through a holistic national competition policy (NCP) could be a suitable way forward. Such a policy would help harmonise government policies and regulations at all levels, foster competitive neutrality, launch competition assessment mechanisms for government policies and regulations as well as ensure that deviations from competition principles to serve social and environmental objectives are notified and publicly justified. Finally, such effort needs to be backed by a strong culture of competition and political will in order to be successful in its endeavour.

BACKGROUND AND OBJECTIVE

Competition is a necessary tool to promote efficiency and innovation of the rival firms in the market which finally leads to greater productivity, economic growth and consumer welfare. Competition should not only be seen as a tool to promote economic growth but also as a key component in poverty reduction and achievement of social gains. In the words of the Nobel laureate Joseph Stiglitz, "Strong competition policy is not just a luxury to be enjoyed by rich countries, but a real necessity for those striving to create democratic market economies."[4]

Competition in the market place can be distorted by anti-competitive practices of firms as well as government policies that result in anti-competitive outcomes that hinder the market process and unduly influence the ability of firms to compete fairly. While it is possible to challenge such firm practices through competition law enforcement, the anti-competitive dimensions of the many government policies such as trade, procurement, price-fixing and others remain outside the purview of the competition law. These policies are largely pervasive because they are aimed at achieving some objectives that are either in the interest of the public, boost domestic industries, promote trade or found necessary to develop one sector over another.

Distortions caused by such government policies are the main obstacles to socio-economic growth especially for a developing country like India. Against this backdrop, it becomes necessary to understand different types of government policies that impact or are likely to impact the competition process as well as find ways to ensure that such policies are formulated in a manner that their anti-competitive outcomes are minimised as a result of which, they are least competition restrictive.

The CUTS research paper brings to light numerous instances of competition distortions induced by government policies in India with a view to devise a framework that would assess the policies on the touchstone of their impact on competition and take steps to minimise their anti-competitive outcomes.

1
Competition: Meaning and Anticipated Outcomes

Competition can be understood as a dynamic process of rivalry between firms that are struggling to enhance their share in the market. The OECD Glossary of Statistical Terms defines Competition as:

"A market situation in which firms or sellers independently strive for the patronage of buyers in order to achieve a particular business objective e.g., profits, sales and/or market share".

Effective competition is a necessary instrument for attaining economic growth seen through increases in employment rates, real wages etc. and an overall enhanced gross domestic product (GDP) growth as well as social gains in terms of greater consumer welfare and over-all poverty reduction. It is, therefore, important to ensure that it is not hampered or distorted so that its beneficial outcomes may be optimised.

Link between Competition and Economic Growth

- In a study, Bayoumi et al. (2004)[5] have estimated that differences in levels of competition account for more than 50 percent of the current gap in GDP per capita between the Euro area and the United States. They conclude that more intense product market competition enhance growth and employment. Aghion et al (2001)[6] and Dutz and Hayri (1999)[7] echo these views through their empirical work.

- A study by the Australian Productivity Commission, undertaken to assess the benefits of promoting competition in Australia, estimated the expected benefits from a package of competition promoting and deregulatory reforms (including improvements in the competition rules) to lead to an annual gain in real GDP of about 5.5 percent, or A$23bn, where consumers would gain by almost A$9bn besides seeing increases in real wages, employment and government revenue.[8]

Competition promotes Productivity, Innovation and Efficiency

Productivity measures output per unit of input. Since productivity increases can mean higher levels of output while input levels remain constant, it is the most direct route to inflation free economic growth, and higher standards of living.[9] The Office of Fair Trading (OFT), UK, evinces a robust and significant negative link between competition and inflation both at aggregate and sectoral levels in a study.[10]

Competition is an important driver of productivity.

How does competition drive productivity?

Competition drives productivity through three mechanisms[11] which may be classified as:

- *Within firm effect:* Competition places pressure on firms to increase internal efficiency and become customer focused. The entry (or threat of entry) of a new firm into an industry, and the subsequent threat to incumbents' market shares, can trigger this process.

- *Between firm effect:* Competition ensures that higher productivity firms increase their market share at the expense of the less productive. These low productivity firms then exit the market and are replaced by higher productivity firms (also referred to as a shakeout).Thus, competition leads to more efficient allocation of resources between firms. Consumer interests are best served when competition is not distorted and only those firms survive that offer better and more products and services at lower prices.[12]

- *Innovation:* Innovation increases dynamic efficiency through technological improvements of production processes and/or the creation of new products. Here there is a complexity in that while competition spurs innovation, too much competition has the risk of harming innovation as well.

An effective competition policy also promotes good governance by curbing rent seeking activities, while a competition law attacks corruption directly by curbing collusive activities among firms and government officials, including politicians.

Competition and Social Gains (Consumer Welfare and Poverty Reduction)

Competition is key if markets are to work well for the poor. In a 2007 study of the World Bank, it concluded that the world's poorest countries tend to have low levels of competition in domestic markets and a high degree of market dominance.[13] This is so because competition ensures better production and distribution of goods and services. Competition benefits consumers both directly, through lower prices, better quality and an improved choice of products, and indirectly, through its impact on economic growth.[14]

In India the effect of competition on price and accessibility is best illustrated by the case of telecommunications with teledensity increasing from a mere 2.32 percent in 1999 to 47.89 percent in December 2009[15] and tariffs falling from ₹16 to less than Re.1 per minute.

Moreover, such intense competition amongst various service providers has resulted in improvement in availability and quality of service. Similarly, consumer gains have been observed in other sectors as well. Similarly, when competition was introduced in generic drugs in South Africa, prices for antiretroviral drugs (AIDS) fell by up to 88 percent since 2003 and access increased from 20,000 to 155,000.

Competition is also important for the effectiveness of government procurement which has a direct bearing on social gains (for example, in the provision of rural infrastructure), as anti-competitive practices by suppliers can reduce what governments can achieve with the limited funds available which if freed up can be utilised towards other social infrastructure. Further, competitive markets are more likely to provide the poor with newer opportunities for employment.

The OECD Report on Promoting Pro-Poor Growth: Private Sector Development (2006) says: *'Competitiveness' is not synonymous with 'competition,' but firms and sectors are far* *more likely to be competitive internationally if they operate within competitive domestic markets. These competitive domestic markets benefit farmers as well who will be in a more favourable position if the markets in which they buy their inputs, arrange transport of their crops to market and sell their outputs are also competitive.*

2
Competition Distortion

In theory (which is often far from reality), the welfare optimum is achieved in perfectly competitive markets where prices are close to the cost of production and no single company has influence over the prices. Such markets are fully transparent and have a large number of sellers and buyers who possess perfect information regarding the products and services.[16]

What is Competition Distortion?
Competition distortion denotes a situation in which companies are not competing under equal conditions posed by several factors characterised by the anti-competitive practices of firms and some competition-distorting government policies, regulations and praxis.

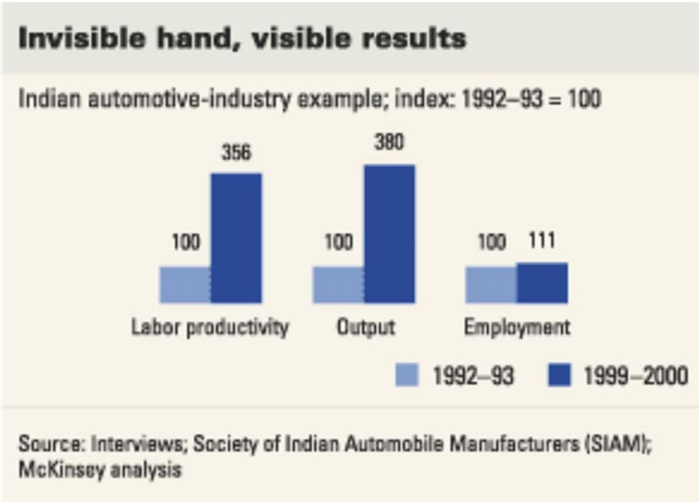
In his book, the Power of Productivity[17], author William Lewis says that one of the main obstacles to economic growth and poverty reduction in many countries is the many policies that distort competition. Similarly, in the theory of political economy developed by Anne Krueger[18] and Gordon Tullock[19], the authors argue that in many market oriented economies, especially developing economies, governmental restrictions upon economic activity are pervasive facts of life. These restrictions give rise to a variety of forms and people often compete for the rents. Sometimes such competition is perfectly legal, for instance lobbying, but at other times it takes the form of policy distortions, bribery, corruption, smuggling and black markets. Rent seeking in such cases may be wasteful of resources, lead to a suboptimal utilisation of resources, a welfare loss associated with a particular set of policies and a divergence between private and social costs of certain activities.

Suppose for instance, that the government decides on licence allocations (say in telecom, where three operators were allowed per circle). Competition can occur through resources to influencing the probability or expected size of licence allocations (3 instead of 4). Some means of influencing the expected allocation may be in the form of inducements, which may not be easily detectable. Others, like bribery, hiring relatives of officials or employing the officials themselves upon retirement are cases of rent seeking leading to a competition distortion.

Furthermore, in the case of a restriction like an import licence or tariffs. For example, the steel industry may lobby for ban on imports or a higher tariff if imports are allowed. Anti-dumping and safeguard actions are also potential weapons of competition distortion though these can be justified on public policy grounds.

If countries eliminated the policies that distort competition, they could grow rapidly. India's government, for instance, abandoned many of the limits on foreign investment in the country's automotive industry during the early 1990s. Subsequently, prices fell, demand for cars exploded, and output nearly quadrupled as seen in Figure 2.1.[20]

Figure 2.1



How is Competition Distorted?

Anti-competitive practices by firms are one cause for altering the market conditions and inappropriate regulations and policies by national, state and local governments that can lead to such changes and cause market failures are another. Furthermore, when government policies limit competition, even unintentionally, more efficient companies can't replace less efficient ones, thereby, having negative implications for growth.

In the Eleventh Five Year Plan Policy Document[21] on Inclusive Growth (paragraph 11.29), the Planning Commission of India has mentioned that there are several existing policies, statutes and regulations of the government that restrict or undermine competition and hence review of such policies, statutes and regulations from the competition perspective needs to be undertaken.

Challenges posed by government policy induced competition distortions

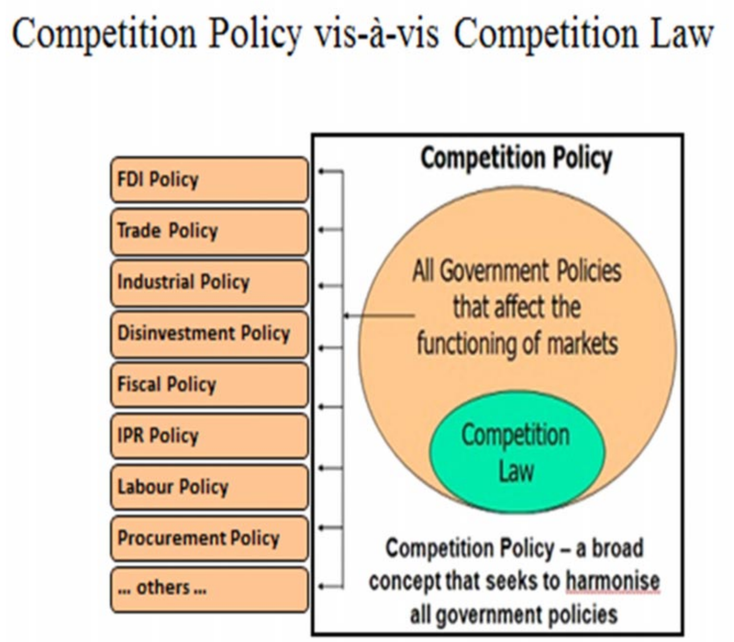
A major difficulty posed by distortions of such nature emanates from the fact that in most government policies such as trade remedial measures, other trade policy tools, procurement policies, pricing policies and others that have the effect of weakening competition, the distortive component is accompanied with significant policy objectives and justifications.

Such justifications may well be necessary in the larger interest of the public or for the achievement of social and environmental objectives which warrants their intervention in the market competition process. However, such justifications cannot be presumed and need to be transparently and clearly shown which is often not the case.

It is sometimes also seen that even when the government is committed to introduce competition based on market principles, the outcome is generally the opposite mainly because of futile and ignorant efforts to reconcile too many conflicting objectives.[22]

A second challenge posed by such policies is that there is no mechanism in the existing competition regime of India that ensures that policies are formulated in a manner that their anti-competitive outcomes are minimised and they are least competition restrictive.

Box 2.1: Tools of Competition: Competition Policy and Competition Law



Competition policy and competition law are the two main instruments that ensure that the outcomes anticipated from competition are optimally realised. Unfortunately, most of the policy community considers these terms as synonymous and interchangeable. However, they are complementary yet distinct concepts (Refer to Box 2.1)Competition law is the framework of rules and regulations designed to foster a competitive environment. India has enacted a competition law regime that regularly checks and seeks to rectify anti-competitive behaviour of enterprises statutorily through the implementation of its legislative provisions that are designed to attack behaviour such as cartelisation, price-fixing, mergers and takeovers that cause or have the potential to cause an appreciable adverse effect on competition in the market. While still maturing, there is a system in place to acknowledge and address such practices that thwart competition and challenge the economic growth of the country.

Contrary to this, challenging the distortions induced by government erected institutional barriers to competition is not a simple application of the existing domestic laws. It is a competition policy that, besides encompassing the competition law, can deal with anticompetitive dimensions inherent in some government policies and/or the anticompetitive outcomes of the manner in which many of them are implemented. It also tries to bring harmony in all government policies that affect competition and consumer welfare, such as trade policy, industrial policy, investment policy and others.

In June 2011, the Ministry of Corporate Affairs, Government of India constituted a Committee on National Competition Policy and Allied Matters.[23] In December 2011, the Committee submitted its report. The draft policy talks about various instruments to promote competition in markets to ensure protection of consumer interests, while at the same time protecting the rights of market players to fair competition.

It also aims to remove overlapping jurisdiction of various regulators and streamline laws aimed at fostering competition. The proposed National Competition Policy[24] also provides for an effective prevention mechanism for anti-competitive conduct, transparent and non-discriminatory market processes. The proposed policy is now with the EGoM.

Practical instances in the current Indian context

The design and operation of several policies and practices of the government are such that they distort the market process and competition, usually in the name of public interest often which invariably means some entrenched/vested interests.[25]

The distortions caused by government policies/practices to the market process may be broadly grouped and classified as those relating to:

- Trade policy
- Procurement policy
- Financial policy
- Industrial policy
- Transport policy
- Fiscal policy

A. Trade Policy

The benefits of trade liberalisation have been seen in the relaxation of quantitative restrictions and reduction of tariffs. Yet, the trade policies adopted in furtherance of developmental objectives may have several anti-competitive dimensions. Likely instances of potential distortions of this nature are given below:

Inverted duty structure

One of the unusual facets of the current import duty structure is its inverted nature witnessed in a few sectors at present. An inverted duty structure refers to a situation where the duty on the finished product is lower than that on raw materials and intermediate products. This is a distortion when the higher duty on raw materials results in production costs that are higher than the selling price of the imported finished product and hurts the domestic manufacturer who relies on the raw materials for production.

There may be many reasons for this such as differential lobbying powers of different industrial groups producing raw materials and the intermediate and/or finished products.

Sometimes higher tariffs on raw materials are imposed to compensate for other inefficiencies in the domestic production chain. Inverted duty structures also often arise when a regional trade agreement is signed which has its own tariff levels in between, while the multilateral trade agreement under the WTO has different tariff obligations for a country. Policy makers do not carefully examine the same together with the consequences that inverted duty structures lead to.

An example can be seen in the form of steep reduction in import duties as committed by India under Free Trade Agreements with countries such as Sri Lanka, Thailand, Singapore and others that has led to the huge differentials in some sectors.

The import duty is zero on certain auto components imported from Thailand like engine parts, lighting equipment, ball bearings, gear boxes, transmission lines, pumps and helical springs. However, certain grades of alloy steel and aluminum alloy that act as raw material attract 5-10 percent tariff, making Indian manufacturers uncompetitive *vis-à-vis* foreign counterparts. Other instances of inverted import duty structure are as below:

- The domestic latex price has been heating up over the last two years. What the All India Rubber Industries Association (AIRIA) argues is that the import duty on latex stands at a significant 70 percent, while that on finished product it is less than 7.5 percent. The price of latex has gone up from around ₹55 a kg in January 2009 to ₹117 currently, touching ₹148 recently.[26] The domestic latex industry has asked for immediate correction in inverted duty structure on natural rubber latex under such circumstances. Liquid rubber latex is the first stage output of the rubber tree. This is processed to yield natural rubber. For natural rubber, a prescribed quantity of imports had been allowed at just 7.5 percent duty till March end while the same was not done for rubber latex. This is indicative of the differential lobbying power between the latex manufacturers and natural rubber producers.

The domestic latex manufacturing industries have been highlighting this to the government and seeking relief on behalf of the latex manufacturers that are mainly small and medium enterprises (SMEs) and cannot afford to pass on the price increases to the end consumers. SMEs are also seeking "SME reliefs" which is likely to further complicate the existing tax structure in this industry.

- A similar concern rose in the cement industry which, in early 2010, urged the Centre to abolish import duty on raw materials such as coal, petroleum coke and gypsum since cement as a finished product does not attract duty. The industry therefore argued that duty on them should be abolished in line with the established principle that import duty on inputs should not be higher than that of finished product.

  The government was requested to align value-added tax on cement with that of steel at 4 percent against 12 percent levied currently since both are important raw commodities for the infrastructure sector. Companies like Ambuja Cement, UltraTech Cement, JK Lakshmi

Cement and India Cement have reported a drop in net profit.[27]

An inverted duty structure denies domestic manufacturers a level playing field and instead favours foreign competitors who have to pay much lower export duties and have access to cheaper inputs in the world market. This distortion therefore needs to be corrected by introducing a phased reduction in import duties, with a three-tier import duty structure in place where finished goods attract the highest duty, raw materials attract the least duty and intermediate goods are subject to duty rates falling between the two levels.[28]

Trade remedial measures

The World Trade Organisation (WTO) agreements prescribe remedial measures such as duties of anti-dumping[29] and safeguards[30] which are often seen to have a protectionist flavour and are used to boost domestic industries even though they are necessary tools to deal with unfair competition and alleviate the suffering of domestic industries at the hands of foreign competitors. However, while in the shorter term, they may be useful to prevent foreign players from capturing the market, in the longer run, some of these actions may hinder competition by creating barriers to entry and also promote inefficiencies.

Recently, there have been many debates about the increasing use of anti-dumping regulations as an anti-competitive tool. There is always a potential for misuse of such measures by powerful domestic players who may deliberately use this to block entry by foreign competitors for fear of losing their own market share.

Therefore, while such measures might have adequate justification in terms of national priorities, it cannot be assumed without proper investigation that this is necessarily the case and the justifications for the same need to be clearly and transparently shown.

Some instances of trade remedial measures imposed by the government and their apprehended harmful impacts are given below:

- A petition seeking anti-dumping duty on polypropylene imports from Oman, Saudi Arabia and Singapore was filed by Reliance Industries Ltd (RIL) and supported by another domestic producer Haldia Petrochemical Corporation Ltd (HPCL). As a result, in November 2010, the Finance Ministry announced the imposition of definitive anti-dumping duty on polypropylene imports from Oman, Saudi Arabia and Singapore for a period of five years starting July 30, 2009, the date of imposition of provisional anti-dumping duty.[31]

  Little is known about whether dumping was really established as the analysis report was not published. If material injury is established along with incontrovertible facts of the exporters selling below the cost, duties are justified. If not, then imposition of duty would be a deliberative means to insulate domestic producers from foreign competition and artificially raise the costs to consumers.[32]

  Such a petition needed further careful scrutiny as it was brought forward by oligopolists who together control the market for polypropylene and might be acting in concert to block the entry of new players that might pose potential threat to their existing market power.

- In July 2010, the government imposed 16 percent safeguard duty on soda ash imports from China in order to protect domestic producers. The safeguard duties would benefit domestic manufacturers of soda ash. However, the market players reported no increase in the price of soda ash as a resulting impact of such a move. According to market estimates, India's soda ash imports during January-April in 2009-10 stood at 128,271 tonne compared with 178,534 tonne in January-April 2009. However, the imports surged by 69 percent in April from March 2010.[33]

  Even though these facts and estimates lean towards the fact that the safeguard duties were probably justified, thorough investigation needs to be conducted to ensure that the situation merits a longer time span for levy beyond the sunset clause. This is because a long time span would promote inefficiency among protected domestic producers to the detriment of competition. Levy of safeguard duty can be justified if absence of such duty is seen as associated with a significantly reduced market share of domestic producers, thus, threatening their businesses. However, as mentioned earlier, care must be taken that the domestic producers do not get too comfortable under this cushion that it becomes a resting spot for inefficiency.

B. Procurement Policy

There are many procurement policies that favour some specific companies over others or distort competitive neutrality between the public and private market players by way of some preference clauses, riders or conditionalities or produce anti-competitive outcomes in the manner in which they may be implemented. While there may be sound policy reasons for these, the benefits need to be compared to the potentially higher prices that distort competition as well as harm the consumers. Hence, it must be established clearly and in a transparent manner that the objectives behind such policies override possible adverse impact on competition and are necessary to achieve some social and environmental objectives. Below are examples:

- In a recent tender call for Ayurvedic medicines, the Directorate of Ayurveda, Government of Rajasthan in Ajmer, Rajasthan was seen to bend the rules governing the procurement of medicines by adding riders/conditions that manufacturers must have minimum five years of experience, a condition that did not figure in the original call for tenders. Though the purchase committee had decided to invite public sector undertakings and cooperatives with Good Manufacturing Practices (GMP) compliance for the purchase bid. Later, in its advertisement, it inserted a condition that the manufacturer must have a minimum five-year experience.

  Of the existing PSUs and co-ops that manufacture Ayurvedic medicines, only eight had an experience of five years and more. Unless an experience of minimum of five years was necessary to ensure the level of quality sought which the purchase committee failed to adequately demonstrate, such a rider acted as a deterrent for entry. Also, operations of most of the qualifying companies were being managed by the same set of people which could raise doubts regarding collusive behaviour between the officials and the specific manufacturers.[34]

Imposing the condition that manufacturers must have five years of experience by Directorate of Ayurveda my well dampen competition for this rider is a form of an entry barrier for competitors that would only add to the burden of the consumers. Therefore, bid conditions should be drafted carefully keeping in mind the potential anti-competitive outcomes that they may have.

- A similar policy which favoured some companies over others was one implemented by the Tamil Nadu government, in October 2010,[35] when it declared that farmers would be given motor pump-sets for irrigation, free of cost. Under the policy, the farmer would have to buy a pump-set with a four-star energy saving rating and the cost would be reimbursed by the electricity board, provided he had registered for supply of free power. However, the catch was that the pump-sets had to be bought only from two specified companies.

  Furthermore, a pump-set with four-star energy saving rating costs ₹6,000-8,000, but the ones specified by the electricity board officials in this case cost more than double that. Government's directive to purchase the pump-sets only from two specified companies is likely to be anti-competitive and irregular. This directive not only impedes the market process but also results in huge financial losses to the government, as the pump-sets are available at half prices in the market.

There are procurement policies that do not have any such preference clause and yet result in anti-competitive outcomes because of the way in which they are implemented. For example, a government agency might impose formalities for market entry that are costly, time consuming or unpredictable, and that has the effect of discouraging new entry.

Moreover, cumbersome regulation for starting a business is likely to lead to the added problem of lower productivity and higher levels of corruption.[36] Limits might be imposed on the number of firms permitted to operate, or there might be limits on the categories of people that are able to enter particular markets.[37]

In another instance of competition distortion induced by a procurement policy, in procuring 16mn broad gauge concrete sleepers, the Railways awarded contracts to the existing 71 firms, and ignored 24 new applicant firms entirely in procuring 16mn broad gauge sleepers. The Parliamentary Standing Committee on Railways (2004),[38] while discussing the question of procurement of concrete sleepers, observed that:

> *The procurement of concrete sleepers has become a very sensitive matter, because a lot of unscrupulous existing manufacturers have formed a cartel to secure orders by unfair means or tampering with procedure and simultaneously keeping the new competitors out of the race. The Committee is constrained to notice that there exists a regional imbalance in the setting up of concrete sleeper manufacturing units. They also express their unhappiness that new entrants are not encouraged, which ultimately strengthen[s] the cartel of old/existing manufacturers.*

Despite extensive privatisation, state-owned enterprises (SoEs) are still a significant force in India and receive preferences that might restrict competition by the private sector. There are procurement policies that distort competitive neutrality in the market place. The concept of competitive neutrality means that government-supported business activities should not enjoy net competitive advantages over their private sector Competitors.

For example, purchase preference policies in favour of Central public sector undertakings (PSUs) which was extended for three more years in 2005 had the effect of discriminating against the private sector players. Under the policy, Central PSUs could enjoy purchase preference if the price quoted by it fell within 10 percent of the lowest bidder's quote. Fortunately, it was terminated by the government in 2008 and not extended further as before in a bid to create a level-playing field between private and state-run companies.

C. Financial Policy

Earlier in 2011 one percent interest subsidy on agri loans was made available to public sector banks while the same was not offered to private banks. Furthermore, in 2010, the Reserve Bank of India (RBI) had asked several state governments not to give new businesses, which could generate thousands of crores of income, to private sector banks. The central bank did not spell out the reason for its decision.

In 2006, the Central Government stopped giving fresh mandates to private banks. And about two years ago, PSUs were told to park at least 60 percent of their surplus cash with government-owned banks, after which the private sector lenders started tapping state governments for business.

As a result, private banks claim that they have initiated financial inclusion programmes, fulfilled priority sector lending obligations and have engaged in government-sponsored schemes wherever possible.[39] The direction of RBI is anti-competitive for it restrains new business being granted by government bodies to the private banks.

Even in 2007, the Competition Commission of India (CCI), under its advocacy functions, had observed that banking sector would reap the full benefits of competition only if the RBI restricts itself to framing prudential norms for banks and leaves all other issues to market forces. Significantly, the CCI had suggested that public sector banks should not be given any preference over private sector ones. On the other hand, this move of RBI could be a result of promoting economic interest by creating jobs, alleviating poverty etc. because public sector banks engage in government sponsored schemes and have good outreach (financial, geographical, etc.).

However, if the claim by private sector banks that they have started engaging in government-sponsored schemes is correct, than RBI's direction will only stifle competition in the banking sector as reduction in competition will not be offset by gains in public welfare. Thus, there is a need to first check the veracity of claims made by private banks and only if it is found wrong, there is a need to weigh between the anti-competitive effects of RBI's direction, *vis-à-vis* its economic gains.

- On August 24, 2012, the capital market regulator, Securities and Exchange Board of India (SEBI), announced its decision to park its surplus funds in fixed deposits of PSU banks, even if the returns offered by them are lower than that of private banks by up to 10 basis points (0.1 percent). The current investment policy of SEBI is guided by the sole criteria of highest return, but it has been now proposed to change to the consideration of return as well as "safety of funds."[40]

- Similarly in July 2011, the government decided to drop a clause from the Life Insurance Corporation (Amendment) Bill 2009 that suggested limits on the sovereign guarantee available to the country's largest life insurer. The dropping of the clause comes amid stiff opposition from private-sector players. State backing for LIC has also been criticised by the Insurance Regulatory & Development Authority for not allowing a level playing field.[41]

D. Industrial Policy

Industrial activity is a major source of stability in an economy. An industrial policy provides guidelines for the effective co-ordination of the activities of various sectors of the economy. The primary objectives of the industrial policy are to maintain a sustained growth in productivity, to enhance gainful employment, to achieve optimal utilisation of human resources, to attain international competitiveness and to transform India into a major partner and player in the global arena.

The policy focus is on deregulating Indian industry, allowing the industry freedom and flexibility in responding to market forces and providing a policy regime that facilitates and fosters growth of Indian industry. Yet in many instances, the policy decisions create anticompetitive outcome in any sector. Some of the examples of such policy induced distortions are enumerated below:

- *Fleet and Equity Requirements for Domestic Passenger Air Service*[42]*:* According to India's Civil Aviation Requirement (CAR) Section 3, Part II and III, a scheduled service operator using aircraft with a takeoff mass of 40,000 kg or more must purchase or lease a minimum of five aircraft with start-up equity requirement of ₹50 crore. Additionally, as an airline's fleet grows in increments of up to five planes, equity requirements grow by ₹20 crore. The aircraft with take-off mass less than 40,000 kg, the minimum start-up fleet is five aircraft (purchased or leased) with the minimum equity requirement starting at ₹20 crore and growing by ₹10 crore with every five additional aircraft.[43]

Further, for non-scheduled operators, the fleet requirements as stated in Civil Aviation Requirement Section 3, Series C, Part III Section 4.2 are minimal. It requires possession of just one aircraft. Given the high cost of entry into the civil aviation sector these regulations unnecessarily raise barriers to entry. Hence, the fleet and equity requirement instituted by these regulations limiting the number of new entrants along with their size as they should have enough capital to fulfil these requirements.

On the contrary, the incumbent firms are not facing any potential threats from new entrants and hence following collusive practice amongst them. Without new and unfamiliar competitors entering the market, there exists no incentive to change the way these established airlines operate and therefore, customer service and choice are adversely affected.

- *Coal mine case:*[44] The primary criterion to determine whether a legislation, policy or practice has an adverse effect on competition is to assess whether it limits the number of suppliers in the market for a particular product and/or grants an exclusive licence on certain participants to the exclusion of others. The essence of competition is increased number of participants in a defined product market.

Limiting the number of suppliers in the market leads to the risk that market power will be created and competitive rivalry will be reduced. Market power is the ability to profitably increase price, decrease quality, or decrease innovation relative to the levels that would prevail in a competitive market.

In the case of the coal industry in India, the legislation restricts entry and confers exclusive rights, by statutorily limiting the production of coal to government companies.[45] In terms of the effects on competition in the coal sector therefore the Coal Mines Nationalisation Act 1973 creates and maintains a monopoly in favour of the public sector by virtue of Section 3 of the Act which prohibits private companies from entering the field. Although the Nationalisation Act does not confer a monopoly on a particular company, in reality there is no competition between public sector companies.

Unlike the petroleum sector in which some level of competition appears to exist between public sector companies, Coal India Ltd. controls 80-82 percent of the market production in the coal sector. The closest competitor is Singareni Collieries Ltd., with a 9.5-11.5 percent market share, and in which Central Government owns 49 percent of the shareholding.

Moreover, the Ministry of Coal governs the overall policy decisions of both companies. Facilitating the removal of entry barriers in coal mining for opening up the sector" has been identified as a "high priority" area by Coal Minister Sriprakash Jaiswal, in the Ministry's latest "Strategic Plan" formulated for the next five years.[46]

Opening up coal mining to the private sector, along with setting up an independent coal regulator and other such proposals, is a part of the broader "blueprint? for reforms the United Progressive Alliance (UPA) government wants to bring in the coal sector. While the proposal has already been cleared by the Union Cabinet, a bill in this regard, introduced in the Rajya Sabha by the National Democratic Alliance government in 2000 is still pending.[47]

It is important that drawing from the positive experiences of oil and gas sectors, the government should open up the coal sector to competition by private players (domestic and foreign). But the idea of a coal regulator is anachronistic, when CCI is there to check market abuses. Competition would not only boost investments but also production to meet the growing demands along with reducing India's import reliance for coal. Removing entry barriers by opening coal mining to the private sector is therefore a welcome move. However it has been opposed by several workers who fear job loss as a result of restructuring and privatisation the Indian coal industry. While their concerns may be well-founded, it is important to note here that if privatisation leads to competition as envisaged and that helps in increasing the productivity, the need for labour would also increase.

A final decision taken by the government must take into account the wishes of the interested players guided by the overall objective of competition and efficiency gains in providing a level playing field for private sector participation by amending various discriminatory provisions against the private players within the current legal and policy framework as well as establishing a regulatory body for the sector.

- *Industrial Park Scheme 2002 in Rajasthan*: Government of India's Industrial Park Scheme is an opportunity to build infrastructural facilities by developing an Industrial Model Town/industrial park for carrying out integrated manufacturing activities including research and development by providing plots or sheds and common facilities within its precincts under Private-Public Partnership (PPP) model. It has been also been subsequently revealed that in most of the states where private sector has been encouraged to launch the scheme, in Rajasthan it has been a monopoly of the Rajasthan State Industrial Development and Investment Corporation Ltd (RIICO-a Government of Rajasthan Undertaking).[48] This reflects poor planning by the Government of Rajasthan, and thus has down side effects on the poor industrialisation of the State. It is also a symptom of lack of competitive neutrality that the public sector is preferred over the private sector without any proper justification.

- Manufacturing licenses of all three public-sector vaccine producing units were suspended by the Ministry of Health and Family Welfare a few years ago. The three units in question are the Central Research Institute at Kasauli, the Pasteur Institute of India at Coonoor and the BCG Vaccine Laboratory at Chennai.

From the outset, the department, while justifying its decision to suspend the manufacturing licences of the PSUs, said that they had failed to comply with the GMP norms specified under the Drugs & Cosmetics Act and Rules. However, as the vaccines produced by the PSUs conformed to the standards of safety, efficacy and quality – a fact admitted by the then Secretary during the course of her deposition before the Committee on October 26, 2009 – the Parliamentary Committee on Health and Family Welfare stressed, in March this year, that the decision to close these PSUs on the grounds of non-compliance lacked justification. In the absence of the supply of vaccines from the public sector, the cost of vaccines in the domestic market appreciated by 50-70 percent within two years from the closure of the these units.[49]

India is struggling to bridge the gap between the demand and supply of vaccines. One of the main objectives of India's national strategy to meet its vaccine needs is to increase the decisive intervention of the government and strengthening the public sector to make safe and effective vaccines available at reasonable prices. Instead, in the face of a shortened supply, the Ministry's decision to close three PSUs for allegedly not complying with the GMP norms has exposed the country to an unacceptable risk in vaccine security which can be seen in the reported increase in the number of Adverse Effects After Immunisation (AEFI) deaths by three times since the closure (128 deaths among children reported in 2010).

The closure of the PSU vaccine units has also stifled competition in the healthcare sector leading to a hike in the cost of vaccines in the domestic market by 50-70 percent within two years from the closure. With the closing down of these units, the government has been procuring vaccines required for the country's national immunisation programme from the private vaccine companies at high prices thereby leading to a substantial increase in the expenditure on universal immunisation programme. Evidence has shown that private players offered vaccines at competitive prices prior to closing down of PSUs after which the government has been to seen to steadily pay higher prices for procuring vaccines from them to this day.

After much hullabaloo and investigation by the Standing Committee on Ministry of Health and Family Welfare, the decision of cancellation of the licenses has now been revoked. This may be referred to as reverse competitive neutrality where policies have been implemented in favour of private against the public sector.

E. Transport Policy

Transport is a key element in the infrastructure in a country. It provides services which is essential for development and influences significantly the pattern of distribution of economic activity. Thus, the transport system must be viewed as an integrated structure in which various modes complement each other, interface appropriately and where possible provide healthy competition to each other.

This competition must be conducted within the framework in which each mode is able to operate on a "level playing field" so that in comparative advantages and economic efficiencies are properly reflected in the costs to the users. But in many situations we found that the existing policy and the legislation is hindering this level-playing field and creating competition distortions. The following case reveals the situation:

- A study of Naathdwara-Choti Sadri Private Bus Operators undertaken by CUTS International in Rajasthan.[50] As per the legislative mandate of Sec 68 C of the Motor Vehicles Act 1939 that corresponds to Section 99 of the Motor Vehicle Act, 1988, the State transport undertaking may prepare a scheme ousting private bus operators in relation to any area or route. Although such a provision seems anti-competitive for it restricts the entry of new private players, the imperative to apply this provision rests on the ground of public interest.

  Accordingly, the Rajasthan State Road Transport Corporation (RSRTC) published a scheme for the notification of various routes, to the complete exclusion of the Private Bus Operators. The reason provided for the exclusion was that such a measure would provide efficient, adequate, economical and properly co-ordinated road transport services.

  The proviso to Section 104 of the Motor Vehicles Act, however, states that temporary permits to private parties in respect of notified areas can be provided only if the State Transport undertaking has not applied to ply their vehicles on that particular route. Subsequently, an application was made by Taradevi Chaudhary for a temporary permit under Section 104 of the Motor Vehicles Act as there was no state bus operating on the Naathdwara route for the past eight years.

  On investigations, the officials of RSRTC accepted that there was a shortage of buses with the corporation and that for the past eight years no bus was plying on the mentioned route. Also, it was found that RSRTC was plying buses only on a part of it as it was not economically viable to operate buses on the complete route. Notwithstanding these considerations, Taradevi's application was turned down since an application to operate on this route had already been made by RSRTC.

Since RSRTC was not operating on the route, the objective of nationalising/notifying the routes to the complete exclusion of private parties has been getting frustrated. Furthermore, the proviso to Section 104 of the Motor Vehicles Act is *prima facie* anti-competitive as it clearly discriminates against private parties. To this date, no decision has been taken on this matter as a result of which consumers have been left in the lurch. In the absence of state buses, illegal transportation is mushrooming on various routes. The legislative framework of the Motor Vehicles Act has, therefore, resulted in anti-competitive outcomes. Such gaps need to be plugged in order to ensure consumer welfare.

A detailed study on competition impediments in the road transport sector was completed by CUTS International for the Ministry of Corporate Affairs, Government of India, recently.[51] Its highlights:

- There is an urgent requirement for an independent body to review India's transport's priorities and policies within an integrated framework on a continual basis, and also to monitor economic regulation thereby promoting competition in the sector. Thus, there is need for a National Transport Commission for the sector. Such independent regulator should be provided with statutory authority, fixed service tenure with provision for removal on grounds of inappropriate act or incompetence. Besides, financial autonomy also needs to be provided to the Commission through levy of fee on service providers.

Sri Lanka's dedicated regulator for private bus transport created by the National Transport Commission Act number 44 of 1991 is a very suitable example to learn from. However, the CCI should ensure that overlaps with the regulator are avoided. The government while constituting the regulator should avoid empowering the regulator to deal with anti-competitive cases, as they are best dealt by CCI. The regulator should be empowered with the *promotion* of competition and not the *protection* of competition, which is CCI's mandate.

- The primary objective of the transport sector, road or any other, keeping in mind the sovereignty of the consumer, should be best quality service at the lowest possible cost. Thus the long run strategy should be to move the STU's to majority private ownership in competitive markets as early as possible. Public sector undertakings are plagued by several problems of their own which only get compounded by red tapism and bureaucracy. The private sector is better equipped to manage corporations, more efficiently, being free of corruption, political influence and vested interests. Also privatisation shall allow more firms to enter the industry and increase the competitiveness of the market, again leading to enhancement of efficiency.

  Thus the STU's need to be restructured and commercialised be brought under private ownership. The appropriate public policy for the inter-city bus services sector would be to remove quantitative regulations restricting entry into the inter-city bus transport markets, and to allow market forces to determine both tariffs and the types of services offered.

- Market forces must be allowed to determine tariffs in passenger road transport. This shall lead to competition and as a result also betterment of services. A lesson here can be drawn from the deregulation of the Airline sector after the liberalisation era in 1991. The airline industry was deregulated to promote economic development, improve air services and achieve liberalised competition. The industry has now witnessed exponential growth, introduction of a great amount of competition among the players leading to the benefit of air travellers both in terms of costs and services. Competition in long-distance public transport sector also commenced after deregulation in UK, when the public bus companies were brought into the private sector, by means of deregulatory measures through 1980 to 1986.

- Competitive neutrality is a pre-requisite for healthy competition in the market which is not possible with the prevailing legislative scenario in the road transport sector. There are several legislative provisions that favour PSU's over private sector players. For instance, section 104 of the Motor Vehicles Act provides for the restriction on grant of permits in respect of a notified area or route. The proviso to Section 104, in utter violation of competition, mandates that temporary permits to private parties in respect of notified area or route can be provided only if the STU has not applied to ply their vehicles on that particular route which is clearly giving the most unfair advantage to public players over private players. Such legislative measures have to be invariably abolished.

- In the transportation of goods via trucks, most of the trucks plying on Indian roads are under single ownership and there are few large fleet operators. About 5000 cargo operators handle the entire cargo in the entire country. These cargo operators cartelise and decide the freight and there is no competition at this level. These practices need to be curbed.

  One of the key advocacy roles to be played by the CCI, is also to impress upon governments for an active oversight of the competitive tendering process. For example, cities in Sweden, Finland, France and Germany have improved the environmental social and economic standards in urban public transport through competitive tendering processes.

F. Fiscal Policy

Fiscal policy is composed of several parts. These include, tax policy, expenditure policy, subsidy or state aid, investment or disinvestment strategies and debt or surplus management. Under the existing tax policy, the present multiple tax structure impels to high compliance cost, excessive litigation and uncertainty about ultimate tax incidence at the time of investment or business transactions. The competitiveness of the Indian industries is adversely affected by the cascading effect of multi-layered taxes which increases the cost of indigenous manufacture. The inefficiency of the existing indirect tax structure and consequent adverse impact on our economic growth are summarised below:

- *Impact on competitiveness of indigenous goods & services:*[52] The existing tax structure is having a cascading impact on cost of indigenous manufacture of goods and services. For example VAT is levied on the sale value of a product which includes excise duty element Thus VAT is also charged on excise duty amount. Similarly when VAT paid raw material is used in manufacture, it forms part of the excisable value (cost of manufacture) on which excise duty is levied. Thus excise duty is also charged on VAT element. Similar is a case of service tax levied on services and central sales tax levied on inter-state sale of goods. This cascading of taxes at each stage in a supply chain makes Indian goods artificially expensive compared to other competing countries which have adopted GST or National VAT. In the case of some indigenous products the resultant competitive disadvantage due to cascading taxes alone can be as high as 10 percent to 15 percent of the price. Such tax disadvantage reduces the competitiveness of indigenous goods and does not allow us to tap full export potential of manufactured goods and agro based processed foods.

- *Central Sales Tax (CST):*[53] CST is the root of many distortions and inefficiencies in the current indirect tax system. It is unjust, difficult to enforce and prone to evasion. The barriers created are a blot on the common market of India. Being an origin-based tax, CST violates the principle of inter-jurisdictional equity. It is an extraterritorial tax by the producing states on the residents of the consuming states.

  Thus, as a buyer, one would always want to buy locally within the state so that VAT paid thereon could be availed as credit. As a seller of goods from outside the state, is constantly challenged to identify alternate distribution mechanisms to be able to finally strike the right price with the buyer. In this regard, making a stock-transfer of the goods to the destination state and thereafter making a local sale to the customer is widely applied. But that makes the supply chain complex and expensive. The enhanced costs create a competitive disadvantage for the Indian suppliers.

Currently, in India, the continuance of CST by the Central Government has to a significant extent impacted the trade between states. The Central sales tax, which obstructs easy trading between different states, should be terminated in order to boost inter-state trade and facilitation of free interstate movement of goods and curtailment of cascading effect of taxes.

Subsidies/State Aid

Further, subsidies have often been used to foster the development of new industries especially in developing countries. Subsidies are also often granted as part of a "defensive" industrial policy, when they are targeted towards distressed firms, with the goal of preventing foreign takeover, avoiding the disappearance of an activity deemed essential for the country's economy, or avoiding layoffs and the ensuing social troubles.[54]

In India, subsidies are granted both by the state governments and the Central Government. Examples include the recurring support to agriculture, power, airlines, and coal mining. However, subsidies may be seen to directly and indirectly distort competition as often SoEs that are recipients of subsidies may use such subsidies to indulge in predatory pricing or other exclusionary behaviour. This is why subsidies/state aids are regulated in the EU and a balancing test is employed by agencies to assess whether the benefits of such aid in addressing market failures outweighs the distortionary effects.

Subsidies also increase inefficiencies and lead to soft budget constraints for the beneficiary. Govenments think that production itself creates economic value—an idea that sometimes makes them protect businesses regardless of their performance. This approach is mistaken as in so doing; they fail to understand the link between production and consumption. Goods have value only if consumers want them. Otherwise, sheer production does little to raise standards of living.[55]

Rampant and wasteful subsidies cause a drain on the fiscal budget as well. An instance is as below:

- In India, agricultural trade policy is a part of a larger food and agriculture policy regime that seeks to maintain food self-sufficiency while providing support to the agricultural sector. The Government of India uses a variety of policy instruments in attempting to achieve these goals, input subsidies being one such major tool.[56] Over the years, the amount of such subsidies has increased to unsustainable levels especially in the fertiliser sector. This has had several detrimental effects where the beneficial effects of such subsidies have been outweighed by macro-economic imbalances. The decision to roll back the subsidy cuts announced in a notification on November 19, 2010 was mainly to enable companies to import DAP (di-ammonium phosphate) and MoP (Muriate of Potash) from global suppliers.[57]

  The huge subsidies granted to the fertiliser industry carry the objective of promotion of domestic agricultural production and achieving self-sufficiency in food production. However, the subsidy bills are increasing the burden of fiscal deficit. While domestic policy support should continue, the Indian fertiliser industry should be made more competitive in order to achieve efficiency gains in the long run so that gradually such subsidies may be phased out pursuant to India's obligations under the multilateral economic governance regime. The bottom line is that markets should take care of distributing resources without government interference. It is pertinent to note here that a large chunk of the subsidies go on to finance the monopoly rents of supplier cartels. An impending problem that plagues the fertiliser sector is of cartelisation by global suppliers that collude to keep the prices of the fertilizers artificially high on the global market, thereby distorting competition in the world fertiliser market and further adding to the subsidy bills.[58]

- Distortions are also seen to occur as a result of grant of state subsidies when it feeds into the inefficiencies of the recipient firms that expect to be bailed out and subsidised no matter what. This hampers their incentive to innovate and compete in the market. The recent debate about Air India's bailout provides an illustration of this. The government indicated that this was the "first and last time" that it would bail out the airline.

  As in any such situation, making this commitment credible was an important part of the overall strategy meant to force managers to make tough but necessary decisions, including staff reductions. However, outside observers considered this commitment not to be credible, inter alia, because Air India, like most national carriers,

> was "too big to fail", because of its symbolic weight and, last but not least, because it was an SoE.[59]
>
> This be true or not, the underlying reasoning behind the argument here is that if it is expected that failing firms will be rescued by governments with some probability, companies may be encouraged to undertake overly risky investments, or to adopt lax management practices. More generally, a firm's incentives to become more efficient so as to cut costs, raise quality or innovate are likely to be dampened if it expects that the resulting competitive advantage will be offset by the granting of aid to its lazier rivals.[60]

In an era of globalisation, the competition for foreign investment is intense. This may make the problem of subsidy races more acute. It could also in some cases result in a protectionist backlash and induce a growing use of subsidies.[61]

The growing use of subsidies is a rising cause for concern. The need for subsidy reform has to be recognised and tools need to be devised to differentiate between subsidies that are necessary for domestic industrial policy from those that breed inefficiencies and distort market competition. Government subsidies, therefore, need to be screened and assessed in terms of their impacts on market functioning and their usage needs to be kept in check so that they are not granted to a point of detriment and distortion.

3
Framework for Analysing the Impact of Government Policies on Competition and Regulation

Due to the anti-competitive outcomes in the formulation and implementation of many such government policies, as seen in the previous sections, there is a need to scrutinise and assess them on the touchstone of competition and the impediments they are likely to cause to the market process. Often social and environmental objectives can override economic interests in terms of determining public interest, as highlighted at different points in this paper. Intervention in markets to achieve such objectives can be entirely appropriate. It is necessary, however, that such deviations are justified and implemented in a transparent manner and the objectives clearly spelt out.

A review of such policies and regulations from the competition perspective which is also known as competition audit in many countries should be undertaken with a view to remove or minimise their competition restricting effects. Proposed policies, statutes and regulations that have an impact on competition should be subject to a competition impact assessment through an internal mechanism. A good model to follow is UK where regulatory impact analysis is a necessary precondition for imposing new regulation in any sector.[62]

Although such an analysis might be too resource intensive and not a feasible option for developing countries, they may draw their own methods of screening and evaluating government policies with the help of such detailed assessment/analytical procedures already being undertaken instead of re-inventing the wheel.

The Working Group on Business Regulatory Framework, an initiative of the Planning Commission under its XII Five Year Plan for which CUTS International was a Knowledge Partner, recommends the adoption of a Regulatory Impact Analysis to improve the quality of business governance in India and is working towards developing an appropriate methodology to conduct such analysis in the Indian context.

Paragraph 11.29 of the Eleventh Planning Commission Report on Inclusive Growth[63] states:

> *Several existing policies, statutes and regulations of the Central Government restrict or undermine competition. A review of such policies, statutes and regulations from the competition perspective (this is referred to as 'regulatory impact assessment' in several countries) may be undertaken with a view to remove or minimize their competition restricting effects. Proposed policies, statutes, regulations that impact competition should also include a competition impact assessment through an internal mechanism which should form one of the inputs in any decision-making process in this regard. Regulatory impact analysis should be a precondition for introducing regulatory changes in any sector.*

Developing country governments need to identify and address anticompetitive arrangements and practices in both the private and public spheres. A competition assessment framework is a useful diagnostic tool that may be employed by developing countries to achieve the objective of fair competition in markets which is crucial for economic and social development, and for reducing poverty.

CUTS has formulated a Competition Impact Assessment toolkit[64] for legislative review of government policies. It takes a step forward from the existing work in the area in that it incorporates additional elements of the commonly understood and widely adopted principles of competition policy as well as political economy challenges onnr vested interests promoted by governments (a major obstacle in the path of competitive reforms in poorer countries). The toolkit complements the checklist prepared by the Organisation for Economic Development (OECD).

The draft National Competition Policy in paragraph 8 has enunciated several valuable policy initiatives such as: (i) a review of existing policies, statues and regulations and impact assessment of those proposed, from a competition perspective; (ii) incorporation of principles of competition in all regulation; (iii) setting up of an in-house cell within Departments/ Ministries with a mandate to (a) carry out competition impact assessment of policies and statues, and (b) align public procurement regulations and practices with competition principles etc.

Given the draft National Competition Policy of India lays down principles of competition, it is important that such a framework be aligned with these principles as well. The CUTS Competition Impact Assessment Toolkit is an attempt in this direction. It is an attempt to arrive at an algorithm that draws on previous work done in the area. It is however a step forward in the direction of marrying the elements previously etched out with the principles upon which competition policy should be hinged. Further, most importantly, it is mindful of the various political economy challenges that have remained unaddressed in the frameworks developed thus far which have and continue to contribute significantly to distortive outcomes.

4
Way Forward

Having a good law is not enough. The introduction of a competition law needs appropriate supporting policies, and effective enforcement. While competition law is already in place, a holistic national competition policy that effectively addresses government policies and regulations so that they are least competition restrictive is yet to be established. In the midterm appraisal of the Ninth Five Year Plan, the Planning Commission recognised the need for a National Competition Policy (NCP) in India to accelerate economic growth and thereby improve the quality of life of people in the country.

The Planning Commission, in the context of formulation of the Eleventh Plan, constituted a *Working Group on Competition Policy* in which professionals from government and non-government organisations were widely represented. The Working Group reaffirmed the need for the government to adopt a broad-based, overarching and comprehensive NCP to promote coherence in the reforms process, establish uniform competition principles across sectors and harmonise all other policies keeping in view the competition objective.

While adopting an NCP would have several advantages to the overall market process and the socio-economic growth, the following benefits may be particularly seen in the area of distortions induced by government policies and regulations:

- Enhanced harmonisation of the government policies and regulations at all three levels.
- Greater competitive neutrality between public and private market players.
- Notification and public justification of deviations from principles of competition policy to achieve social/ environmental objectives.
- Formulation of a framework for competition assessment of all government policies, practices and regulations on identified benchmarks determined and prescribed by the NCP.

Finally, competition is an issue of national priority which needs to be addressed as such through a comprehensive framework of policy and advocacy. There is often a "chicken and egg" conundrum between the two due to a probable causality in both directions. However, both competition policy and advocacy go beyond mere law enforcement and are interdependent for effective competition enforcement.

Competition advocacy helps in minimising unnecessary government interventions in the market as well as in educating and persuading all stakeholders and not just business enterprises on the benefits of competition. It helps in empowering consumers who are directly affected by the market competition process as well as in strengthening political will necessary to implement competition reforms. On the whole, competition advocacy helps in building a culture of competition which is necessary for all countries but crucial for developing countries which are mired in poverty and severe political economy constraints.

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23. The committee was headed by Dhanendra Kumar, former Chairman of Competition Commission of India and included members like Pradeep S Mehta, Pallavi Shroff and Amitabh Kumar.
24. Available at: http://www.mca.gov.in/Ministry/pdf/Draft_National_Competition_Policy.pdf
25. *Ibid.*
26. http://www.financialexpress.com/news/latex-users-seek-import-duty-cut/764515/
27. http://www.forum4finance.com/2010/02/12/cement-makers-urge-to-scrap-import-duty-on-coal-pet-coke/
28. http://www.thehindubusinessline.in/bline/2007/03/19/stories/2007031903360300.htm
29. An anti-dumping duty is a duty levied on imported commodities. Article VI of the General Agreement on Tariffs and Trade (GATT) permits special anti-dumping duties that are equal to the difference between the import price and the normal value of the product in the exporting country (the "dumping margin")
30. Safeguards are remedial measures applied when there is a surge in imports of a particular product irrespective of a particular country/ies and it causes serious injury to the domestic industry. Safeguard measures are applied to all imports of the product in question irrespective of the countries in which it originates or from which it is exported. Safeguards are applied in the form of either safeguard duty or in the form of safeguard QRs (import licenses). India has adopted its own antidumping and safeguard regimes in consonance with the WTO agreements. Alas, the problem with these laws is that 'public interest' considerations have not been provided for. Thus, the authorities which deal with such complaints only rely upon the charges of the aggrieved parties that they have suffered an injury.

31. http://www.thehindubusinessline.in/2010/11/24/stories/2010112451850400.htm
32. Consumers include both final consumers and intermediate customers.
33. http://www.business-standard.com/commodities/storypage.php?autono=400039
34. <<http://findarticles.com/p/news-articles/dna-daily-news-analysis mumbai/mi_8111/is_20100925/dept-adds-riders-restricts-firms/ai_n55412840/>>
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42. CIRC-IICA Sector Studies Project (2011): Civil Aviation sector, available at http://www.circ.in/CIRC-IICA_Sector_Studies_Project.htm
43. Civil Aviation Requirement Section 3, Series C, Part II - Sections 3.2.1 and 3.2.3
44. CIRC-IICA Sector Studies Project (2011): Report on Competitiveness in the Coal sector, http://www.iica.in/images/Coalpercent20Sector.pdf
45. "Section 3(3)(a) of the Coal Mines (Nationalization) Act 1973 Act, prohibits any person other than (a) the central government, government company, or corporation, (b) a sub-lessee of the government, or (c) a company engaged in (i) production of iron and steel, (ii) generation of power, (iii) washing of coal, (iv) such other uses as may be specified, from carrying on coal mining operations in any form. Sub-clause (c) of Section 3(3) enhances the prohibition by mandating that a lease for winning or mining coal may be granted only to a government company or corporation, however provides further that a sub-lease may be granted by the government company or corporation to private parties in isolated small pockets not amenable to economic development and not requiring rail transport" IICA sector studies.

46. http://www.business-standard.com/india/news/coal-min-to-renew-privatisation-push/427703/
47. *Ibid.*
48. This condition was later dropped and now private sector players are also operating industrial parks in Rajasthan
49. http://www.thehindu.com/news/states/other-states/article1509881.ece
50. For details, please refer the Policy Option Note published by CUTS-International, 'Anti-competitive Provisions in the Motor Vehicles Act, 1988: *Case Study of Private Bus Operators in Nathdwara*'.http://www.cuts-ccier.org/pdf/Anticompetitive_Provisions_in_the_Motor_Vehicles_2011.pdf
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63. *Ibid.*
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ISBN 978 81 8257 192 1
9 788182 571921