Competition Distortions in India – A Dossier

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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 6th volume of the bimonthly dossier that we are producing to report and comment on policy distortions and benefits to the competition process in India that have been highlighted in the media. For example, in this Volume we deal with the possible competition benefits that may be produced by reducing or removing import duties on products such as coal, kraft paper etc. and imposing anti-dumping duty on rubber tyres. Policy and related practice recommendations to make the tendering process employed by the *Indian Railways* and the *National Highways Authority* more competitive have been discussed as also existing and potential schemes towards market rationalisation of prices of diesel and petrol.

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A. Trade Issues

1. Scrap Import Duty on Coal, Pet Coke: Cement Makers

The cement industry has urged the Centre to abolish import duty on raw materials such as coal, pet coke and gypsum since cement as a finished product does not attract duty. Duty on them should be abolished in line with the established principle that import duty on inputs should not be higher than that of finished product.

The government has been requested to align value-added tax on cement with that of steel at four percent against 12 percent levied currently since both are important raw commodities for the infrastructure sector. These investments have impacted bottomlines and the likes of Ambuja Cement, UltraTech Cement, JK Lakshmi Cement and India Cement have reported a drop in net profit. Companies expect the Centre to reverse the excise levy based on retail sale prices and introduce uniform duty instead.
http://www.thehindubusinessline.com/2010/02/11/stories/2010021152070400.htm
http://www.forum4finance.com/2010/02/12/cement-makers-urge-to-scrap-import-duty-on-coal-pet-coke/

Food for Thought

The abolition of import duty on raw material seems to be a reasonable demand as the import duty denies domestic producers a level playing field vis-à-vis foreign producers who have access to cheaper inputs from the world market.

Whether the mentioned value added tax (VAT) has really affected profitability with adverse consequences for competition needs to be determined through empirical research. Note that the direct burden of VAT falls entirely on the consumers without any effect on the per unit revenue of producers. Producers would only be affected if tax-induced increase in prices results in contraction of demands with adverse implications for profitability.

2. Duty Free Import of Kraft Paper Sought

The corrugated packaging industry's major raw material, kraft paper, has been recently subjected to multiple, prohibitive and unprecedented price increases, making the corrugated packaging dearer by almost 25 percent and the paper mills are planning for further hikes in prices. To aggravate the situation further, prices of all other critical inputs of this industry have shot up substantially.

The corrugated packaging industry appeals to the Centre to allow import of kraft paper at nil rate of customs duty to tide over the present crisis and also to give opportunity to this industry to upgrade the quality of their products to international standards at affordable prices.
http://www.thehindu.com/2010/03/26/stories/2010032666622000.htm
http://bx.businessweek.com/packaging-industry/duty-free-import-of-kraft-paper-sought/38110026810107465 89-516df91fd9f8704cb8b651d8db82b168/

Food for Thought

Note that input costs per unit in the mentioned industry would depend on two factors: price levels of inputs and their quality. The appeal by the corrugated packaging industry points to a need for upgrading the quality of inputs in order to stay competitive in the market. The analysis presented below hinges on the authenticity of this need which should be verified.

As better quality inputs cost more, this would affect competitiveness in terms of price. In order to allow domestic producers to compete better in international and domestic markets, it would be advisable for the government to remove the mentioned price distorting customs duty. This would enhance competition in the domestic market as well as competition provided by domestic producers in the international market as adequate competitiveness of domestic producers would be ensured. Such competition would have a beneficial impact on both producer and consumer welfare.

3. Tyre Imports Hurting Rubber Growers

The surging import and dumping of tyres is severely impacting the interest of the natural rubber market in the country. This was mainly due to the significant increase in the import of truck and bus tyres over the past few years. The spike was all the more evident in the recent months with import of truck and bus tyres surging from 27,000 in April to two lakh in December 2009.

When import of tyres (2009) is taken into consideration, the import of natural rubber increased from 680 tonnes in April to 5,102 tonnes in December. Recognising the large-scale import and dumping of truck and bus tyres, the designated government agency has recommended the imposition of anti-dumping duty on radial truck and bus tyre imports from China and Thailand. The Rubber Board has also urged the government to check the dumping of tyres with a view to safeguard the interests of the domestic rubber growers.
http://www.thehindubusinessline.com/2010/02/25/stories/2010022553881800.htm
http://beta.profit.ndtv.com/news/show/tyre-makers-seek-ban-on-rubber-futures-32637
http://www.business-standard.com/india/news/tyre-makers-seek-banrubber-futures-duty-free-import/89756/on

Food for Thought

The import of tyres could be promoting competition or acting against it depending on whether import prices have a basis in costs of production incurred by foreign producers. If low import prices are indeed due to low costs of production then such imports are pro-competitive and should be encouraged as these induce domestic producers to also enhance their efficiency and reduce costs. But if these prices correspond to a temporary loss being borne by foreign producers as part of a predatory action to wipe out domestic producers from the Indian market, then such imports are anticompetitive and should be discouraged through the imposition of anti-dumping duty.

Suitable action, therefore, should be preconditioned on an appeal to data regarding actual costs of production and/or the prices charged by these producers in markets other than the Indian one. If data on actual costs is available then one can easily determine whether import prices are above or below the actual cost of production. Alternatively, it might be possible to find out whether import of tyres into the Indian market is taking place at prices which are at par with international ones.

Such research would point to whether such imports are pro-competitive/anti-competitive and help facilitate a decision regarding the imposition of anti-dumping duty.

B. Other Issues

1. Captive Port Terminals

Private companies may soon be able to carry goods faster through the Indian waters, as the government is working on a plan to reduce the turnaround time in ports of the country. The government is creating a policy on allotting captive berths at major ports to privately-held firms, enabling them to utilise the given facilities exclusively for their own goods.

The initiative has been taken by the shipping ministry to give a level-playing field to private companies vis-à-vis the public sector. Some public sector undertakings, especially fertiliser and oil companies already operate captive port terminals. Such captive units result in lower berthing and turnaround time as ships do not have to wait for berthing and goods can go straight out of the port if the company so requires.
http://www.financialexpress.com/news/captive-port-terminals-for-private-companies-likely/597186/
http://www.eximin.net/past_news/news_template_sql.asp?newsid=59977

Food for Thought

There is a conflict between competitiveness and competition in this case. In the existing regime, public sector ships have captive berths and save costs/time with respect to berthing and turn around. Such savings enhance their competitiveness. But at the same time such capture amounts to the absence of a level playing field across private and public sector firms, limiting participation by the former.

Thus, changes in the existing regime to nullify capture of berths by the public sector should be based on an evaluation of these trade offs. To elaborate, if the benefits from enhanced competition are large in comparison to the decrease in competitiveness of public sector ships, then a clear case for change emerges. If the exact opposite is the case then it maybe ruled that a regime change is not advisable. If the benefits and losses are comparable in magnitude then the decision to allow or disallow the change would hinge on value judgement as to the extent of sacrifice considered justifiable for the promotion of competition.

2. New Rail Catering Policy

The current catering policy being implemented by the Indian Railway Catering and Tourism Corporation (IRCTC) leads to monopolisation in tendering process. In the revised policy, this needs to be checked to ensure broader participation of local persons in the process.

The current policy has many loopholes since it allows cornering of the catering licences by a few operators which in turn affects the quality of food, causing trouble to the passengers. In order to promote equity and broader participation in the award of catering licences, there is a need for a comprehensive review of the system prior to policy formulation.
http://www.dnaindia.com/india/report_ensure-participation-of-locals-in-new-catering-policy-medha-patkar_1349859
http://www.thehindu.com/2010/02/20/stories/2010022059640300.htm

Food for Thought

Not only does the current catering policy promote inequity it also leads to inefficiency as it provides opportunities to only a few operators to enter the catering *business associated with the operations of the railways. In other words, the policy is both iniquitous and anticompetitive.*

Thus, the policy needs to be changed. But smooth facilitation of the change would involve certain administrative procedures.

To elaborate, notices can be issued/publicised asking interested caterers to submit applications for empanelment with the IRTC. Empanelment would be based on the applicant's ability to meet certain basic pre-conditions (scale of operations, equipment etc) and evaluation based on inspections by an expert committee.

It may be stipulated that once an application for empanelment is rejected the applicant would have to wait for a considerable period of time before applying again. However, new applications would be invited at reasonably short but regular intervals of time, say every two years. This would ensure that unnecessary time/expenditure is not spent/incurred in reviewing applications and at the same time the mentioned catering business does not become the preserve of a few.

It may also be stipulated that each catering assignment would lead to a call for bids. Only empanelled operators would be able to submit bids. Bids would be evaluated on the basis of financial and quality considerations.

In this way, the new catering policy would promote both competition and equity and at the same time be consistent with the principles of viability and economy of use of resources.

3. Cap on Highway Bidders May be Back

A clause limiting the number of bidders that qualify to submit financial bids for National Highway projects may be reintroduced, which was earlier dropped prospectively from the bidding process of the highways sector. The NHAI Board was to consider a proposal where for projects with a total estimated cost of up to Rs. 3,000 crore, a maximum of 10 bidders could be technically qualified to submit the financial bids. And for projects with a total cost of above Rs 3,000 crore, the number of qualified bidders taking part in the request for proposal (financial bidding) stage should not exceed eight, said the proposal.

The proposal also has an enabling clause to relax this condition on a case-by-case basis for certain projects if required. The proposal seeks to limit the number of contenders to the top five or six technically qualified applicants. The Government may be under pressure to limit the level of competition as that has been one of the demands of the foreign players and sections of Indian industry wanting to participate in highway projects.
http://www.thehindubusinessline.com/2010/03/27/stories/2010032753330100.htm
http://www.thehindubusinessline.com/2010/03/29/stories/2010032950310800.htm
http://www.thefinance.co.in/2010/03/26/cap-on-number-of-highway-bidders-may-be-back/257786

Food for thought

Limiting the number of bidders per se would be anticompetitive. But the proposed clause actually calls for filtration of bidders in two systematic steps. First, the bidders would be evaluated on technical grounds and if found suitable, financial bids would be entertained. In other words, this clause would not restrict the potential for competition; on the other hand, it orders the criteria according to which bids would be evaluated. Such an ordering makes sense as ensuring a minimum quality of road construction is desirable.

The proposed methodology for evaluating bids ensures acceptable quality of road construction and economy of effort/expenditure in processing bids while simultaneously facilitating promotion of competition.

C. News & Views

1. Proposition of Freeing Petrol and Diesel Prices

Kirit Parikh committee constituted to give its recommendations on oil sector reforms has suggested that the Central Government should completely decontrol the oil prices. The committee is also aiming for a level playing field for all players in the market, whether state-owned or private.

The government-appointed committee has recommended an immediate increase in prices of kerosene by Rs. 6 per litre and LPG by Rs 100 a cylinder. The price of petrol could rise by about Rs 5 a litre and that of diesel could go up by about Rs 3. Furthermore, the committee has proposed that diesel prices should be decontrolled at the retail level and the government to free petrol prices at both refinery and retail levels. There is no way the government can continue with the current pricing policy.
http://www.wheelsunplugged.com/ViewNews.aspx?newsid=5604
http://economictimes.indiatimes.com/articleshow/5547362.cms
http://economictimes.indiatimes.com/news/news-by-industry/energy/oil-gas/Fuel-price-hike-may-come-as-early-as-tomorrow/articleshow/5555898.cms

Food for Thought

Decontrolling prices would involve removal of all subsidies which have till date been directed exclusively towards public sector undertakings. This will in effect remove the advantages that the public sector has vis-à-vis the private sector. Thus, implementation of the mentioned suggestion would provide all players a level playing field and thus promote competition.

However, the stipulations regarding price hikes seem to run contrary to the principle of allowing the market to determine prices unless such hikes are seen purely as a transitory step to market determination of prices.

2. Plugging the Loopholes

The Food and Civil Supplies department has started to plug the loopholes in price control mechanism of essential commodities in Delhi, to either formulate a new law or to strengthen the Essential Commodities Act to have more grip over the wholesalers and retailers. The new legislation would curb the rise in prices of food and essential commodities and would take appropriate action against hoarders and black-marketeers.

The local Government has been finding it difficult to control prices at the retail outlets although it somehow managed to bring down the wholesale prices of various essential commodities as well as vegetables.
http://www.delhilive.com/page/essential-commodities-act-may-be-reworked-bring-effective-price-control-2010022413244
http://www.dnaindia.com/india/report_delhi-govt-to-strengthen-price-control-may-bring-in-new-law_1351653
http://www.indianexpress.com/news/delhi-govt-to-strengthen-price-control-may/583386/

Food for Thought

Control of price hikes might help to alleviate cartelisation and its ill effects. But at the same time it is quite possible that certain price hikes are warranted by increases in costs. If price controls rule out such price increases then this impacts provision of certain commodities/services adversely with negative implications for consumer welfare. Thus, control of price hikes has to be based on robust estimates of costs and trends in these over time.

3. Wide-ranging Reforms

The Planning Commission has called for wide-ranging reforms in agriculture, while criticising the strategy employed by the government to increase farm output and tame soaring food prices. It said the agriculture pricing system should be made more market-oriented by delinking support prices from procurement prices. It suggested measures such as abolition of levies and stocking limits, encouraging free movement of goods across the country and doing away with bans on exports and futures trading.

The performance in 2009 and 2010 reflect that the government's strategy was not effective and more needed to be done on the supply side to maintain growth. The government's management of agriculture has drawn criticism after its policies failed to rein in food price inflation and growth in agriculture production dropped.
http://economictimes.indiatimes.com/news/economy/indicators/Montek-wants-agri-reforms-pushes-for-market-prices/articleshow/5713961.cms
http://epaper.timesofindia.com/Repository/getFiles.asp?Style=OliveXLib:LowLevelEntityToPrint_ETNEW&Type=text/html&Locale=english-skin-custom&Path=ETD/2010/03/23&ID=Ar00300

Food for Thought

Free movement of goods across the country would facilitate competition among producers located in different parts of the country and lead to a national market for produce as opposed to regional markets which are currently the norm. The widening of the domain for competition would obviously have a beneficial impact on consumers in terms of price, quality and magnitude of consumption.

Though bans on exports are a competition restricting measure from the point of view of the international market, these actually increase competition among domestic producers in the Indian market in the short run with a depressing effect on prices. However, in the long run, such decrease in prices will in turn have an adverse effect on participation in the Indian market by domestic producers and lead to a decrease in competition. In other words, in the event of export bans, rewards associated with competition decrease, making it less attractive for producers. Thus, removal of export bans is actually a pro-competitive measure.

A similar argument applies to the removal of the ban on futures trading.