Competition Distortions in India – A Dossier

(CDI-28: April – June, 2015)

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.

We are pleased to present to you the Competition Distortion Dossier Edition No: 28 for the second quarter: April-June, 2015. As always, we have attempted to capture interesting stories ranging from trade, anticompetitive practices, reforms, development in various economic sectors and industries. The stories reflect a mix-bag of both good and bad policies affecting the economy.

This edition has attempted to showcase the progress made by the Modi government in its first year of coming into power. It highlights various sectors including banks, fuel, defense and the development made by the economy with the incorporation of certain policies. Introduced with the singular purpose to simplicity of doing business in India, the present government is expecting to attract more and more foreign investments thereby realising India's true potential and making it a better platform to do business.

Supporting the Goods and Services Tax (GST) the Finance Minister, Arun Jaitley has recently stated that *"…opportunity for India to improve growth after the setbacks from global slowdown and the policy paralysis….We have the ability to grow at double digit."* Introduction of GST would terminate the multitude of indirect taxes across the country thereby reducing the complexity involved in doing business in India. Eventually, this would integrate the entire country into a single market economy, also create a competitive export market as it involves no hidden cost. As per estimated figures, it would increase GDP rate by 1-1.5 per cent, the tax-GDP ratio by up to two per cent and reduce the cost of indigenous goods up to 10 per cent. This would consequently facilitate a healthy environment for competition, thereby boosting the growth of the country.

We welcome the initiative by the government to introduce e-Biz portal, where entrepreneurs can apply at ease for 26 different services. Simplifying the business procedures would encourage more participation, thereby enhancing healthy competition in the market.

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A. Anticompetitive Practices

1. Smash the PSU Oil Cartel

With deregulation of oil industry, national oil companies, HPCL, BPCL and IOCL have recently increased the price of petrol and diesel by significant margins depicting cartelisation behaviour. The Public Sector Undertakings (PSUs) have their own cost structures and margins dictated by their refining capacities, distribution network, retail outlets, staff strength and other items of cost. However, such an act of the three PSUs adjusting prices in tandem is anticompetitive.
Therefore, without deriving benefits from the present situation, the government needs to play the role of a facilitator by fostering fair competition between both private and public entities.

http://www.thehindubusinessline.com/opinion/columns/raghuvir-srinivasan/smash-the-psu-oil-cartel/article7170799.ece

Food for Thought

Petrol and diesel are considered as the most used fuel products in various sectors such as agriculture and transportation industry which affects food prices, thereby having direct impact on consumers. To enhance healthy competition in the transportation fuel industry, the government took a pro-competitive step to deregulate the market. These PSUs would have their own cost structures and margins dictated by certain factors, such as their refining capacities, distribution network, retail outlets, staff strength and other items of cost. This allowed public sector entities as well as private sector players to participate and compete fairly in the same platform. Increased competition thus means improvised services and more competitive prices, as well as wider choice for consumers.

However, these PSUs account for around 98 percent of the market for transportation fuels and dominate their private peers. These entities have tried to take undue advantage of their prevailing situation by significantly increasing the price of their products, thereby abusing their dominant position. Deciding the prices in tandem clearly depicts cartelisation behavior or collective abuse of dominance if there is no explicit collusion. Such an anticompetitive activity should not be encouraged by the government.

On the contrary, the government is not concerned as it is benefiting from such price coordinating action by the PSUs. The pro-competitive step by deregulating the market has turned out to be insignificant. As excise duties were raised in November and December 2014, the government has now appropriated for itself through the gains which would have otherwise been passed on to consumers.

To conclude, it is submitted that this is the pre-eminent time to complete the unfinished reforms in the downstream petroleum industry. It is suggested that the PSU majors could be freed from the government control, thereby encouraging them to compete with each other and with the private players. Introducing differential pricing can lead to customer choice without compromising quality of service. The government must play the role of a facilitator by fostering competition amongst both private and public entities. Such a reform would not only lead to better quality of service and price preference but also help control the fiscal deficit thereby contributing to increased economic efficiency.

2. Power Grid's Monopoly Irks Private Cos.

On June 30, 2015 request for proposals was submitted by both private and government entities for four power transmission projects worth ₹4,058 crore which are part of the government's plan to auction transmission projects worth ₹1 lakh crore through competitive bidding process. Power Grid Corporation of India Limited (PGCIL), a government entity enjoys a market share of over 95 percent has won several bids causing private developers, international players to stay away from transmission sector. As a government entity, it gets funds at a cheaper rate with lower rate of return than private players, causing troubles for private entities to endure such stiff competition.

http://liveindia.in/private-cos-bid-rs-4k-transmission-projects-next-week

Food for Thought

Transmission capacity in India has surfaced as a bottleneck due to huge demand supply gap and failing to keep pace with the rise in generation capacity which is currently at over 272,000 MW. Therefore, the government made it mandatory for the state-run companies to compete with private firms for securing power projects. Auctioning transmission projects was done with a view to increase wheeling capacity at a faster pace by attracting private investments into the relevant market. It intended to encourage fair and healthy competition through competitive bidding, thereby enhancing transparency, innovation and better technology in the electricity transmission sector. Private sector accounts for three percent of transmission capacity, while it stands at 38 percent in generation. Private firms present in the power sector are very keen to become integrated players by investing in the transmission sector, where the rate of return is at par with that in the generation sector, at around 16 percent.

Later in June 2015, the government invited request for proposals to build transmission lines worth ₹1lakh crore through the Tariff Based Competitive Bidding (TBCB), which was not appreciated by private sectors. It is so because the private players fear that they may not be able to compete against PGCIL. Being a government entity, it would be able to get funding from banks at a cheaper rate than them. Also, it can bid with a lower rate of return, which the private entities would be unable to match. On the other hand, PGCIL which has a monopoly in transmission sector with a market share of 95 percent has recently won five out of seven projects auctioned, adversely affecting participation from private entities. Also, there is a fair possibility that winning more projects might overburden it which PGCIL may not be able to handle.

To conclude, as PGCIL has a multitude of projects, the government could hive off PGCIL as the Central Transmission Utility (CTU) thereby ensuring a level playing field to private-sector bidders. Although the government must continue auctioning through competitive bids as it would ensure better participants competent to bridge the demand supply gap with the use of better technology. Consequently, it would lower the transmission cost, thereby benefiting the consumers and making it affordable.

B. Sectoral Reforms

3. Govt may let Employees Shift Corpus between EPF and NPS

The Labour Ministry is proposing to make the pension funds portable by allowing subscribers of the Employees' Provident Fund (EPF) to migrate to the National Pension System (NPS), and vice versa. This requires amendments in the ancient Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPFMPA).

Allowing two-way movement is expected to help in saving tax, as withdrawing provident fund money in less than five years attracts tax deduction. Also, end users are provided the option to choose between these schemes. Such a move by the government is going to greatly benefit workers by reducing their tax burden.

http://www.livemint.com/Politics/J9DbNW65Yz4rEkWnmxlbgI/Govt-may-let-employees-shift-corpus-between-EPF-and-NPS.html

Food for Thought

As a part of contribution pension schemes, the Budget 2015 introduced two instruments, NPS and EFP for salaried employees. In this regard, certain amendments were proposed in the long standing Employees' Provident Funds and Miscellaneous Provisions Act, 1952. With the introduction of new clause 16AB in the Act, formal sector workers would now be free to choose between EPF scheme, run by EPFO, and NPS. This is a positive move by the government as subscribers are being provided with the option to choose between the pension schemes. This also gives discretion to employees or subscribers to opt for the scheme which suits them the best. Hence, opening it for a greater mass would create a competitive market thereby enhancing the investments. Also, employees not meeting the mentioned threshold have the preference not be a part of such money saving schemes. Thus, keeping it optional would not compel all the service employees to register themselves in the scheme.

Another amendment in the bill recommends change in the definition of 'wages.' This would eventually increase provident fund contributions by workers and employers, resulting in higher saving for the subscribers. Currently, the schemes are managed transparently, which indicates that the fund managers' bid to manage this corpus and investments are market-linked with their net asset values declared on daily basis. By January 2015, NPS and EPF had around 8million and 43million subscribers with assets worth more than ₹76,000 crore and ₹800,000 crore respectively.

Such an initiative may be termed as first step towards pension fund portability. The Pension Fund Regulatory and Development Authority (PFRDA) aims to create a level playing field which would allow fair competition in the relevant market. It is concluded that keeping the process transparent encourages further participation in terms of investments which would eventually facilitate saving funds for the subscribers. However, it is suggested that the government must work towards the proper implementation of the saving schemes for retirement which would eventually benefit the end users which is the main objective of this portability scheme.

4. Indian Pickle No Longer Preserve of Small Business

Certain consumer items were reserved exclusively for production by small-scale industries, as part of their effort to reduce the influence of large private capital over the economy. However, recently New Delhi relaxed restrictions on the production of the last 20 items, still 'reserved' exclusively for small-scale industries.

Such a decision has removed the last vestiges of a reservation policy that was once a vital pillar of India's economic development strategy. The intention is to cut red tapism and make efforts to spur growth thereby promoting more job-generating manufacturing industries.

http://www.ft.com/cms/s/0/089bca2a-e280-11e4-aa1d-00144feab7de.html#axzz3dbCIA08q

Food for Thought

During the late 1960s, the policy of reservation of products was introduced for manufactures exclusively in small scale industries (now MSMEs) with the sole objective of achieving socio-economic development through the development and promotion of small enterprises across India. Over the years, the list of items reserved for manufacture by MSMEs has been reduced from over 800 to 20 items.

Presently, the sector account for about 37 percent of the country's manufacturing output and around seven percent of the gross domestic product (GDP). With the introduction of import liberalisation, all remaining items are also allowed for imports. Therefore, there was no prima facie reason to continue reservation of manufacturing in the MSME sector. The items that have been eliminated range from pickles and chutneys to bread, laundry soap, steel almirahs and chairs, and stainless steel utensils.

The initiative to remove the remaining 20 items was taken to encourage greater investments, including in the existing MSME units, to incorporate better technologies, standard and brand building to boost competition in Indian and global markets for these products.

Encouraging the growth of the MSME sector is believed to encourage employment as well. The sector employs the largest proportion of the labour force after the agricultural sector. Such a step has paved the way for their large scale production, thereby removing hurdles in the way of these enterprises to become bigger and scale up. Even big companies would be able to take benefit of this opportunity, using their financial muscle to set up large units. It would eventually create a better market for healthy competition encouraging entities to expand, contributing well to India's economy.

Also, the government has taken care of small scale entrepreneurs by introducing Mudra Bank with a refinance corpus of ₹20,000crore and a credit guarantee corpus of ₹3,000crore for financial assistance to establish business. Thus, to conclude de-reserving the 20 items from MSME list is going to eventually boost the sector as it would not only help emerge bigger entities but also push India to grow into a thriving economy.

C. Trade Reforms

5. Entrepreneurs Can Apply Online for 26 Services

The government is encouraging applications from various entities through online transactions which is fast, transparent as well as convenient for the applicants, i.e. entrepreneurs. Through this initiative, the entrepreneurs can apply for around 26 different services through e-Biz portal which includes PAN and DIN numbers.

With the integration of these services on e-Biz portal, an entrepreneur can avail all these services 24x7 online, such as submission of forms, attachments, payments, tracking of status and obtaining the licence/permit from the portal. The government also intends to have just one form for different types of approvals including for water and power connections.

http://articles.economictimes.indiatimes.com/2015-04-23/news/61457608_1_e-biz-portal-26-services-transaction-cost-and-time

Food for Thought

As per the 2014 World Bank report on Doing Business, India slipped two places to 142 out of 189 countries for ease of doing business. Therefore, the government has become keen on improving India's world ranking to attract investments. It has facilitated application through e-Biz portal which is a single window mechanism to make some serious regulatory repair. The platform would bring together 26 central departments and some state ministries for improving the procedures to do business in India. This would also enhance transparency in procedures across departments which would eventually help combating corruption. Also, it would encourage further participation from various entities creating a competitive environment in India and a better market to do business. Launched in February, the portal aims to integrate with 10 states by end of 2015.

India is very complex and difficult country to do business. An entrepreneur has to take several approvals and clearances from different authorities in Central as well as state governments to start or run or expand its business. Therefore, simplifying the procedure to file applications and fulfill further regulations has created a virtual interface for the government departments and entrepreneurs. This indicates a shift to consumer-centric approach which would ultimately benefit entrepreneurs and swift the process. Also, it would benefit a lot in terms of attracting FDI into the country, thereby enhancing participation and building healthy competition in the relevant market. India would provide a fair competitive market to both Indian as well as foreign investors.

To conclude, the government has taken an optimistic step by encouraging use of modern technology to simplify the procedures and reduce the time and costs. However, like every technological innovation, the government has to make sure that E-Biz portal focuses on seamless implementation through proper maintenance and complete data security. Ultimately, this would attract more investments into the country creating a competitive market to do business in India.

6. Lapsed Tenders hurt Modi's 'Make in India' Defence Industry Push

India imports 70 percent of its arms from abroad. With the 'Make in India' slogan, Modi announced indigenous manufacture of weapons and technology. However, tenders from air defence guns to surface-to-air missiles to transport planes have lapsed. The tenders worth US$15bn have lapsed since early 2013.

Trying to move projects along, Modi's government in February 2015 approved an US$8bn proposal to build warships in India that had been awaiting cabinet signoff since 2012. Although the government is making efforts to simplify procedures in order to create a level-playing field, some tenders report zero participation.

http://www.reuters.com/article/2015/04/07/india-defence-idUSL6N0WY34D20150407

Food for Thought

The change-oriented Modi government introduced the 'Make in India' campaign which encouraged manufacture of defence products indigenously. Sadly, India is pretty much handicapped in terms of manufacturing such products. India imports 70 percent of its arms from abroad to meet it needs. In 2014, the government approached several Indian companies to show interest in an estimated US$1.7bn deal to replace 1960s-era Swedish air defence guns, however, only one said it could meet the requirements. Over the past 18 months, more than 41 requests for expressions of interest have been floated for naval projects alone, unfortunately, all fell through because of problems relating to manufacturing requirements. Complicating things further, military does not want weapons from Indian firms with no track record in defence manufacturing.

Filled with the zeal to reduce the dependence from foreign defence firms and make Indian arms marketable abroad, Modi proposed the laudable aim to manufacture weapons and other products including vessels, platforms etc. through Indian defence firms or foreign firms manufacturing it indigenously. In November 2014, the government put an estimated US$2bn proposal to replace its ageing fleet of Avro cargo planes on ice after the tender attracted only one bidder, a partnership between Europe's Airbus Group and India's Tata Sons.

To conclude, the approach adopted by Modi government towards manufacturing weapons and machineries in India is admirable. Encouraging foreign firms to develop and grow in India would help Indian defence firms additionally on developing their own capacity. However, it is suggested that the government could welcome suggestions from the defence firms in India and understand the lacunae industry faces due to which these entities are inept *to provide services similar to defence firms of foreign origin. As a silver lining to this entire sorry state of affairs, new policy is going to be unveiled by June end this year to address the concerns of private firms which include opaque procedures, unrealistic quality requirements and slow decision-making. Support from government can surely help India establish a level playing field for arms market, thereby encouraging healthy competition from indigenous firms to participate in the production as well as distribution of arms and other products. Also, it is suggested that both the domestic and foreign sector entities can be encouraged to work together in form of joint ventures which would establish a robust defence sector in India.*

D. Miscellaneous Reforms

7. Banks Selling Policies of Multiple Insurers to be Counter-productive

The Reserve Bank of India (RBI) had released guidelines allowing banks to sell insurance policies, one insurance company tied to one bank. However, recently, banks were allowed to sell multiple insurances of different companies.

Although an open architecture Bancassurance model would provide customers the much needed choice at a competitive price in selecting a product best suited to them, banks on the other hand acting as a corporate agent are allowed to sell the products of multiple insurers. This would eventually overburden banks and complicate the structure dealing with multifaceted matters involving multiple insurers.
http://www.business-standard.com/article/news-ians/open-architecture-bancassurance-will-be-counter-productive-115042100249_1.html

Food for Thought

In 2014, the RBI released guidelines which overextended the role of banking entities to become insurance brokers, also called as 'Bancassurance'. This pragmatic move by the RBI intended to establish and develop a healthy insurance market in India. In addition, the guidelines mentioned that according to Section 6(1)(o) of the Banking Regulation Act, 1949 each bank would be allowed to sell insurance products and services of only one life, one general and one health insurance company. Also, the guidelines clearly mentioned that only those banks would be allowed to sell insurance as a corporate agent that have made a net profit for the past three years and the record of the performance of the subsidiaries has been satisfactory. However, the number of banks were limited and the relevant market had already been consumed by the existing insurance companies, creating entry barriers for new companies to compete in the relevant market. Therefore, on January 15, 2015, the RBI released final guidelines which allowed multiple insurers.

As the marketplace was not so friendly for new entrants, this guideline came as a saviour to create a level playing field and competitive market. From the perspective of competition, this open architecture would provide plenty of options to consumers as they are free to choose among the various insurance policies as per their requirements. This is also likely to benefit insurers that are not promoted by banks and depend on the agency channel for business initially as it is more cost effective.

Nevertheless, insurance is not the core product for banks, and contributes only two to three percent to their revenues. Almost all private and public sector banks either have joint venture agreements or are corporate agents of insurance companies. With the present role as a broker, banks would be liable for insurance claims and handling consumer grievances, unlike the case with a corporate agent. The liability is also high, especially now that the banks have to sell products of multiple insurers. To conclude, selling insurance policies of multiple insurers might be a challenge for them as they are not professionally trained or equipped well with the technical know-how of the insurance sector.

8. Interoperable Cash Deposit Machines May Soon be Reality

The RBI is proposing to connect all cash deposit machines to the National Financial Switch (NFS) which would make them interoperable, thereby allowing customers to deposit cash into their accounts from any bank's machine. This would ultimately help reduce black money as all the cash deposited in bank would be recorded.

Also, National Payments Corporation of India (NPCI) has proposed to link all cash depositing machines to the NFS, boosting alternate banking channels for day-to-day transactions. Boosting the usage of cards and point of sales (PoS) terminals would not only reduce cash transactions but also enhance transparency in the system.

http://articles.economictimes.indiatimes.com/2015-04-16/news/61217717_1_rbi-governor-raghuram-rajan-cash-deposit-cyber-security

Food for Thought

At present, ATMs provide the facility to withdraw money from not only their home banks but also from most other banks. However, the central bank has taken a leap by allowing cash deposit transactions through machines. Existing banks presently competing in the market have already spent huge capital to provide e-transactions and other facilities to customers. Due to lack of funds the new entrants would have to be dependent on the infrastructure of these existing banks which would not be much appreciated by the existing market players. These existing banks create barriers for startup banking entities and restrict them from competing in order to recover their initial investment costs on infrastructure and technology. Such would also have a negative impact on the overall growth of the market.

The government has been encouraging people to use plastic money in order to reduce tax avoidance and check counterfeiting of currency. This measure by the government is intended to enhance transparency in the system as well the tax received could be better utilised for the greater good of the economy. It has also provided certain incentives in this regard. It has proposed tax benefits for people making payments through credit or debit cards for transaction charges on purchase of petrol, gas and rail tickets. It is also proposing to allow settling high value transactions of more than ₹one lakh through electronic mode.

To conclude, providing the facility of interoperable cash transactions is a boon to consumers in terms of easing the transactions. However, this might not prove to be such a jolly moment for the market players. Any premature attempt by regulators to force competition could also impede investment and innovation in the sector, which would distort the existing market. On the other hand, delay in regulatory interventions also might give an opportunity to incumbents to abuse their dominant position at the expense of market development and interests of consumers. To conclude, there is a need for effective regulations that would strike a balance between the existing market entities and the new entrants in the relevant market. Also, such regulations have to be drafted in a manner that encourages fair and healthy competition as well as takes care of consumer's interests.