Competition Distortions in India – A Dossier

(CDI-7: April-May 2010)

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

This periodic dossier produced by CUTS looks at the interface of policy issues having an impact, both negative and positive, on competition in India. The dossier relies on published news from reputed sources but at the same time CUTS does not guarantee its 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. Judgments would require greater analysis particularly in terms of cost and benefits therewith.

This is the 7th volume of the bimonthly dossier that we are producing to report and comment on policy induced competition distortions and benefits in India highlighted in the media. This Volume highlights the potential competition distortions that can occur from trade related measures such as import and anti-dumping duties and export controls – the focus is on the rubber sector and BT cotton which are linked vertically to the tyre industry and textiles respectively. It is emphasised, as has been done in previous volumes, that competition distortions can be tolerated only if there are other welfare gains in terms of employment etc which overwhelm these. Similarly, measures that seek to enhance competition are justified only if associated welfare losses are overwhelmed by these. Other competition issues associated with policy discussed in this dossier are those associated with futures trading, the use of the infant industry argument in promoting India's evolving renewable energy industry, promotion of the public sector in the transport industry, official entry barriers in the financial sector, and the effect of the merger of *Air India* and *Indian Airlines*.

List of Contents

Trade Issues

1. Rubber farmers slam demand by tyre firms for easing duty

Rubber growers have strongly criticised the tyre industry's demand to lower the import duty on natural rubber and a ban on futures trading on the grounds that such a demand has no rational. The tyre makers had demanded lowering of the import duty and a ban on futures trading because of an over 13 percent rise in natural rubber prices in the last few days.

In a memorandum to the Union Commerce Ministry, the growers pointed out that while consumer industry had imported about 1, 52,000 million tonnes in 2010, most of these were without any customs duty, availing export incentives.
http://www.financialexpress.com/news/rubber-farmers-slam-demand-by-tyre-firms-for-easing-duty/627421/
http://www.thehindubusinessline.com/2010/05/13/stories/2010051354070400.htm
http://www.thehindubusinessline.com/2010/05/29/stories/2010052951101900.htm

Food for Thought
Lowering of import duty, while resulting in a decline in government revenue, will enhance the level of competition facing domestic producers of rubber, with positive implications for consumer welfare. Similarly, because futures trading reduce competition in the spot market by pledging supply at a future date, banning such trading can be labelled a pro-competitive move in regard to the spot market, at least in the short run.

However, in the long run, such a ban would reduce some of the options for rubber traders and this, in turn, can adversely impact the domestic production of rubber. Moreover, rubber production being labour-intensive, a reduction in import duty resulting in the market getting flooded with foreign rubber would have a significant adverse impact on employment in addition to that on incomes accruing to domestic producers of rubber.

Thorough research is needed to compare the costs (in terms of employment reduction, decrease in producer incomes, reduction in government revenues etc.) and benefits (welfare gains associated with increase in competition from the mentioned ban and reduction in import duty) stated above.

2. Commerce Ministry for anti-dumping duty on Chinese chemical

Acting on a complaint by Tata Chemicals, the Commerce Ministry has recommended imposition of anti-dumping duty on imports of a chemical from China used in household cleaning products.

Based on preliminary findings, the Directorate General of Anti-dumping and Allied Duties (DGAD) has recommended a provisional duty of up to US$0.671 per kg on import of Sodium Tripolyphosphate (STPP) from China.

Tata Chemicals Ltd. (TCL), Mumbai, and others local firms had alleged dumping of the chemical from China. TCL produces STPP at its Haldia plant and the company accounts for over 90 percent of domestic production.

The domestic industry was earning profits in 2005-06, which declined steeply in the following years. It started suffering financial losses from 2007-08, which continued during the period of investigation (April 2008-March 2009).
http://www.financialexpress.com/news/commerce-min-for-antidumping-duty-on-chinese-chemical/628500/
http://www.thehindubusinessline.com/2010/05/28/stories/2010052851690400.htm

Food for Thought
The imposition of anti-dumping duty is warranted if Chinese industries are importing chemicals into India at prices which are less than corresponding average costs of production and therefore not on par with international prices. It would help to protect producer incomes and employment and also, if the hypothesis of import price being below average cost is indeed true, prevent market capture through predatory pricing which gives way to monopoly control once competition is eliminated. Viewed in this manner, anti-dumping duty is actually needed to promote competition in the long run.

But if import prices exceed average costs of production, anti-dumping duty would be only another means to insulate domestic producers of chemicals from competition and artificially bring about economic viability of uncompetitive producers, with industrial and domestic buyers of chemicals unnecessarily bearing the brunt of such support in the form of higher prices.

Research, therefore, needs to be conducted into whether mentioned import prices are actually less than corresponding average costs.

3. Cotton body opposes export controls

Distressed by successive assault on cotton exports – first in the form of an export tax and then suspension of export contract registration and regulated shipment – Cotton Association of India (CAI) has expressed shock and dismay over recent developments and urged the government to restore *status quo ante* as far as export shipments and contract registration are concerned.

"The decision to impose export controls on cotton will hurt the financial interests of domestic cotton growers and sideline Indian cotton in the overseas market", Dhiren Sheth, CAI President, said.
http://www.thehindubusinessline.com/2010/04/24/stories/2010042452841700.htm

Food for Thought
There is a short and long run effect of export control. Controlling exports will increase supply (competition) in the domestic market in the short run, driving the cotton price down. In the long run, the decrease in profitability associated with falling prices would lead to a contraction in supply (competition) which would be harmful for consumers, producers and also labour because of the associated contraction in employment.

Given the above considerations, the government should first ascertain whether the current level of domestic prices is high enough to warrant export controls. Even if that is the case, it should ensure that export controls are neither permanent (through moves to lift the export controls once international prices decline to affordable levels) or envisaged as being so (through announcements that such controls are only temporary and based on the current situation in international markets).

Other Issues

1. Local content to shine in solar photo-voltaic projects

The Ministries of New and Renewable Energy (MNRE) and Power plan to make it mandatory for solar power developers to source crystalline silicon-based modules from domestic manufacturers.

This provision will be in the soon-to-be notified guidelines by the Ministries for implementation of the solar power projects under the Jawaharlal Nehru National Solar Mission (JNNSM).

An official source opined this is to ensure that the domestic industry gets a boost. The decision has been taken after consultations with all the stakeholders. The intent is to encourage both new technology and the domestic manufacturing sector.
http://www.thehindubusinessline.com/2010/05/23/stories/2010052351900100.htm

Food for Thought
This decision to insulate domestic sellers from foreign competition is obviously anti-competitive. The move can, however, be justified through the infant industry argument, given that the technology-intensive nature of the industry can be seen as warranting support from the government to facilitate economic viability in spite of low competitiveness in these early stages of development.

Through research, the projected gains based on the infant industry argument should be weighed against the losses resulting from decrease in competition and consequent increase in domestic prices. This would enable correct decision making in regard to whether this industry should be protected from foreign competition. Even if such protection is provided at present, it should give way to foreign competition in course of time after the domestic industry becomes competitive.

This course of action and the associated lack of permanence of protection should be spelt out clearly to producers so that incentives to attain competitiveness remain undiminished.

2. Shipping monopoly policy draft finalised

The Shipping Ministry's aim of having a monopoly policy for major ports has moved a step forward. The policy draft – prepared by the Ministry – has been forwarded to the Law Ministry for approval. The draft had been made in consultation with private players and their concerns had been addressed to the extent possible. In order to speed up the process, the Shipping Ministry would appoint an expert to help the officials of the Law Ministry understand the technicalities involved.

Under the policy, a private player would not be allowed to bid for consecutive berths for the same cargo. It would also not be allowed to bid for a terminal within the 100-km radius of an existing one. The policy will address issues such as the quay length limit beyond which one player cannot have a berth. The policy would also put a cap on overall capacity and the number of terminals one can have at a port.
http://www.business-standard.com/india/news/shipping-monopoly-policy-draft-finalised/22/16/395771/

Food for Thought

Given the characteristics of the shipping industry, there may be economies of scale in regard to operations in this industry. In that case, restricting major market players may actually reduce the welfare gains produced by this sector.

Further, the behavioural approach to competition, which has now gained wide acceptance as the right approach, focuses on prevention of abuse of dominance or the creation of barriers to competition (entry of players) rather than dominance gained on the basis of competitive advantage. Prevention of dominance by fiat, as is being envisaged in this case, to artificially generate competition is not optimal from a welfare perspective.

3. Why increase entry barriers when we need more competition

There was news of Securities and Exchange Board of India (SEBI) recommending that the minimum net worth for mutual fund companies be increased from the current Rs 10 crore-Rs 50 crore. While this move has obviously been demanded and welcomed by the bigger mutual funds, it is hard to see it achieve any outcome except to make the bigger fund houses a little safer from smaller competitors.

The main reason for this increase is that fund houses need to have enough capital to absorb shocks of the kind that were faced by them during the liquidity freeze of October 2008. This is a strange argument because it legitimises a scenario whereby a fund house will use its own capital to either smooth returns or fill in liquidity in its funds. This is a slippery slope because it completely nullifies one of the bases of the very concept of a mutual fund – that it is a pass-through vehicle, which simply provides investment management services for its customers. All the risks and losses must be customers' alone.
http://www.thehindubusinessline.com/2010/05/15/stories/2010051552861100.htm

Food for Thought

Increasing the lower bound on net worth will work as an entry barrier facing small firms. The SEBI recommendation will thus reduce competition. The logic of having a higher lower bound is that it will ensure that companies can mitigate risks and ease the liquidity constraint when required.

Research is needed to establish whether the losses in terms of reduced competition, with implications for both potential entrants and those served by this sector, outweigh the potential gains in terms of a lower average risk burden on customers. If that is indeed the case then the recommendation is correct. Otherwise, it is not appropriate.

4. Rush to sell ULIPs ahead of July 1

Insurance companies are in a rush to sell as many unit-linked plans as possible before the new guidelines force them to bundle a life or health cover with these popular instruments that account for nearly half of their business. Insurance executives feel selling these policies will be difficult once the new guidelines proposed by the Insurance Regulatory Development Authority (IRDA) are introduced from July 01, 2010. Once the new norms are in force, agents will have to convince the customer to buy a health or insurance cover along with pension plans.

Pension products have been the favourite unit-linked products, as insurance cover was not mandatory with the policy. These were sold as an investment product wherein customer was currently given the option to surrender his policy after a five-year lock in. Traditionally, all unit-linked plans are frontloaded and an agent can earn a commission up to 20 percent by selling such policies.

Further, the new law will also restrict the customer from surrendering their pension plans, as they will not get the full amount on surrendering their policy. The customers will only get one-third of the invested corpus and the rest amount through annuity or monthly/yearly payments.
http://economictimes.indiatimes.com/personal-finance/insurance/insurance-news/Rush-to-sell-Ulips-ahead-of-July-1/articleshow/5996576.cms

Food for Thought
Compulsory bundling of insurance and health covers will reduce competition because companies not able to sell the two products jointly will have to exit the market for unit linked products.

However, compulsory bundling would imply that consumers would not have to go for health insurance separately. The ability to leverage multiple benefits from an investment can be seen as enhancing consumer welfare whereas the consequent reduction in competition has adverse implications for both producer and consumer welfare.

Research to compare these costs and benefits should be used as a tool to review the new regulation.

5. UN Civil Aviation

When the bond breaks between those who lead and those who are led, no quick-fix repair will work. Neither carrots nor sticks can motivate sullen managers and workers. It is not new aircraft or new airports, but a new leadership with a new strategy that Air India needs.

Air India is over-staffed, with over-aged aircraft and air hostesses. In a highly competitive services sector business like civil aviation, the morale, the efficiency and the commitment of people matter every minute of the working day. Air India's biggest problem is that morale is low in the most critical segment of company management – the middle management.

What is also clear is that the merger of the erstwhile Air India and Indian Airlines has not produced a happy marriage. Corporate mergers are like arranged marriages. Love has to be created between partners for the merger to succeed. Managing a merger is an art as much as a science and companies pay good money to get expertise for the job.

At the time of the merger, the Civil Aviation Ministry claimed the initiative had six objectives:

- Create the largest airline in India and comparable to other leading airlines in Asia;
- Provide an integrated international/domestic footprint which will significantly enhance customer proposition and allow easy entry into one of the three global airline alliances;
- Enable optimal utilisation of existing resources through improvement in load

factors and yields on commonly serviced routes as well as deploy 'freed up' aircraft capacity on alternative routes;

- Provide an opportunity to fully leverage strong assets, capabilities and infrastructure;
- Provide an opportunity to leverage skilled and experienced manpower available to the optimum potential; and
- Provide a larger and a growth-oriented company for the people and the same shall be in larger public interest.

That these objectives have not yet been met is clear from two parliamentary reports. Even if critical remarks of the Parliamentary Standing Committee on Transport, Tourism and Culture are to be discounted because its chairman is communist party leader Sitaram Yechury, who has trade union interests in public sector airlines, one cannot ignore the views of the Committee on Public Undertakings, chaired by a sober and moderate parliamentarian like Kishore Chandra Deo (Congress party).
http://www.business-standard.com/india/news/sanjaya-baru-uncivil-aviation/396481/

Food for Thought
The merger of Air India and Indian Airlines has made the aviation market more concentrated and thus increased the likelihood for abuse of dominance. The justification offered for the merger in the form of the objectives mentioned above seems valid. However, the reports by the Parliamentary Standing Committees seem to suggest that these objectives have not been realised. Poor management and implementation of the merger, as stated above, might be reasons.

While expected benefits have not materialised, the bargaining power of unionised labour associated with these two airlines has increased and so has their disruptive influence.

News & Views

1. Private bus operators can't ride on STU failure

The Supreme Court has ruled that failure by state transport undertakings (STUs) to ply buses cannot be a ground to grant permanent permits to the private bus operators to run their buses.

The apex court set aside the ruling of the Punjab and Haryana high court upholding an order from the state transport appellate tribunal of Punjab. It had said in a case a STU fails to operate the services, it would lose its right of the permit unless the route in question in inter-state or monopoly route. It was challenged by the Punjab Roadways by filing a bunch of appeals in the apex court.

Food for Thought
This is a clear attempt to maintain the share of STUs in the total number of plying buses. While a level playing field for private and public operators does not exist even at present, the skewed nature of competition is bound to increase once the mentioned ruling is implemented.

The lack of permanence of permits is bound to discourage potential reputed bus operators because of the associated lack of certainty in regard to revenues. In the long term, therefore, competition will decline with clear adverse implications for consumer welfare.

2. Seed price controls may impact Bt cotton availability

Seed companies have expressed concern over imposition of price controls on Bt cotton hybrids by state governments, which, they say, will impact availability and plantings by farmers.

For the 2010 sowing season, Andhra Pradesh, Maharashtra and Gujarat have fixed an unchanged maximum retail price of Rs 650 for every packet of Bt cotton seeds incorporating Monsanto's 'Bollgard-I' (BG-I) trait and Rs 750 a packet in the case of second-generation 'Bollgard-II' (BG-II) technology.
http://www.thehindubusinessline.com/2010/05/22/stories/2010052251791700.htm
http://www.thehindubusinessline.com/2010/05/24/stories/2010052450761400.htm

Food for Thought
Any kind of price control distorts competition. The mentioned price control may be harmful even for farmers if it is imposed without taking into account the cost of production. Such price control would discourage much needed further research and development in this sector and thus hamper the exploitation of the potential of Bt cotton seeds as a source of increase in productivity. Research to ascertain whether the mentioned price caps have a basis in cost of production is necessary.

3. Govt. may regulate steel prices

The government may put pressure on steel companies to limit price hike as it fears a major revision could add to the inflationary pressure, but the industry is not happy with the attempt to regulate prices.

The wholesale price index based inflation was almost into double digits in March, a 17-month high of 9.9 percent. Policymakers expect high inflation to persist in coming months on the back of rising commodity and fuel prices.

The metal prices are expected to move up further due to rise in raw material prices which constitutes over 40 percent of the final cost of steel prices are currently ruling at Rs 35,000-38,000/tonne in the domestic spot market, below the Rs 48,000-50,000/tonne they touched in 2008.
http://economictimes.indiatimes.com/news/economy/policy/Govt-may-regulate-steel-prices/articleshow/5829899.cms

Food for Thought
Price regulation distorts competition unless it is needed to check cartelisation which itself constitutes an anticompetitive practice. In any case, any upper bound on price has to have a basis in costs.

Research is, therefore, required to ascertain whether the recommended upper bound on price is greater than the average cost of producing steel. If that is not the case then price regulation is bound to lead to a contraction of the steel industry. Similar research on cost structure would also help determine the likelihood of cartelisation as in the absence of cartelisation, competition would drive price down towards marginal cost.