Competition Distortions in India – A Dossier

(CDI-12: April-June 2011)

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.

Firstly, a deep regret for sending this Dossier so late. In this edition covering the period April-June 2011, we have covered several issues, and three are particularly on the lack of 'competitive neutrality' against the public sector.

Competitive neutrality means providing a level playing field to businesses, whether in private sector or public sector, to operate easily. In a mixed economy like India's, this issue becomes more important that the government does not discriminate against private sector by mollycoddling the public sector.

There are many such instances which we have reported in the earlier editions. For example, offering sovereign guarantee to LIC's insurance policies and not the same to private insurers. Or asking public sector units to keep their moneys only in public sector banks, and so on and so forth.

In this issue, we have reported three cases of competitive neutrality against the public sector. Apparently, these have arisen due to the severe governance deficit in our country, which Anna Hazare is battling against. These stories are that of Air India, Vaccine Units and captive coal mining blocks to power and other consuming industries.

By the way, the Government of India is also in the process of adopting a National Competition Policy to promote healthy competition in the economy. Of the competition principles to be covered in the Policy, one crucial one is on competitive neutrality. Comments have been invited on the draft Policy by 22nd August, which can be seen at: http://www.mca.gov.in/Ministry/Draft_Policy.html.

List of Contents

A. Trade related competition distortions

1. Tyre, tube imports may skid on quality roadblock

Tyre and tube imports could hit a speed-breaker and see a possible drop of about 40 percent over the next three-four months.

This is because all tyres sold in the country after March 13, 2011 have to conform to quality standards prescribed by the Bureau of Indian Standards (BIS), as mandated by the Ministry of Commerce & Industry, Government of India.

With tyre demand peaking in the summer months, the new rules are expected to result in higher sales for domestic tyre-makers.

Originally issued by the Ministry's Department of Industrial Policy and Promotion in November 2009, the notification had been extended twice. With the final notice of enforcing the original Quality Control Order 2009, tyre dealers can only stock and sell tyres and tubes that are ISI marked on the sidewalls with certification from BIS. It covers all domestic tyre manufacturers, whether big or small, and imported brands sold in the Indian market.

http://www.thehindubusinessline.com/industry-and-economy/article1697072.ece?viewImage=1

Food for Thought

All tyres sold in the country after March 13 have to conform to BIS quality standards as per the Ministry of Commerce & Industry order. The order covers all domestic tyre manufacturers and imported brands sold in the country. This is likely to affect many tyre exporters to India that may not have the necessary certification. As a result, an anticipated dip in imports by 30-40 percent is predicted.

Given the timing of the order and the fact that the demand for tyres would peak around summer, the domestic tyre manufacturers would gain well from the enhanced demand and falling imports. While this will serve well for consumers as well as domestic tyre manufacturers, it will act as a non-tariff barrier (NTB) for foreign tyre-makers. Furthermore, it might be difficult for small domestic manufacturers to acquire such quality certification as that may involve costs that they may not be in a position to incur. Instead companies that can afford the certification may use it as a marketing tool over others who cannot to eliminate players in the market. Ensuring high quality standards is, however, a necessary policy objective.

Compliance with domestic standards was also seen in the case of cement imports from Pakistan when the domestic cement cartel was fleecing the market. The excuse was that Pakistani cement has to comply with BIS standards. At the World Trade Organisation (WTO), we have been arguing for mutual recognition of standards, but when it comes to the crux, we forget what we have been asking for. Mind you, even our exports suffer from NTBs due to this gap.

2. EU Wines to Get Cheaper But is India Willing to Cut Duty?

Imported liquor is likely to get cheaper, with the government willing to lower import duty on alcohol from the European Union (EU) in return for easier visa norms and greater market access to Indian products there under the proposed EU-India Free Trade Agreement (FTA).

…The EU's demand for a lower import duty on its wines and spirits in India has been a long-standing one. In 2007, it successfully used the WTO platform to force India to slash duties on wines and spirits to 150 percent, from 177-550 percent.

According to the EU, the cut in duties in 2007 to WTO-compliant levels has been negated by state governments raising taxes on liquor, which, in some cases, exceed those on domestic producers.

"While state governments have addressed the problem to a large extent, the EU is still of the view that market access for wine remains poor in many parts of the country," the official said.

A recent report on an on-line market access database maintained by the director-general of trade in the European Commission states that tax legislation on imported wines in Karnataka and Delhi are still discriminatory. It also says rules on wholesale import and retail of imported liquor is still unclear in Tamil Nadu.

"We have asked states not to discriminate against imported liquor, but we cannot ask them not to apply duties, as long as they apply the same on domestically-produced items," the official said.

http://articles.economictimes.indiatimes.com/2011-06-23/news/29694622_1_import-duty-imported-liquor-wines-and-spirits

Food for Thought

India's proposed FTA with the E U is held up inter alia *over the issue of lowering import duty on automobiles and wines and spirits. India is struggling with this demand as it argues that it is unable to reduce tariffs for both products that have a strong domestic lobby. Besides, fears of similar demands from other trading partners such as Japan and South Korea, with which India has already signed agreements without cutting customs duty on these products, is also holding it back.*

While these constraints are appreciated, the high import duties on liquor maintained by state governments have been allegedly discriminatory in that in some cases they exceed those on domestic producers. This may be a potential violation of national treatment principle that mandates governments to treat both foreign and domestic like products equally.

Furthermore, this is a market barrier which discourages foreign players to enter the Indian market for liquor. On the reverse side, it also stands in the way of enhanced market access for India in industrial goods such as chemicals and textiles and garments where applied duties in EU are as high as 40- 50 percent for some items as well as stringent quality barriers that hamper export of farm products.

3. Cut import duties on automobiles, components: Ratan Tata

At a time when the domestic automobile industry is strongly opposing lowering of import duty in the proposed India-EU FTA, the Tata Group chief, Ratan Tata wants tariffs reduced on vehicles and components coming from abroad.

The Indian automobile industry, primarily the home-grown makers, are strongly opposing lowering of import duty in implementing the India-EU FTA saying that it will threaten the competitiveness of domestic firms. Component producers are also of the view that reduction of duties will lead to dumping of products in India.

… In an interview to the market research firm JD Power, Tata said such high import duties are unrealistic and create an artificial barrier of protection for local companies.

http://www.thehindubusinessline.com/industry-and-economy/economy/article2101908.ece

Food for Thought

Protectionist measures such as levying high import duties so as to benefit the domestic industries may work to their advantage in the short term but discourage foreign players from entering the markets thereby impeding competition in the long term in the absence of which inefficient domestic industries enjoy the blanket of protection with no incentives to improve.

The lowering of import duties would encourage FTAs which is necessary for Indian automobile industry to mature and become sophisticated with the help of advanced technologies as well as promote competition giving impetus to domestic industries to become more efficient.

Furthermore, India may become a global source of automobile components at affordable rates by lowering the import duties and boost international trade. Apprehensions of dumping are not that grave and even in the event that it does happen, remedial measures such as appropriate anti-dumping duties may be imposed for a reasonable period of time to correct that. However, anti-dumping is often used as a political weapon without the necessary economic justification.

B. Distortion of competitive neutrality (reverse)

1. Vaccine related deaths on the rise since 2008

Vaccine-related deaths have shown an increase in the country since 2008, according to the information provided by the Ministry of Health and Family Welfare in response to an application filed under the Right to Information Act (RTI), 2005. This has been happening as there is shortage of vaccines perhaps accentuated by the closure of three public sector manufacturing units.

The total number of deaths reported due to adverse effects from immunisation (AEFI) from 2001-2007 was only 136, whereas it went up to 355 in the following three years.

The information has come in response to an RTI application filed by K V Babu of Kannur district in Kerala.

… "There seems to be some coincidence with the increase in the AEFI deaths and the period when the three major public sector undertakings (PSUs) at Kasauli, Coonoor and Chennai were closed," Dr Babu said.

http://www.hindu.com/2011/05/29/stories/2011052956262000.htm
http://www.thehindu.com/opinion/Readers-Editor/article2098885.ece?css=print

Food for Thought

A Delhi-based report by the Union Ministry of Health and Family Welfare gave the shocking news that the number of children who die soon after being administered vaccine shots more than doubled in the last three years compared with the previous seven years. In January 2008, three PSUs, the 103-year-old Central Research Institute, Kasauli, the 100-year-old Pasteur Institute of India, Coonoor, and the 60-year-old BCG Vaccine Laboratory, Chennai, were shut down. In 2008 alone, 111 AEFI deaths were reported. In 2009 it was 116 and in 2010 there were 128 deaths. The three units accounted for over 70 percent of the vaccines needed for the country's Universal Immunisation Programme.

These PSUs were closed on the ground that they were not adhering to the Good Manufacturing Practice (cGMP). Experts averred that cGMP was not related to the quality of vaccines produced in three units; it was rather about the infrastructure such as staff strength *and air-conditioners. This could have been rectified by suitable government intervention and thus the question therefore arises as to what factors called for the urgent need for closure of these PSUs.*

Furthermore, following the closure, the vaccines were procured from the private sector in addition to those supplied by the World Health Organisation. In the absence of the supply of vaccines from the public sector, competition was stifled in the healthcare sector and the cost of vaccines in the domestic market has appreciated by 50-70 percent within two years from the closure of the these units.

With the closing down of these units, the government has been procuring vaccines 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 seen to steadily pay higher prices for procuring vaccines from them to this day.

2. Why spare private companies and revoke our coal licences, ask PSUs

State-owned power companies whose coal blocks were taken back early have questioned the government's move to revoke their licences while sparing private companies.

Public sector firms, including National Thermal Power Corporation, Damodar Valley Corporation, Andhra Pradesh Power Generation Corp and Jharkhand State Electricity Board, said they have invested huge sums in developing the mines while many private firms have not even begun the preliminary groundwork.

A senior coal ministry official, however, said the decision to cancel allocations was made after a thorough evaluation.

NTPC has invested over Rs 300 crore in five mines which were cancelled, Chairman and Managing Director Arup Roy Choudhury said, adding that his company had a better record in mines development in comparison to CIL. "The progress made by us is comparable with international benchmarks. The decision will be detrimental for the nation. We are sure to convince the ministry of coal".

Ministry rules say an opencast mine should become operational within 36 months while underground mines in 48 months. An additional six months is allowed if the block is in a forest.

http://articles.economictimes.indiatimes.com/2011-05-09/news/29525178_1_coal-blocks-coal-ministry-coal-india

Food for Thought

The decision to cancel allocations of coal blocks has raised much stir for reasons well understood since many companies have already invested a great deal in the mining blocks. Furthermore, of the 14 blocks that were cancelled pursuant to Coal Ministry's order, 12 were public sector enterprises.

This raises certain doubts especially in the backdrop of a report of a review committee headed by Coal Ministry's Additional Secretary Alok Perti which had recommended issuing cancellation orders to 26 firms, including private players like Tata Steel, Hindalco Industries, JSW Steel and Jindal Power.

However, coal blocks of only two private companies Shree Baidyanath Ayurved and Bhatia International have been revoked, leaving out the bigwigs. Nonetheless, the Coal Ministry has *said the decisions to order cancellations were made after a thorough evaluation which revealed that the blocks were not developed on time. Such a decision of the Ministry may be well-founded and may act as a lesson for companies to appreciate timeliness when undertaking the development of mines.*

This case, however, flags an issue that needs to be further investigated which pertains to the apparent favourable treatment meted out to the private sector companies. The case, therefore, needs attention to ensure that the decision does not suffer from a distortion of competitive neutrality, i.e. providing a level playing field among private and public sector enterprises.

C. State aid and subsidies hampering competition

1. The Royal Falooda in the aviation sector

The recently concluded strike by the Indian Commercial Pilots Association (ICPA) while causing enormous hardship to passengers and adding to Air India's ever burgeoning losses has done one good of bringing the issue of corruption-inspired mismanagement of Air India to the centre stage. That Air India, once the country's symbol of pride, has lost all the sheen in recent years will be a gross understatement.

What has gone wrong with the national carrier? Who's responsible? Is there merit in the charge of ICPA that there is rampant corruption in the organisation?

…Air India would not have been saddled with problems withdrawal of flights from profitable routes, being made to buy more aircraft than it needed or could afford, grant of bilateral rights to foreign carriers in excess of requirement; muddled mergers and civil aviation policies framed in favour of the private airlines if only there was someone to take up its cause at various platforms where decisions were being taken, writes Jitender Bhargava, former Executive Director of Air India in Mumbai Mirror, a Times of India, Mumbai publication. "…Much of Air India's current pitiable state is due to various decisions of the government and mismanagement by its nominees on the Board of Directors or as Chairman".

http://www.mumbaimirror.com/index.aspx?page=article&sectid=82&contentid=2011050820110508051431457e8db200f

Food for Thought

Competition distortions are a likely 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 Civil Aviation Sector in India is an example. The recent debates about Air India's bailout provide 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, external observers considered this commitment not to be credible, inter alia*, because Air India, like most national carriers, was "too big to fail". This may 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 incentive 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.

A large section of the employees of the airline continue to perform as if there is no competition in the market place since their airline is the most "preferred" one for passengers and that ensuring the Air India's survival is not their responsibility. For example, the rule that people travelling on government business have to travel only on Air India. These factors are also major causes contributing to the rampant corruption in airline. Notwithstanding this, Air India's decline in fortune in the recent years has also taken place since it has been run by Babus who have their own perspectives and priorities that are different from that of Air India.

This is not to say that babus cannot run the airline or any other public sector unit in profit, but they are exceptions. They are able to do so, if their independence is respected. For example, when IAS officer, Sunil Arora ran Indian Airlines in 1990s, he had turned it around by acting like a CEO and not as a bureaucrat. He did everything that a corporate executive does to see that Indian Airlines turned into a profitable venture. (http://www.rediff.com/money/2005/may/25spec.htm) Alas, the problem with posting IAS officers is that they can be appointed only for a short term, and not for good, unless s/he resigns from the government and sticks on. Example of this is R C Bhargava, CMD of Maruti-Suzuki Ltd.

D. Preferential procurement policies

1. Ministry issues draft norms for "competitive" bidding with preference clauses

The Coal Ministry issued draft guidelines for allocation of coal blocks through competitive bidding to ensure transparency in the process.

This is in line with the New Exploration and Licensing Policy (NELP), which invites oil and gas companies to explore and produce hydrocarbons in the country.

The Ministry in consultation with the Central Mine Planning and Design Institute has come out with four set of options in the draft notice inviting offers for captive mining of coal for permitted end use in the blocks offered for the purpose namely steel, power and cement sectors. Stakeholders have been asked to comment within 15 days.

An interesting feature is that the Ministry proposes to give preference in allotment of coal blocks to bidders whose end-plants are in the same State as the coal blocks.

The notified coal blocks will be offered with reserve price tags fixed by the Ministry on the basis of the assessed potentiality of the blocks. The bidders' net worth shall have to be at least equal to the reserve price tag and 15 percent of the cost of its end use plant.
Successful bidders shall be responsible for exploration, development, operation and post operation activities including mine closers of notified captive coal blocks for end use.

At present, the coal blocks are offered to the end-users on a preferential basis by an inter-ministerial screening committee.
An amendment to the Mines and Minerals (Development and Regulation) Amendment Act, 2010, in August 2010 paved the way for introduction of auction through competitive bidding for allocation of coal blocks to private companies for captive use.

http://www.thehindubusinessline.com/industry-and-economy/government-and-policy/article1599663.ece

Food for Thought

The draft guidelines for allocation of coal blocks through competitive bidding is a welcome step as it would ensure transparency and some amount of fairness in the process. The Ministry has invited offers for captive mining of coal for permitted end use in the blocks offered for the purpose namely steel, power and cement sectors. However, the Ministry *proposes to give preference in allotment of coal blocks to bidders whose end-plants are in the same State as the coal blocks. Having the end-plants which will use coal mined in the same state will make it less costly, time-consuming, cumbersome and maybe more efficient. However, such a policy needs to be balanced on various grounds: a) environmental burden on the state due to concentration of production, and b) the fate of such plants located in states where there are no mining prospects at all.*

The new norm gives favourable treatment to select bidders without giving the necessary policy justifications behind such a norm which need to be assessed carefully as the preferential treatment in the bids hampers the incentive to compete for other bidders of coal blocks and renders the bidding process less than "competitive".