Competition Distortions in India – A Dossier

(CDI-16: April-June 2012)

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.

Herewith please find the 16th edition of our popular periodical: Competition Distortions Dossier and comments are more than welcome as we do wish that our country progresses by attacking distortions which adversely affect our growing economy.

In this edition, there are three stories on subsidies. All of them are good news: removing subsidies on LPG cylinders for the rich; offering reverse subsidies to electronic manufacturers and a debate on subsidies to private ship yards, where the shipping ministry feels that it will disadvantage government-owned shipyards, but the defence and finance ministries disagree.

The last is a matter of competitive neutrality, something which is being addressed in the proposed National Competition Policy. The draft is yet to be discussed by the Group of Ministers, which was headed by Pranab Mukherji who has resigned from the Cabinet to contest the Presidential elections. It is heard that P Chidambaram will head the GOM, but that is yet to meet.

One expose on reverse competitive neutrality is covered in this Dossier, that of favouring private airlines over public airlines. The denouement comes from the horse's mouth. Former Civil Aviation Secretary, M K Kaw has written explicitly about it in his book. Another story of corruption and crony capitalism comes in this Dossier about how the terms of the PPP contract were twisted in favour of GMR in the Delhi airport case.

List of Contents

1. Rich households to pay double for LPG

Households with a monthly income of Rs 50,000 or more may soon have to pay the market price of cooking gas (LPG), which is Rs 480 more than the current price of around Rs 400 per cylinder……….It has also been proposed that the affluent can buy the subsidised LPG and pay the market price difference to the oil companies directly through cheques.

"We need to do away with a large part of subsidies going to the class of people who do not need subsidies," a Senior Petroleum Ministry Official said.

www.hindustantimes.com/business-news/Markets/Rich-homes-may-pay-double-for-LPG/Article1-850820.aspx

Food for Thought

The Petroleum Ministry is considering coming up with a proposal that could be termed as a serious step towards subsidy reforms in India. According to sources, government is contemplating restricting the supply of subsidised LPG cylinders to those households that are having monthly income of 50,000 or more. The empowered group of ministers (EGoM) is supposed to discuss the matter in the near future under the leadership of the Union Finance Minister.

The whole concept is backed by the fact that few years ago many high income families declined the opportunity to buy food grains from PDS shops despite having ration cards with them.

In the initial period of implementation of the proposal, supply of subsidised LPG cylinders will be withdrawn for all MPs, MLAs and first class gazetted officers and later it will be applied to high income households.

Further, it has also been proposed to make it mandatory for all households with piped gas connections in major cities to surrender their LPG gas connection else they will be asked to choose between two connections. The step envisages curbing down black marketing of LPG cylinders.

The whole idea, if implemented, would be a commendable step towards subsidy reforms in India. The current energy subsidy regime in India has created heavy burden on the government's resources at Rs 24,000 crores in 2010-2011 and expected to touch Rs 30,000 crores in 2011-2012. While the bill is increasing, subsidies are not reaching the intended beneficiaries. A large portion of subsidies are wasteful as they accrue to high income households, who are able to procure it at the market price without any assistance.

2. Airlines may lose peak slots at business airports

Domestic and foreign airlines may lose their right to retain peak air slots allotted to them at the country's busiest airports – Delhi and Mumbai – if they fail to utilise them for a month. Slots refer to arrival and departure time periods allotted to them at a given airport. Mumbai airport has nearly 700 slots per day, of which 500 are for domestic flights. Delhi airport has over 850 slots, of which 600 are for domestic operations.

www.indianexpress.com/news/truant-airlines-risk-losing-peak-slots/934626/0

Food for Thought

There is a chance of domestic and foreign airlines losing their slots at some of the busiest airports in India if they fail to utilise the slots for the period of one month in an optimal manner. The step will suffice government's plan to revamp the existing policy regarding allotment of slots at airports. The endeavour is to create high level of transparency regarding *availability and allocation of slots. Airport operators have been asked to provide online information on the whole issue.*

According to Civil Aviation Minister, Ajit Singh, the present system is inequitable in terms of allocation of slots and lacks transparency and hence, fair play has to be there while allotting slots to airlines. He mentioned that his ministry is committed towards coming up with slot allotment policy envisaging higher air connectivity, evenhanded distribution of slots and to discourage hoarding of slots by airlines.

The policy will have provisions regarding appointment of a coordinator to look after management, allotment and monitoring of slots. Maintenance of infrastructure, such as terminals, parking bays, runways and taxiways will also be supervised by the coordinator. Besides these, policy will look into matters, such as giving preference to those airlines in the slot allotment process which will provide connectivity between non-metro and metro city or between two non-metros, cases related to merger and acquisitions etc.

The current rules and regulations do not contain any clause to penalise airlines involved in the hoarding of slots nor do they include any policy to ascertain fixed timeline for submission of airline's slot requests proposal.

The proposed policy could be a commendable step from the part of government as it will not only ensure improvement in quality of services being provided to customers by airlines, but also help creating a competitive environment in the industry by applying checks on anticompetitive activities, such as hoarding of slots by some big players in the industry just to keep other competitors at bay.

3. Jet thwarted Tata plan to float private Airline in 1997

"The Tatas had mooted a proposal for a private airline with 40 percent equity contribution from Singapore Airlines.

"As this would have been a formidable competitor, Jet tried hard to upset rules regarding foreign equity contribution," the former Civilian Aviation Secretary in the IK Gujral government writes in 'An Outsider Everywhere: Revelations by an Insider', published by Konark.

Kaw, who was in the IAS for 37 years, says he advocated a rule in the policy related to allowing 40 percent equity contribution by foreign airlines even in new proposals, but that did not fly then.

http://paper.hindustantimes.com/epaper/viewer.aspx

Food for Thought

"The history of civil aviation in this country would have taken a different trajectory, if Tata-Singapore airlines had been allowed to float an airline". These are few lines in the book 'An Outsiders Everywhere: Revelations by an Insider' written by a former Bureaucrat MK Kaw. Kaw who was Civil Aviation Secretary in the IK Gujral government, has made an attempt to expose grey areas pertaining to the connection between powerful industrialists and politicians leading to dearth of competition in the entire economy and hence, poor quality of products being supplied to consumers.

The book has highlighted the case in the year 1997, when the Tatas presented their proposal, in front of the Aviation Ministry, of setting up private airlines in partnership with Singapore Airlines which was supposed to have 40 percent stake in the joint venture. According to Kaw, it was a formidable plan which could have boosted the aviation industry immensely, but was not allowed to take-off as some of the existing players in the industry *created obstacles in the process of policy restructuring required to allow foreign investment in aviation industry.*

Jet Airways, holding a very dominant position in the industry, was not comfortable with this development and used its political connection to refrain any change in policy regarding foreign equity contribution in aviation industry.

Kaw has mentioned in his book that he tried to facilitate the process in an unbiased manner and approached the then Civil Aviation Minister Chand Mahal Ibrahim several times, but all in vein. On the contrary, officials of Jet Airlines complained against him that he was trying to provide undue advantage to the Tatas.

Kaw has presented one example that has resulted into negative impact on overall progress of the aviation industry and also damaged the spirit of competition. But the fact is that there could be many cases where process of reform has been deliberately slowed down just to benefit very few dominant players present in various industries. Such unholy nexus between the political leaders, bureaucrats, and industrialists has always created hurdles in the way of industrial growth and also given rise to anticompetitive practices in India.

It is advisable for the government to take note of such incidences that has brought bad name to the country around the globe. Adopting ostrich-headed approach, just to protect few powerful people present in various fields, would not help the Indian government to achieve high rate of growth in the long run.

4. Re-farm spectrum for level field

Tata Teleservices supports the government proposal to 're-farm' spectrum in the 900 megahertz (Mhz) band which it expects will create a level-playing field between the older Global System for Mobile communication (GSM) operators and newer ones……………………

……………….Tata Teleservices, with more than 80 million customers, is present across all 22 circles in code division multiple access (CDMA) and 18 circles in GSM. However, Srinath said that due to lack of spectrum it was unable to launch GSM services in the Delhi circle and in 39 districts across nine circles since 2008.

www.thehindu.com/business/Industry/article3452898.ece

Food for Thought

Tata Teleservices (TTSL) has lauded government's proposal to re-farm spectrum in the 900 Mhz band. According to Managing Director of Tata Tele-Services N Srinath, the move will help initiating process for creating level playing field for older as well as the newer GSM service providers in the industry. He further added that it is imperative for the government to provide all GSM service providers with 900 MHz band otherwise it would not be possible to establish a competitive environment in the telecom industry. The existing disparity between different players is result of absence of level playing field in the telecom industry.

TTSL have also flagged the issue regarding their inability to expand GSM service in several parts of Northern India due to non-availability of spectrum. On the other hand, many GSM players have enjoyed the advantage of 1800 MHz spectrum for decades. However, the recent developments in this regard has provided TTSL with much needed relief in terms of providing better and improved services to its subscribers.

The proposed re-farming will allow government to replace the 900 MHz spectrum band by the 1,800 MHz spectrum band. It will be followed by re-auctioning of the 900 MHz band when renewal process of the existing licences will take place in 2014. The whole process will lead to better regulated telecom industry and also provide equal opportunity for all players to do *business. It will create conducive environment for competition to prevail in the industry leading to improved consumer welfare.*

5. UPA changed NDA Cabinet note to favour GMR

In a charge that is likely to heighten the war of words between the Opposition and the Congress, a draft report of the Comptroller and Auditor General (CAG) says the contents of a Cabinet note approved in 2003 were "omitted" by the government in April 2006 when the Operation Management Development Agreement (OMDA) for Delhi's T3 terminal was signed to suit the interests of the GMR-owned Delhi International Airport Limited (DIAL). These omissions are an example of an "undue favour" being given to the company, the draft report notes, and led to serious discrepancies in the government's final agreement with DIAL, which operates the terminal.

www.thehindu.com/news/national/article3456775.ece

Food for Thought

The line for battle has been drawn once again between Congress and the opposition. This time the bone of contention has been the issue raised by Comptroller and Auditor General related to omission of some important clauses from a cabinet note approved in the year 2003 by the then ruling coalition party National Democratic Alliance. The incidence took place in the year 2006 when OMDA for Delhi's T3 terminals was signed.

According to CAG, the cabinet note was altered and reframed to provide undue advantage to DIAL allowing it to operate the airport for the period of 60 years, which was initially subject to mutual agreement and negotiation of terms after the completion of concession period of 30 years. CAG has termed this move from the part of government as a deliberate one, which could have very serious implications on the future of Delhi airport.

CAG has raised its concern over the issue of absence of any provision in the OMDA for mutual agreement and fresh negotiations before an extension of the original concession period is granted. In its report on the whole issue, CAG has highlighted the fact that the four main elements e.g. traffic volumes; tariffs; the concession period; and the capital cost, are generally termed as the foundation stone for concessional agreement in any public-private partnership (PPP). However, the OMDA which contains the basic provisions to regulate the IGI airport does not take into account these four elements that have to be taken under consideration while fixing the concession period for any PPP.

The whole matter is another example of irresponsible conduct on the part of the government, ostensibly for rent seeking purposes. Allowing any particular entity to operate and manage Delhi IGI Airport for considerable period of time, and that too, without any provision to review the contract based on various parameters would adversely affect competition in the industry. Not only this, government has also disregarded public interest by undoing the clauses in the cabinet note related to fresh negotiations for extension of original concession period.

6. Coordinated fuel price tweaks grabs CCI attention

At a time when dissenting voices are emerging from the Cabinet over the recent steep hike in petrol price, the competition regulator has started a dialogue with the government on what it perceives as anticompetitive behaviour by the three public sector oil marketing companies.

The Competition Commission of India (CCI) has written to the government on this issue, a senior official told.

The regulator reckons that these companies revising petrol prices in tandem and roughly by the same measure is a case of policy-induced market distortion, the senior government functionary said.

www.financialexpress.com/news/coordinated-fuel-price-tweaks-grab-cci-attention/958043/

Food for Thought

It is the first time that the issue of policy induced market distortion has been raised by CCI. The matter is related to the recent steep hike in the price of petrol. The point that CCI has brought to everybody's attention is that the timing of the price hike and also the manner in which the whole process has been executed is almost similar for all the three oil marketing companies. According to experts, CCI has the authority to investigate into matters related to policy induced anticompetitive practices resulting in the formation of cartel within an industry.

Further, it is obvious that oil marketing companies speak to each other and also with the Oil Ministry before taking any final decision on price change of oil products. The CCI has the power to investigate even against government departments in such cases, because these activities are of a commercial nature. However, regulator has to consider the fact that sometimes price of oil products are adjusted in order to take care of the consumer welfare aspects and this also makes part of the state policy.

There are other issues also that have been taken up by CCI specifically involving distortion of competition in fuel markets. One of the issues that CCI often raises is the matter of subsidies being provided on oil products. According to CCI these subsidies lead to market distortion and also boost the consumption of diesel that is potentially more dangerous to the environment. Further, as these subsidies are available only to PSUs, it creates artificial entry barriers for private sector players as they find it very difficult to do run their business in the absence of level playing field for them in the industry.

Another issue taken up by CCI related to subsidy on oil products is the disparity between the pricing of petrol and diesel. The price of petrol has been deregulated while pricing of diesel is still under the control of government. This again enhances the consumption of diesel leading to adverse impact on environment and also distortion in fuel and automobile markets.

So it would be judicious on the part of government to think on the line of gradually phasing out these subsidies which would not only help addressing environmental concerns but also facilitate the process of providing equal opportunity to private sector players to compete with their public sector counterparts.

7. 'Oligopolistic environment sets jet fuel soaring'

Jet fuel or aviation turbine fuel (ATF) costs are highest in the country largely due to the oligopolistic environment created by government-owned oil companies, which supplies it to the domestic airlines, according to a report. The co-ordinated pricing arrangement of these companies, which account for over 60 percent of the ATF supply, raises barriers to competition and efficiency, added the report.

www.financialexpress.com/news/oligopoly-of-psu-oil-cos-reason-for-high-atf-prices/943191/0

Food for Thought

A report commissioned by the Ministry of Civil Aviation in 2011 highlighted the point that the high costs of ATF in India are the result of intentionally created oligopolistic market condition by public sector oil companies. According to the report, three major public sector oil marketing companies which together supply 60 percent of the ATF to domestic airlines, have *agreed upon co-operative agreements for sharing of pipeline infrastructure between them. The coordination between these companies has created entry barriers for a private oil supplier as it does not have access to the pipeline and storage infrastructure and hence is not able to compete with the public sector oil supplying companies.*

The report has also held these PSUs accused of indulging into anticompetitive practice of fixing prices of ATF which again leads to lack of level playing field for private oil companies in the sector.

The report has also taken into account the fact that differential pricing policy followed by public sector oil companies for ATF leads to higher fuel price for domestic flights as compared to international flights. It says that the airlines have often raised their concern over issues of lack transparency while determining the price of ATF in India. The report has suggested that lowering of sales tax on fuel would allow airlines to reduce their fuel bills by 6 percent. This would provide airlines with the much needed relief, which are experiencing financial crisis for the past few years.

Taking into consideration the issues raised in the report, Civil Aviation Minister, Ajit Singh, has communicated with the oil ministry. He has urged oil ministry to take quick action on the recommendations made in the report in order to improve the overall situation. The report has suggested for greater transparency for determination of oil price by oil companies and also allowing private players to get equal access to pipeline as well as storage infrastructure. This is also a violation of the Essential Facility Doctrine.

The case can be termed as the perfect example of cartelisation in oil industry leading to market distortion. Government must take some quick action against such anticompetitive practices adopted by public sector units as it is not only affecting the private oil suppliers by depriving them of the level playing field, it is also creating obstacles for already struggling aviation industry in their endeavor to achieve a growth trajectory.

8. Reserve subsidy on cards to boost local manufacture of electronic goods

The government may introduce a 'reverse subsidy' scheme for local manufacture of electronic goods.

The scheme will be part of the proposed national electronic policy, which aims to encourage local manufacturing of goods, including mobile handsets, semiconductor wafer fabs, consumer electronics and telecom network equipment.

The Cabinet is expected to take a call on the proposed policy soon.

www.thehindubusinessline.com/industry-and-economy/article3367699.ece

Food for Thought

Government is thinking over the idea of promoting the concept of reverse subsidy for electronic goods manufacturing industry. The proposed system envisages boosting local manufacturing of electronic goods. The Cabinet is supposed to take the final decision on the policy in the near future.

The rationale behind the concept of reverse subsidy is to encourage the process of competitive bidding from the manufacturing companies intended to produce electronic goods in the domestic market. According to the reverse subsidy scheme, the company requesting for least capital subsidy during bidding process would be allowed to set up the manufacturing plant for production of electronic goods.

Of late, similar sort of system has been adopted in other sector such as road and highway construction, where entities opting for less support from the viability-gap funding has been awarded with the project.

Further, under the proposed policy the indirect taxes and subsidy of 20 percent on capital expenditure invested by high-tech electronic goods manufacturers in Special Economic Zones will be reimbursed.

It is assumed that the proposed subsidy factor in the bidding process will encourage manufacturers to invest in improved technologies for the production of electronic good, hence enhancing the project outcome.

9. FinMin, defence oppose subsidy to shipyards

The ministries of finance and defence have opposed the Shipping Ministry's demand for subsidies to the ship-building industry. While The Defence Ministry has said that it will benefit private players and deny a level playing field for defence shipyards, the Finance Ministry has argued that open-ended subsidies cannot be given and shipyards must become self-reliant and the maritime states should provide free land and infrastructure support to them.

www.indianexpress.com/news/finmin-defence-oppose-subsidy-to-shipyards/933179/0

Food for Thought

The Finance and Defence Ministry have shown their discomfort over the Shipping Ministry's request for re-introducing the subsidy for ship-manufacturing industry. The subsidy scheme, if implemented would cost Rs 7,243 to government from 2012-13 to 2017-18.

According to the Defence Ministry, such subsidies would be harmful for defence shipyards in the long run and provide undue advantage to the private ship-manufacturing companies as defence shipyards would not be able to compete with them in absence of a level playing field. It further added that subsidy should be allowed for defence shipyards also in order to strengthen their ship-manufacturing capability and also to make them able to compete with private competitors in the sector. Backing the stance taken by defence ministry, the finance ministry has said that any such provision of subsidy for ship-manufacturing industry would hamper competitiveness in the industry. It has further suggested that maritime states should provide free land, technical back-up and other infrastructural support to shipping industry which would help to develop the spirit of self-reliance among firms.

In its defense, the Shipping Ministry has argued that India is losing to countries like China, Japan and South Korea in maritime trade due to its high dependence on foreign vessels. Also factors like high dependence of Indian shipyards on imports along with high customs duty and high lending and insurgence costs have reduced the profit margins.

Government must think wisely before arriving at any decision on whether to allow subsidy for Indian shipyards or not. The argument made by both parties is valid to some extent. The Shipping Ministry is seeking relief from the government in the form of subsidy as they are struggling to compete with their foreign counterparts. However, opting for the route of subsidy would lead to additional burden on government exchequer and also distort the market in favour of private ship-manufacturers.