CUTS International

COMPETITION DISTORTIONS IN INDIA – A DOSSIER

(CDI-35: January-March, 2017)

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

Periodic Dossiers look at the interface of policy issues which have an impact on competition in India. Such impact could be negative, positive or mixed, depending on sectors and markets. In these Dossiers, news as published is utilised without verifying its accuracy, but ensuring its veracity.

The purpose is to flag issues and provide food for thought to the layman as well as to the policymakers and regulators. A detailed analysis has not been undertaken as it would require deeper examination of the issues, particularly in terms of cost and benefits.

We are pleased to present to you the CUTS Competition Distortion Dossier Edition No: 35 for the quarter of January to March, 2017. As always, we have attempted to capture interesting stories having an impact on competition, in sectors such as steel, oil, renewable energy, finance, and other key economic sectors. The stories reflect a mixed bag of both good and bad policies which could affect the economy.

In this issue, we highlight how preferential policies favouring select market players adversely impact competition and also global competitiveness of market players. In addition, the Dossier seeks to point out the reduction in consumer welfare owing to lack of a level-playing field and sub-optimal competition.

Launching protectionist measures might not be beneficial for domestic players in the long-run as they reduce their capabilities to compete globally. Moreover, to tackle the lack of global competitiveness of Indian firms in key sectors such as oil, consolidation might not be a feasible solution. It is also important to look at domestic regulations from the lens of competition principles, especially in important sectors like finance in order to ensure a market-oriented approach, which benefits consumers at large.

Contents

A. Trade Policies

1. Government mulls preferential market access for India-made steel

The government is considering granting preferential treatment to steel made in India. According to this policy, government funded and public-private partnership (PPP) projects in infrastructure and construction, and sectors such as defence and shipbuilding must procure steel made in India. The rationale behind the move is that it would help in substituting a part of the imports while enhancing market for domestic steelmakers, improving capacity utilisation and generate employment opportunities.

https://goo.gl/1wlnYe

Food For Thought

The government's move to provide exclusive market access to Indian steel producers aims to generate more investments in the domestic steel sector. This move is simultaneously intended to protect the domestic market players from external competition by creating a regulatory entry barrier for imported steel products in the public sector.

Although such a policy has the potential to improve market conditions in India, it might not be a positive step in the long-run. This is because India is poised to become the second largest producer of steel by 2018 and domestic players would have to look at markets abroad as viable export options in the near future. For this, Indian steel producers will have to effectively compete with international players and protecting them at this crucial juncture might hamper their potential to compete at a global level. Apart from affecting their competitiveness, granting exclusivity to domestic producers and barring import competition in the sector might not bode well with other steel-producing nations. This can reciprocate such measures, thus harming India's future prospects to gain entry in newer markets in this sector.

2. WTO-wary Commerce Ministry turns against minimum import price on aluminium

In what may dash hopes of domestic aluminium manufacturers like Hindalco, Vedanta and state-run National Aluminium Co. Ltd (NALCO), the Commerce Ministry favoured protection to the domestic aluminium industry via World Trade Organisation's (WTO)'s) compliant measures, including safeguard and anti-dumping duties, instead of imposition of minimum import price (MIP). This move assumes significance after Japan dragged India to the WTO against measures taken to check iron and steel imports.

https://goo.gl/Iui0Ij

Food For Thought

The measure of levying MIP on imported products ensures that they trade at a floor price which is typically on par with domestic prices. Post Japan's WTO complaint concerning MIP in the Indian steel sector, it seems that the Indian government is avoiding such measures in other sectors due to their anticompetitive and restrictive nature, and levying anti-dumping duties instead.

Notably, anti-dumping duties help prevent transnational price predation, facilitate market discipline and theoretically increase the competitiveness of domestic players. In the short-run, anti-dumping measures might even help in promoting and maintaining competition in the market. However, the government must also keep in mind the possible long-term anti-competitive distortions of such measures like suboptimal growth and breeding inefficiencies in functioning of domestic firms.

B. Policies Inhibiting Competition

3. Government proposes to merge oil PSUs

The 2017-18 Budget floated the idea of creating an integrated oil major through mergers and acquisitions to make a globally competitive public sector player. The intended objective behind the government's move is to create an 'oil major'. It will enable India, which is world's third largest oil consumer, to meet its energy requirements to some extent and help mitigate the rising oil prices. At the same time, it was intended to bring down the price of other commodities and build the capacity of Public Sector Undertakings (PSUs) to bear higher risks, avail economies of scale, take higher investment decisions and create more value for their stakeholders.

http://economictimes.indiatimes.com/articleshow/57217756.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

Food For Thought

Merging the Indian oil PSUs into a single entity is likely to improve efficiencies, increase competitiveness and upsurge production capacities in the oil sector in the short term. Notably, a similar strategy of amalgamation has been successful for private oil companies such as Exxon-Mobil, Shell-BP and Chevron-Texaco, and has helped them to improve balance sheets and achieve economies of scale.

However, it is important to acknowledge that the nature of proposed merger between Indian PSUs is different from that of private entities. This is because it intends to merge 13 PSUs into *one entity which is expected to create a much powerful state-owned entity. It can possibly lead to diverse effects on competition in the oil sector. While it might initially increase economic welfare, it could ultimately have the opposite effect as the government proposes to eliminate a sufficient number of competitors and capacity from the market. Needless to say, the effects of such a giant leap should be carefully assessed ex-ante. Moreover, a large-sized government entity is unlikely to perform well on indicators like professionalism, operational efficiency, optimal utilisation of capital, and might find it difficult to blend culture and retain jobs.*

4. To drive digitisation, government promotes bank-led payment services

The Union Budget 2017-18 proposed launching of two schemes to promote usage of Bharat Interface for Money (BHIM), a mobile application developed by the National Payments Corporation of India (NPCI). It also declared that *Aadhar* Pay, a merchant version of *Aadhar* Enabled Payment System (AEPS) to be operated by NPCI, will be launched shortly. A Mission will be set up with a target of 2,500 crore digital transactions for 2017-18 through Unified Payments Interface (UPI), Unstructured Supplementary Service Data (USSD), *Aadhar* Pay, IMPS and debit cards. Banks have targeted to introduce additional 10 lakh new Point of Sale (PoS) terminals by March 2017. They will be encouraged to introduce 20 lakh *Aadhar*-based PoS by September 2017, thus indirectly benefiting the NPCI.

The Committee of Chief Ministers on Digital Payments (Convener: Chandrababu Naidu, Chief Minister, Government of Andhra Pradesh) also recommended 50 percent subsidy to all merchant points for adoption of biometric (fingerprint and iris) sensors to be used for *Aadhar* pay transactions. It also recommended promotion of AEPS by incentivising and not charging Merchant Discounts Rates (MDR), among other measures to promote *Aadhar* enabled payments through NPCI. Consequently, the government proposed certain tax exemptions on specific PoS machines through the Union Budget 2017-18.

http://indiabudget.nic.in/ub2017-18/bs/bs.pdf and
http://pib.nic.in/newsite/PrintRelease.aspx?relid=157655

Food For Thought

All these steps are expected to stimulate the uptake of digital payment solutions such as BHIM and Aadhar enabled payments services. Although the novel objective of such measures is financial inclusion, it is important to concurrently recognise that the potential benefits of Aadhar-based payments and BHIM are expected to remain under-fulfilled in the absence of a level-playing field. Given that the NPCI is the sole organisation offering Aadhar-based *payments facility, it is but natural that it will feel constrained in rolling out operations in the entire country without other market players being eligible to offer such services.*

Moreover, absence of competition could result in sub-optimal performance and limited accountability. Such an effect was observed by the Watal Committee on Digital Payments, which stated in its report that more than 60 percent of Aadhar enabled transactions inter-se banks were failing (Report available at: http://www.finmin.nic.in/reports/watal_report271216.pdf). While such external nudges might be temporarily useful to promote digital payments, they might not be sufficient to create a sustainable ecosystem for digital payments, in longer term. Creating such a sustainable ecosystem would be possible only through allowing optimal regulation and competition in the sector.

C. Policies Promoting Competition

5. Railways looks at private suppliers for tracks

The Indian Railways (IR) is considering ending state-owned Steel Authority of India Ltd's (SAIL) virtual monopoly on supplying steel for standard rail tracks, opening up annual purchases worth up to U$700mn to the private sector. In the current financial year, according to the company's data, SAIL is set to fall around 250,000 tonnes of rails short of its 850,000 tonne target, its eighth shortfall in 10 years, and it is the biggest.

http://www.business-standard.com/article/economy-policy/railways-looks-at-private-suppliers-for-tracks-in-a-blow-to-sail-117032401116_1.html

Food For Thought

This move is perhaps a part of the IR' plan to undertake a U$130bn, 5-year overhaul to modernise the world's fourth-largest network, which is blighted by ageing track and saturated capacity. Notably, train accidents due to track defects have risen 25 percent in the past 2 years. While Jindal Steel had previously highlighted anticompetitive nature of Memorandum of Understanding between SAIL and IR, its complaint with the Competition Commission of India did not succeed.

Nevertheless, opening up the procurement process to private players has been long due and is bound to have positive effects for the Indian Railways. As Indian steel producers move towards excessive capacities, injecting competitive pressure in the procurement process would help solve the problem of increasing demand and simultaneously improving quality standards. Moreover, a competitive procurement process would also mean that IR will have the option to choose the most cost-effective input for railway tracks, resulting in savings.

6. India announces new Hydrocarbon Exploration Licencing Policy

The Indian government has announced a new Hydrocarbon Exploration Licencing Policy (HELP) which offers single licence to explore conventional and unconventional oil and gas resources, as the country seeks to propel investment in the energy sector. HELP, the new policy is part of the government's strategy to make India a business and investor-friendly destination and achieve the plan to double India's existing oil production from current 80 million metric tonne to about 150-155 million metric tonne by 2022.

http://businessworld.in/article/India-Announces-New-Hydrocarbon-Exploration-Licensing-Policy-/07-03-2017-113943/

Food For Thought

Currently, India meets two-thirds of its oil demand through imports. HELP will expectantly change this scenario by providing impetus to oil and gas discoveries in India. The policy is aimed to propel investment in the energy and petroleum sector and provide operational flexibility to investors. It basically changes the present model of multiple-licence, profit-sharing arrangement and regulated prices to a framework which advances common exploration licence for different hydrocarbons and flexible non-regulated pricing.

Remarkably, the new policy allows for a competition-led pricing model which offers an incentive for early entrants in the industry. To promote efficiency, the policy provides calibrated marketing freedom through a single licence approach and non-regulated pricing structure. The policy also paves the way for a level-playing field between domestic and local gas. Resultantly, the companies will now be allowed to fix prices as per competitive global benchmarks, which would support the development of a competitive gas market in India.

7. India to announce policy for competitive domestic solar equipment manufacturing

The Indian government is working on a plan for making domestic manufacturing of solar power generation equipment competitive *vis-à-vis* other countries. As part of this strategy, the government plans to come out with a policy to promote manufacturing of the entire range of solar power generation equipment in the country. Currently, most of the solar power developers in India have been sourcing solar modules and equipment from countries such as China as they are cheaper.

http://www.livemint.com/Industry/xOTfVYqDEMHcExA6pgMu3N/India-to-announce-policy-for-competitive-domestic-solar-equi.html

Food For Thought

India is currently the third largest energy consumer and seeks to achieve 100 GW of solar power generation capacity by 2022. This move has the potential to attract foreign companies to invest in India and setup their manufacturing hubs in light of increasing demand. It will purportedly increase competition in the renewable energy sector and also help India to achieve its global climate change commitments.

However, this move has come after the WTO Appellate Body, the highest court for resolving trade disputes, struck down India's local content requirements for solar cells and modules last year. Claiming discrimination against foreign manufacturers, the US challenged India's solar panel procurement policies and won. Hence, while formulating policies for domestic solar manufacturing, the Indian government has to be wary about the anticompetitive challenges which these policies might pose.