Competition Distortions in India – A Dossier

(CDI-24: April-June, 2014)

For earlier Dossiers please see: http://cuts-ccier.org/Competition_Distortions_India.htm

Periodic dossiers look at the interface of policy issues which has an impact on competition in India, which can be both negative and positive. News as published is used without verifying their accuracy. The purpose is to flag issues to the layman as well as to the specialised policymakers and regulators, rather than be judgmental about them. This would require greater analysis particularly in terms of cost and benefits.

Dear Readers,

We are pleased to bring before you the Competition Distortions Dossier Edition No: 24 for the first quarter: April-June 2014. As always, we have captured several interesting stories, a mix of good and bad.

Though the union budget was announced in July, it is worthy of reporting that a common national market was emphasised in the Finance Minister's speech in speaking about Goods and Services Tax (GST) and similar measures. What was not mentioned is the adoption of the National Competition Policy (NCP), but sources say that a cabinet note has been moved and it is likely to be adopted soon.

Once the NCP comes into being, many of these distortions can be addressed headlong. There are instances of potential competition distortions caused due to ignorance of the principle of competitive neutrality and trade policy tools, such as import duty and adopting protectionist approach. Also, they are quick fixes that do not serve a long-term goal of encouraging competitiveness of domestic industries by artificially insulating/shielding them. In some cases, we can agree that some local factors inhibit their competitiveness and thus they need protection. But such protectionism needs to be rationally analysed and the fundamental problems be resolved.

The dossier gives a glimpse of trade policy distortions caused by vested interests, such as Reliance Industries' plea to impose antidumping duty on imports of PTA, when they are an oligopolistic domestic player or through the higher import duty imposed on the Chinese Solar Panel manufacturers, when they are able to supply cheaper. Hike in sugar import duties is another example. The wrong interpretation of Section 11 of the Electricity Act, 2003 on Open Access by states to disturb level playing field thereby reduction of choice is also highlighted in this dossier.

Further, the dossier appreciates the pro-competition decision of TDSAT that enhances consumer choice in the telecom sector. It also requests the FinMin to facilitate competition in banking sector and easy access and higher penetration of banking sector by allowing India Post to enter banking sector.

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A. Trade Policy

1. User Industries Oppose RIL Plea for PTA Dumping Duty

A plea made by Reliance Industries (RIL) and Mitsubishi's MCC PTA India Corp to impose anti-dumping duty on imports of Purified Terephtalic Acid also called PTA used in the production of Polyester from select countries of China, EU, Korea and Thailand has stirred up the PTA industry. The allegation raised by the PTA User industries is that the plea is an attempt by RIL to generate profit by distorting the market and also benefit its recently acquired PTA plant in Malaysia.

http://www.financialexpress.com/news/user-industries-oppose-reliance-industries-plea-for-pta-dumping-duty/1238726

Food for Thought

The plea by Reliance Industries has undergone huge criticism due to the fact that RIL itself is one of the interested parties that will benefit in case the antidumping duty is duly imposed. Reliance being an integrated producer of both PTA as well as polyester will benefit not just due to the presence of the duty on PTA but also because the key ingredient for production of polyester will be within easy reach of the textile giant. While on one side increase cost of production for other synthetic textile manufacturers and on the other will distort the market substantially to create a domino effect for the PTA producers.

It is to be borne in mind that RIL already enjoys market dominance in a sector that is plagued with the low cost effectiveness. The industry unanimously has opposed the demand for the move especially since there is no requirement or justification of the antidumping duty.

In absence of any sound justification to impose antidumping duty over the PTA import and that has from select countries would substantially increase the cost of production of synthetic fibre, yarns, fabrics and readymade garments. In such circumstances it is obvious that other players would suffer while the integrated polyester player will not just benefit by the move but will gain a higher market share and it will later lead to market dominance by RIL.

2. Solar Panel Makers Energised by Chinese Import Duties Plan

Commerce Department has proposed to impose duties on solar panels manufactured in China. Though the final scheme is yet to be made, it is proposed that it would impose a tariff of 26.9 percent on nearly all solar panel manufacturers, though it would differ from company to company. The move is hugely criticised as being one that that may substantially disrupt the market.

http://www.ft.com/cms/s/0/ec0a8f0c-ec00-11e3-ab1b 00144feabdc0.html#axzz35eRk9Ivy

Food for Thought

The solar power sector in India is proliferating. On one hand, India is proud to claim Gujarat Solar Park as world's largest power plant hub and of late also inaugurated India's largest solar power plant. In this backdrop, it is to be understood that solar energy is the answer to the clarion call of dire energy requirements of India. What the country needs is solar panels at subsidised rate that would make electricity generation more cost effective and cheaper at the same time.

Increasing import duties on the Chinese manufactured solar panels would result in the increase in price of the solar panels, which in turn would facilitate the US based companies (who would benefit from the higher import duties levied on the Chinese counterparts). The import duty would further distort the level playing field and would subsequently affect the *consumers who would have to suffer due to higher cost of the panels imported from China, on one hand, and the leverage given to the US based photovoltaic panel manufacturers would impair the market dynamics adversely affecting the sector, on the other.*

The policymakers need to appreciate the fact that when a product is imported into the country, the related scientific knowhow, research and development also ushers in the country. The domestic solar panel manufacture can benefit from the research and development done on the Chinese solar panel. A potential reverse engineering can allow the Indian domestic solar panel manufacturers to establish low cost solar panel market. That being said, the policy makers also need to understand that the financing agencies are not very enthusiastic about financing solar power projects that use Indian solar panels owing to their lack of quality. This could be rectified by allowing import of the solar panel at reasonable duty.

Another aspect is that if high import duty is levied on one manufacturer it should be equally be applicable on the peer manufacturers in the sector irrespective of their country of origin. This would create a level playing field for all the manufacturers and not create advantage of one manufacturer on the cost of another, as in the present case.

Under the present circumstances, the market will get distorted and the consumer interest will get hampered. The fact that the import duty so levied would increase the cost of China made panels and the subsequent effect that US panels would henceforth would be preferred and would become comparatively costly would jeopardise the sector from all levels. Instead of levying a huge import duty the government should impose a duty at a subsidised rate which would not just control the Chinese manufactured photovoltaic panel would also keep the price in check as well as maintain a competitive market structure along with acting as an incentive to the domestic players to manufacture quality and cost-effective panels.

3. How Sugar Tariff could dent growth

Food Minister Ram Vilas Paswan announced changes in the tariff structure for the sugar industry. The import duties have been hiked from 15 percent to 40 percent and export subsidies of Rs 3,300 per tonne of raw sugar shipped overseas, will continue till September. The sugar industry is delighted with the hike in tariff, however, the hike can have a bitter implication on the economy.

http://articles.economictimes.indiatimes.com/2014-06-25/news/50855986_1_sugar-mills-levy-sugar-sugar-companies

Food for Thought

The Minister has not just hiked tariff on import but also have subsidised the export of sugar. The recent tariff increase made by the Food Minister would be another step to pacify the sugar mill owners and the farmers. The Minister is of the view that the hike will allow the sugar mill owners to pay the dues to the farmers by increasing profitability of the produce. However, the question lies whether such pacification is made at the cost of the development potential and growth pace of the economy.

Hiking of the import duty and subsidising export of sugar will certainly lead to increase in the sugar prices in the country. The rise in price will in turn not just affect adversely the households but also the manufacturers of sugar related products such as gur (jaggery) *and soft drinks etc. It is also to be borne in mind that such manufactured products account for three percent of the wholesale price index. The cumulative effect would be witnessed as higher wholesale inflation, further impeding growth.*

On one hand, the Minister is trying to appease the sugar lobby and the Reserve Bank of India (RBI) is constantly trying to deflate the consumer inflation, on the other. Inflation is one of *the primary concerns of the RBI. Rise in sugar prices will foster higher inflation, compelling the RBI to hike the rates resultantly reducing the pace of growth.*

Therefore, the interest of the sugar lobby must be – for the time being –kept on shelf to promote the economy of the country.

B. Sectoral Policy

1. A Pro-Consumer Call

The Centre in order to check the practice among operators of sharing of 3G services in each other's circle, has penalised such action. The Centre opined that operators have no rights of offer 3G services in areas wherein they have no Spectrum rights. The issue was taken to the Telecom Disputes Settlement and Appellate Tribunal (TDSAT) that has permitted the mobile operators to share spectrum.

The spectrum licences were distributed through auction and distributed in such a manner that not more than three operators were allowed in one circle this fostered the arrangement between the operators to expand their operating network by entering into inter-circle roaming arrangement.

http://www.thehindubusinessline.com/opinion/editorial/a-proconsumer-call/article5963166.ece

Food for Thought

Spectrum licences, in first place, were auctioned and distributed in the most hastened and flawed manner. It is to be understood that by allowing just three operators per circle distorts competition thus creating entry barriers and is also harmful for the interest of consumers not just by reducing consumer choice but also by restricting level playing field and competitiveness in the market.

The TDSAT noted that the Unified Access Service Licence (UASL) permitting the operators to provide all types of fixed and mobile services. By the very nature of the agreement incorporates within its ambit the proposition of using the 2100MHz spectrum of other operator who is licensed only for 2G spectrum. There is no separate agreement made or license granted in case of distribution of 2G and 3G spectrum, the UASL guides all.

Moreover, the Centre has itself been fostering the removal of restriction on exclusively ear-marking waves for certain specific spectrum. That being said, creating segregation between the two spectrums waves without presence of any agreement or licence openly creates a difference which, in turn, questions the decision of the Centre.

One has to appreciate the fact that effective usage of idle spectrum must be made to provide for the optimum benefit to the consumer and also to allow higher penetration of 2G and 3G services in the respective circles. Allowing usage of idle spectrum would through agreement between two operators would also remove entry barriers for the new operators which in turn would facilitate healthy competition. Therefore, the cumulative effect would be having greater choice for the consumers and enhanced competitiveness in the sector.

The decision of the TDSAT is, therefore, pro-competitive and enhances not just consumer choices but competitiveness in the sector itself. The decision will allow uninterrupted spectrum wave to the mobile phone operator who in turn will provide better service and competitive rates to the consumer.

2. FinMin not Stamping Postal Bank Plan

India Post's attempt to enter the banking sector has irrupted into muddled waters. The attempt of the Post Department to enter into the sector is marred by the fears of the Department of Financial Services (DFS) that allowing the proposed postal bank might turn into another government bank competing with other public sector banks. The department, however, is of the opinion that there is a case of '*strong lobbying*' against it.

http://www.business-standard.com/article/economy-policy/finmin-not-stamping-postal-bank-plan-114040700068_1.html

Food for Thought

Enabling access of formal financial services into the remote region is one of the prime objectives of the RBI. India has the largest postal network in the world and sound access into the rural India. With its wide network the aspiration of the postal department to enter into the banking sector must not be foiled.

Alas, the reality is that the department's application has been put into muddled water in the garb of increasing "yet another government bank competing with other public sector lenders". The reality is that despite of having substantial number of public banks, accessibility still remains a distant dream for many in the remote and rural parts of the country.

The rationale put across by the DFS is that by creating a clone of public sector bank would adversely affect the proposal of consolidating the 25 existing public sector lenders to achieve economies of scale. The DFS has also opined that the public sector banks are anyway infested with impediments such as lack of skilled personnel's and low experience in handling universal banking operations.

What DFS is not looking at is that though India Post may be a "clone" but its very nature and penetration level is much stronger than any other lender in public sector. Moreover, the Postal Department has been conducted certain banking activities such as running savings bank scheme, selling tax – saving instruments and accepting public provident fund deposits. Therefore, it cannot be said that the department is complete novice in providing banking and related services.

Allowing India Post into the banking sector will foster the banking sector into remotest part of the country. Creating a base for the growth and development of financial inclusion and inculcating spirit to save and providing access to lenders for economic development must be on the priority list of the Finance Ministry. Creating more players leads to higher competitiveness in the market, a fact that FinMin must remind itself.

Therefore, the FinMin must reconsider its move and allow India Post to enter the banking sector to facilitate competition, easy access and higher penetration within and of banking sector.

3. India Considers Splitting Power Utilities to Cut Losses

The government is of the opinion that breaking up its power distribution utilities since it has incurred a debt of more than US$32bn on the state-owned industries. The policy reform aims at reducing regulator intervention in setting up of tariff ceiling allowing the consumers to choose their electricity supplier.

Power sector is general suffers hugely from the archaic method and means of distribution network. Though the reform empowers the consumers to opt for their own supplier of electricity, speculation is that many state governments may oppose the move, especially since tariff is frequently used by them to lure in the voters.

http://www.livemint.com/Politics/Jx5f4mq8F7NekaV9dp6rGK/India-considers-splitting-power-utilities-to-cut-losses.html

Food for Thought

The move on the part of the Regulator is not just pro-competitive but also logical. Electricity sector in India is impaired in terms of supply and distribution of electricity. It is well understood that despite of having huge generation potential, the electricity sector suffers in terms of its poor distribution channels. The power distribution companies shun away their responsibility to ensure steady and constant supply of power in the name of lacunae in distribution network. On one hand, the distribution channels in the country are not just archaic but are based upon poor infrastructure. While on the other, the suppliers are plagued by the leakages in wires, theft and slack billing making the task of distribution of power non-profitable and cumbersome.

The move by the Regulator is like whiff of fresh air wherein the consumers will have a wider choice and would be in a position to choose between suppliers of electricity. Ceiling of tariff is one of the major reasons why most of the distributors are sceptical in providing for the enhanced services to their customers. In March 2012, the distribution network incurred loss of about US$36bn, while the average cost of supply increased by 24 percent, widening the revenue deficit.

The move is driven to increase competition in the market and also to foster better supply of electricity and services from the end of distributors. Giving consumers the choice to choose for supplier of utility, such as electricity creates a fertile ground for suppliers and distributors to enhance their services create incentives for the buyer, and at the same control the tariff in such a manner that power remains affordable to the common man. What the government needs to ensure in the process is to assure that the 'level playing field' is maintained in the market and that the competitors do not indulge in any anticompetitive activities that hamper the market, in general, and consumers, in specific.

4. Disallowing Electricity Sale through Open Access could Negatively Impact Industry

The states of Gujarat and Karnataka have decided to disallow sale of electricity through Open Access. This decision will have an adverse impact on the operations of close to 200 industrial consumers. On one hand, Gujarat has decided that industrial electricity consumers with a consumption of over 1MW will now buy power at Rs 6-7 per unit as opposed to Rs 4-4.5 per unit charged by power exchanges. While on the other, in Karnataka the choice of power generators to sell power to consumers outside the state has been curbed with the state restricting power sales with the boundaries of the State.

The state of Gujarat has been facing challenges due to grid disturbances, while Karnataka government has invoked Section 11 of the Electricity Act 2003 which states that '*the appropriate government may specify that a generating company shall in extraordinary circumstances operate and maintain any generation station in accordance with the directions of that government'.* The explanation of the Section clarifies that the extraordinary circumstance would mean circumstances culminating from threat to the security of the state, public order, natural calamity or public interest.

http://www.cii.in/ResourceDetails.aspx?enc=g03/ZgB/NGgXSKSqiplgbfgUIdSEQm8GaCO3p74krxXhWgzKMlx6aFhOeLvOXJtZ2MyF4l7t+pFiQtUI73Q8XA

Food for Thought

Electricity Act, 2003 envisages states to implement open access for consumption of more than 1 MW. Open access was primarily envisioned with the objective of creating no barriers to flow of power on economic principles without any regard to ownership of transmission. Open access facilitates power trading in an orderly manner and to usher in competitiveness, transparency and efficiency in the sector.

However, open access has been impeded by the misuse of certain aspects within the Electricity Act, 2003, Section 11 being the most significant. State governments, many a times, by citing 'extraordinary circumstances' have restricted open access to generators. In fact, it has been stated that legislative amendments should be made to curb the practice of misuse of the section. The concept of open access rests on the premise that electricity as energy can be classified as commodity distinct and separate from transmission as a service. The State Electricity Regulatory Commission (SERC) needs to segregate 'content' and 'carriage' business to achieve optimum competition in the sector.

The move by Gujarat and Karnataka governments to discontinue open access will disturb the market balance increasing the tariff rates and the subsequent billing in the electricity sector. The basic premise for which open access was introduced gets frustrated by the illegitimate utilisation of Section 11 since it disturbs the level playing field and reduces choices that are extended to consumers in terms of tariff. Therefore, it stands imperative that the Section 11 explanation lucidly explains the meaning and the ambit of 'extraordinary circumstances' and also sets qualifiers that allow the use of the section rather than fostering misuse of the same.

C. Industrial Policy

1. Odisha Govt's Ore Distribution Policy gets High Court Nod

Odisha High Court has upheld the state government's circular that directed the mine owners in the state to supply half of their mine lumps to local standalone units. The Court has stated that such action by the government lies within the ambit of right of pre-emption as exercised by the state.

By the directives issued in December 2012, states have requested miners to allocate 50 percent of their produce to units with an attempt to regulate the activities of the miners within the state.

http://www.financialexpress.com/news/odisha-govt-s-ore-distribution-policy-gets-high-court-nod/1238170

Food for Thought

The right of pre-emption as exercised and upheld by the Odisha government and the High Court respectively is a much debated issue. The right of pre-emption of the state as upheld by the Odisha High Court has been quite often questioned as being too broad to interpret with unidentified limits. In absence of a well-defined structure the concept engulfs all aspects of the state action within its ambit. The fact that the Odisha government has asked the mine owners to allocate 50 percent of the produce questions the nature of the policy. On the face itself the policy sounds restrictive in nature.

The law of restrictive trade practices (RTPs) is based on the concept of public interest. It is tough, however, to define public interest on the basis of certain parameters since the ambit of the concept may increase or decrease depending upon the nature of the issue or subject it is attached to. In the present case, it is to be appreciated on one side that the state government has taken up the cause of regulating the mining operations of the state while on *the other hand the state has allocated more than half of the production of the miners making the business restrictive in nature. The fact that such huge amount of the produce is to be kept with the state would either raise the price of the commodities to be traded or else would lead to shortage in production itself. Also, the local units would become lax and inefficient as supply is guaranteed.*

RTPs have always been abhorred by the players of the market, not just because it retards the growth of the sector that they relate to. The present move of the Odisha government will have repercussions in terms of lower production and subsequent rise of prices.

2. Reversal of FDI Policy in Multi-Brand Retail would have an Adverse Impact

Foreign Direct Investment (FDI) in India has been received with mixed responses. On one hand, the present BJP-led government is fostering the idea of 100 percent FDI in defence, while on the other hand the same government is against 51 percent FDI in multi-brand retail trading (MBRT). The government does realise that FDI is essential for the economy and investment inflow into the country is an essential part of the same. However, the government has paradoxical views on MBRT and has clarified its intention of scrapping the policy.

http://www.business-standard.com/article/economy-policy/reversal-of-fdi-policy-in-multi-brand-retail-would-have-an-adverse-impact-amitabh-kant-114042100043_1.html

Food for Thought

The Department of Industrial Policy and Promotion (DIPP) is entrusted with the task of creating conducive environment that would change the experience of ease of doing business in the country. The DIPP under the Ministry of Commerce had allowed the 51 percent FDI via automatic route for MBRT allowing retailers around the world to invest in India with certain conditionalities subject to state government's consent.

FDI ushers with itself not just investment in monetary terms but also in terms of research and development. The issue, however, is with the manner in which the FDI is first implemented and then reversed. Such practice leads to uncertainty that affects the FDI flow; it also creates speculation as to the stability of the policy and the sector in the market affecting the investor confidence.

Fostering FDI in one sector while negating in another can be taken as a case of preferential treatment and protectionist tendency of the government. Retail sector is one of the most unorganised sectors that cater to the major portion of the Indian economy. FDI in MBRT would allow creating a defined structure to regulate the manner in which retail sector works. The reversal of the policy would single handedly send the message that Indian retail sector is firstly, not business friendly, secondly, that it is unstable and uncertain in nature.

One of the major rationales forwarded in defence of FDI in MBRT is that the policy and the resultant economic environment would facilitate competitiveness in the sector. Reversal of the FDI policy in MBRT would therefore be anticompetitive in nature and would in turn adversely affect the economy.