

Competition Distortions in India – A Dossier

(CDI-23: January-March, 2014)

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.

Dear Readers,

We are pleased to bring before you the Competition Distortions Dossier Edition No: 23 for the first quarter: January-March 2014.

As always, we have captured several interesting stories, a mixed bag of both good and bad. There are instances of potential competition distortions caused due to trade policy tools such as import duties and adopting a protectionist approach.

There is the case of the AAP's state Government in Delhi which withdrew approval for FDI in retail sector, on the grounds that FDI in retail would increase choice of consumers only at the cost of large-scale job losses for people employed at small retail shops. It did not do any cost-benefit analysis of the benefits FDI in retail. More importantly, the policy was adopted by the former Congress government in Delhi state, and thus the cancellation of the policy by a new government would send very bad signals to investors, affecting the whole country. Even though the AAP is no longer in government, will be the Lt Governor restore the old policy. If so, will investors come in knowing that the flip flop can happen again. Adding insult to injury, Rajasthan too has cancelled the FDI in retail policy adopted by the previous Congress government.

On the other hand State Government of Uttar Pradesh seems all set to follow anti-competitive foot prints of previous government by once again rewarding the entire liquor vending business of western UP to Ponty Chadha's group. Ponty was killed by his brother in a sardonic tale, yet his ghost continues to function in a true story of crony capitalism.

There are instances of violation of the competition owing to lack of level playing field for domestic private players, which can be seen in this edition as well. The case pertains to telecom sector where state owned company BSNL has not allowed domestic manufacturers of telecom equipment to participate in bidding for a contract which involves procurement of equipment for establishing optical-fibre based communication network.

The government has taken some positive steps in terms of encouraging competition in two infra sectors and not surrendered to protectionist lobbies. The government has rejected the request of Federation of Indian Airlines (FIA) to not allow the two Tata Group airlines joint ventures with Singapore Airlines and AirAsia to operate in India. Likewise Government is pondering over implementation of a plan focusing at separating the distribution and production in the electricity sector, enabling consumers to purchase electricity from power producers of their own choice.

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A. Trade Policy

1. Steel Ministry asks Commerce Ministry to Impose 10% Export Duty on Iron Pellets

In order to check the iron ore exporters circumventing the law by exporting iron ore in pellets, thereby hurting the steel industry, the steel ministry has written a letter to the commerce ministry asking it to impose a 10 percent export duty on iron pellets. The move may hurt companies like Kudremukh Iron Ore Company Ltd (KIOCL), Jindal Steel and Power Limited, Essar Steel and Bhushan Steel which have set up large pelletisation plants.

At present, iron ore lumps and fines attract 30 percent duty, but there is zero duty on pellets, which was resulting in exports of iron ore in the form of pellets.

<http://www.financialexpress.com/news/steel-min-asks-commerce-min-to-impose-10-export-duty-on-iron-pellets/1221098>

Food for Thought

The Ministry of Steel has urged the Ministry of Commerce and Industry to impose 10 percent export duty on iron pellets in an effort to reduce the size of loss faced by domestic steel industry due to export of iron ore in the form of pellets by exporters in India. Export of iron ore in pellets does not attract any duty. However, on the other hand, 30 percent duty is charged on export of iron ore lumps and fines. Thus, in order to avoid the duty charges, exporters usually prefer to export iron ore in pellets. According to the domestic steel industry such export affects overall growth of the industry in adverse manner. The industry has supported the steel ministry stating that there is no significant value addition by pelletisation of iron ore.

If the Commerce Ministry takes such a decision, KIOCL, Essar Steel Ltd, Jindal Steel and Power Ltd and Bhushan Steel are likely to suffer a lot as they have built large pelletisation plants. According to experts, the move may create barrier towards expansion of Rs 500 billion pelletisation industry in the country. State owned entity KIOCL has asked the Commerce Ministry not to take such step.

It would be advisable for the government to take into consideration interest of steel industry as well as the burgeoning pelletisation industry and adopt a middle path in order to ensure sustained growth of both the industries. Cheap export of iron ores in the form of pellets definitely affects domestic steel industry in an adverse manner by putting them at disadvantageous position, when compared with foreign iron ore firms. However, one cannot deny the fact that it helps in ensuring cheap input for the growing pelletisation industry in India.

2. Rising Imports of Chinese Bicycles Threat to Local Industry

Growing import of cheap bicycle and components from China to India is posing a serious threat to the domestic bicycle industry, says a survey by industry body, Associated Chambers of Commerce & Industry of India (ASSOCHAM).

Besides seeking review of free trade agreements, ASSOCHAM sought imposition of anti-dumping duty to curb import of bicycle and its parts.

"There is a need to increase import duty on bicycle and its parts. As by doing this the prices of bicycles made both in India and China would equate in the global market," said the study entitled 'Future of Indian Bicycle Industry'.

http://www.business-standard.com/article/pti-stories/rising-import-of-chinese-bicycles-threat-to-local-industry-114031300730_1.html

Food for Thought

According to a study conducted by the industry body ASSOCHAM, cheap import of bicycle and its components from China is causing serious threat to domestic manufacturers of bicycles. According to experts, import of bicycles and components from China to India has increased by about 41 percent during the course of last five years.

Further, comparing the export and import of bicycles by India, exports to other countries have grown at a compounded annual growth rate (CAGR) of about 17 percent. On the other hand, imports grew at over double the rate of about 35 percent. One of the main reasons for the present situation is absence of competitive pricing of bicycles manufactured in India as compared to bicycles manufactured by foreign companies.

Considering this, ASSOCHAM has recommended for increase in import duty on bicycles and its parts as well as taking anti-dumping measures against Chinese exporters who have been dumping their products in India. According to the body, such steps are required to provide level playing field to domestic bicycle industry in terms of competing with their foreign counterparts.

The measures suggested by ASSOCHAM would certainly help in protecting Indian domestic industry from cheap imports of bicycle from China and other bicycle producing countries. But using antidumping measures should be sanguine. The country should also try to build the capacity of domestic bicycle manufacturers in terms of producing quality and cost effective bicycles. Such approach would be more beneficial in terms of enabling bicycle manufacturers in India to face competition from foreign players in the long run, rather than adopting protectionist measures.

B. Sectoral Reform

3. Objection from Existing Airlines not to Stop New Entrants

The Aviation Ministry would not stop any airline from starting operations in the country based on objections by existing airlines, clearing away one potential risk to the launch of two new Tata group airlines.

"The Ministry is acting on well laid down policies. The policies are clear and it cannot act based on individual interpretations," Civil Aviation Secretary Ashok Lavasa said.

The Federation of Indian Airlines (FIA), with IndiGo, Jet Airways (India) Ltd, SpiceJet Ltd and GoAir as active members, has been aggressively lobbying against the entry of the Tata group airlines, arguing that India's recently relaxed foreign investment norms did not apply to new airlines.

<http://www.livemint.com/Politics/3K2nd6dS4WK3J5UmkR8OCJ/Objections-from-existing-airlines-not-to-stop-new-entrants.html>

Food for Thought

Civil Aviation Ministry has decided to adopt a firm stance in order to allow Tata Sons teaming up with Singapore Airlines Limited and Malaysia's AirAsia Bhd and start operations in India in near future, by overruling the objections made by FIA.

The entire row started with FIA which includes IndiGo, Jet Airways (India) Ltd. SpiceJet Limited and GoAir as its members raising their concern over Tata reentering the aviation sector in partnership with foreign airlines. The foreign direct investment (FDI) policy introduced by the government in 2012 which permitted foreign airlines to make investment in airlines in India up to 49 percent, helped Tata to secure deals with Singapore Airlines to start a full service airlines and with AirAsia to start a low budget airline to further intensify competition in the aviation sector.

According to FIA the policy permitting foreign airlines to invest in airlines applied to operating airline companies and not new entrants with new international partners. The FIA tried to draw the attention of the Prime Minister to the issue of interpretation of substantial ownership and effective control, prior to grant of air operators permit (AOP) to Tata and its partnering companies after Directorate General of Civil Aviation (DGCA) rejected the plea of FIA to stop Tata from entering the Aviation Sector.

Rejecting the demands of FIA is a welcome step in the right direction adopted by the government which would lead to enhancement of competition in the Aviation Sector and would also boost the confidence of foreign investors to invest in India. Increase in number of airlines operating in India would result in better services and more choice for consumers. On the other hand, approach of the existing member airlines of FIA could be considered as a protectionist move. Creating hurdles for new players to enter the market would negatively impact the growth of the entire sector in the long run. Moreover, it would also create ambiguity among potential foreign investors regarding the investment climate in India further denting inter alia the prospects for airline companies raising money through the FDI route.

4. Cabinet to Consider Separation of Wire and Supply Business

India is moving towards implementing a radical plan to separate the so-called carriage and content operations of existing power distribution companies, with the draft cabinet note on the matter expected to be circulated within the next three weeks.

"The issue is at an advanced stage of discussions within the ministry. The draft cabinet code for inter-ministerial consultation will be moved within the next three weeks. It will be a huge move," said a Power Ministry official, who spoke on condition of anonymity.

Once implemented, the plan may make it possible for people and companies in India to buy electricity from a power company of their choice, resulting in lower tariffs. Carriage refers to the distribution aspect and content to power itself. Implementation of the plan would require changes in the Electricity Act of 2003.

<http://www.livemint.com/Politics/h1rkbROB62bCA61SBO1K9J/Cabinet-to-consider-separation-of-wire-and-supply-business.html>

Food for Thought

The government is thinking on the lines of implementing a path breaking plan which would aim at separating the distribution and production of electricity in the electricity sector in India. According to experts, if implemented properly, would enable consumers to purchase electricity from power companies of their own choice. The plan would require changes in the Electricity Act 2003 and National Tariff Policy.

The government is also looking to open the final price bids for the 4,000 megawatts (MW) Odisha and Cheyyur power projects, estimated to require an investment of around Rs 25,000 crore each. Both are part of the Power Ministry's ambitious ultra-mega power project (UMPP) programme, as the country's attempt to create large power generation capacities at a single location to meet the projected power demand for future.

Aforementioned initiatives on the part of government would be helpful in boosting the spirit of investors to invest in electricity sector in India. At the same time, it would also improve competition among the power producers in the country as consumers would be free to choose providers of their own choice based on the quality of service they provide, ultimately leading to improved consumer welfare.

The move would also help meeting the main objective of introducing Electricity Act 2003, which was passed by the government for developing a liberal framework for development of the power industry, promoting competition and protecting interests of consumers. The Act included provisions related to open access for everyone having 1MW consumption or more.

C. Anti-competitive Practice

5. BSNL Overlooking Go-local Policy in Awarding Contracts

The battle between the crouching tiger and hidden dragon is playing out for real in the telecom space. Indian telecom equipment makers, citing security reasons, are up in arms against *Bharat Sanchar Nigam Ltd* (BSNL) for allowing Chinese companies to bid for its contracts.

Bangalore-based telecom gear-maker Tejas Networks has written to the National Security Advisor and the National Security Council, saying that even though the government has notified the go-local policy, BSNL is not giving preference to Indian manufacturers.

<http://www.thehindubusinessline.com/companies/bsnl-overlooking-golocal-policy-in-awarding-contracts-tejas-networks/article5614961.ece>

Food for Thought

The step adopted by the government some-times back to promote domestic manufacturing of telecom equipment, citing security reasons also, is under the scanner. Bangalore based, telecom equipment manufacturer Tejas-Network has shown its dissatisfaction over the recent development, in which the state-owned telecom service provider BSNL has overlooked go-local policy floated recently, in awarding the contract for procurement of telecom equipment by the telecom service providers.

According to company sources, BSNL has decided to go for restrictive tender process which would not allow domestic companies to participate in bidding for the contract which involves procurement of equipment for establishing optical-fibre based communication network for the defence forces. Tejas-Network has also blamed BSNL for not taking into consideration the security reasons before permitting Chinese companies to participate in the tender.

Government-owned entities, such as BSNL usually award contract to the companies having lowest prices. However, in any case, points raised by Tejas-Network are genuine as Indian companies should at least be allowed to participate in bidding process. Completely barring them would keep them deprived of level playing field and would also discourage domestic manufacturers of telecom equipment to produce quality products as they would be deprived of market to sell their products and earn profits.

6. Akhilesh Retains Liquor Policy, Ponty Chadha Group Gains

The Uttar Pradesh government is all set to hand over its liquor business and retail vends in 18 districts of western UP to the Ponty Chadha group and that too for the next two years instead of one, as has been the norm till now.

The Ponty Chadha group controls the entire liquor trade in UP and also operates retail vends in a joint venture with UP Co-operative Sugar Mills Federation.

According to sources, the state cabinet is all set to clear the state's liquor policy for two years, from 2014-15 to 2015-16.

The state government has fixed the revenue target at Rs. 14,500 crore for 2014-15 and Rs. 17,500 crore for 2015-16. UP's excise receipts targets for 2012-13 were Rs. 9,782.86 crore and till December 2013, it achieved Rs. 7,905.70 crore.

<http://www.financialexpress.com/news/up-cm-akhilesh-yadav-retains-liquor-policy-ponty-chadha-group-gains/1221100>

Food for Thought

Governments, at the both levels Centre as well as the states play the most crucial role in infusing and ensuring competition in every dimensions of economy. Competition could be considered as one of the most important tools which require proper application in order to ensure consumer welfare through optimum allocation of scarce resources.

However, if the government itself indulges in anticompetitive policies, it might lead to anticompetitive situations where interest of consumers as well as industry is sacrificed to favour a particular entity or person.

This might be the case in Uttar Pradesh once again where the Akhilesh Yadav's government is planning for rewarding the entire liquor business of western UP to Ponty Chadha's group, following the practice of the earlier Mayawati government.

Prior to this, Uttar Pradesh was known to have had a very healthy liquor auctioning system which provided a level playing field to different players participating in it. However, with this development, most of the market would be monopolised at the hands of a single player. And the fact that this will be done with full governmental support needs to be vehemently condemned.

Further, Uttar Pradesh government can draw lessons from Rajasthan, where till 2004-05 the State of Rajasthan followed the 'Exclusive Privilege System' for liquor sales. As per this system, the state was divided into regions for liquor vending contracts. Contracts under each region gave the licensee-contractor the exclusive right to trade in liquor in the specified area for one year. In this system a number of malpractices developed and competition was restricted to a few contractors who had sufficient money and muscle power. Over time, it encouraged cartelisation, resulting in high prices and concentration of business in the hands of few licensees. Bids were also suppressed and state excise revenue remained almost stable in spite of the increase in demand over time.

However, in 2005-06, facilitated by a CUTS research report Towards a Functional Competition Policy for India,¹ adopted changes in excise policy which resulted in quantum jump close to 30 percent in excise revenue for the State. In order to achieve this surge in excise revenue, the Rajasthan government established the Rajasthan State Beverages Corporation Ltd. (RSBCL) to take over the role of purchaser and supplier of liquor, dispensing

¹ <http://www.cuts-ccier.org/pdf/FairCompetitionLeadstoRiseinStateRevenue.pdf>

with exploitative middle men. Furthermore, in a significant departure from its earlier policy of exclusive privilege system, the government introduced a two-tier system of licencing – licences for wholesaler as well as retailer, on the basis of a fixed license fee. The process of allotment was based on a lottery system. The new system provided liquor selling rights to a large number of vendors.

D. Foreign Direct Investment Policy

7. Railway FDI Policy may have a Caution Note on Chinese firms

Even as the government readies to open some segments of the railways to 100 percent foreign equity participation, in an unprecedented move, it might incorporate in the enabling policy a clause cautioning against investment from Chinese companies. It is even opposed to Chinese labour working in areas near India's borders with China and Pakistan.

The proposal to allow 100 percent FDI in the construction and maintenance segments of the railway network was floated by the Department of Industrial Policy and Promotion (DIPP) in August 2013.

While the government had earlier raised questions on the presence of Chinese companies in the telecom sector, no restrictions in the FDI policy were put in place. However, while clearing a proposal by telecom major Telenor to increase its stake in its Indian venture, the Foreign Investment Promotion Board (FIPB) had come up with an unusual rider that 'officials who have worked in Pakistan should not be allowed to work in India'.

http://www.business-standard.com/article/economy-policy/railway-fdi-policy-may-have-caution-note-on-chinese-firms-114013001080_1.html

Food for Thought

Government has adopted a cautious approach in allowing 100 percent foreign direct investment in railways, in the construction and maintenance segment. Under the policy, the government wants to open the doors to FDI in areas, such as rail corridor projects, station development, locomotive manufacturing units, power plants related to railways, dedicated freight lines, high speed train systems, logistic parks and freight terminals, as well as suburban corridors.

DIPP had put forth this idea in 2013 and prepared a cabinet note which is still under review by the Home Ministry. The Home Ministry has raised its concern over the matter of allowing Chinese companies to invest in Indian railways or getting involved in any kind of work related to railway network. The objection is largely on account of security reasons as India and China have been involved in lingering border disputes over the past many years. Both countries are arch rivals in the economic field also.

The proposed FDI policy is expected to bring in approximately Rs one lakh crore of investment in the form of public-private partnership projects and Chinese firms are very much interested to invest in it. However, considering the intent of Home Ministry it might be difficult for Chinese companies to make their presence felt in Indian railways. Earlier also government raised questions on the presence of Chinese companies in the telecom sector but the FDI policy for telecom sector never included such clause of excluding Chinese investors.

Opinion of Home Ministry on not allowing Chinese companies to invest in railways in India has some merit as it involves security issues. Nevertheless, government should also think on the line of adopting some lenient approach with appropriate safeguards in case of reputed Chinese companies having good record of doing business internationally and also in India in

other sectors. It would also lead to healthy competition among the potential investors considering investing in Indian railways.

Further, the Ministry of Railways recently, identified need for augmenting of coach manufacturing capacity as a pressing priority and has decided to set up a new Rail Coach Factory at Palakkad, Kerala to manufacture passenger coaches, through a Joint Venture Company to be formed with a private sector partner selected through international competitive bidding.

However, the project has received only one bid from CSR China. Given this situation of only one bidder, ministry should speak to other capable parties about their objections and relax conditions in order to allow other bidders to participate in the bidding process by re-inviting tenders. Otherwise going with single bidder will be questioned. Government Financial Rules also do not permit procurement unless there are at least three bids.²

8. U-turn On FDI in Retail

Arvind Kejriwal's government has withdrawn permission for foreign multi-brand retailers to set up shop in Delhi, recklessly reversing the previous state government's policy decision. This is a patently wrong move. AAP is misreading its voters' mandate. They were seeking better governance, not anticompetitive protectionism. Beyond disregarding the aspirations of India's largest urban conglomeration, this FDI about-face puts the spotlight on policy instability.

As the election season spreads across India, it raises fears of further turnabouts, underlines the undependable arbitrariness of decision-making, and does investment sentiment no favours at all. It is India that takes a hit.

<http://timesofindia.indiatimes.com/home/opinion/edit-page/U-turn-on-FDI/articleshow/28801714.cms>

Food for Thought

The AAP government in Delhi led by Arvind Kejriwal has written to the Central Government to withdraw approval given by the previous Congress government for allowing FDI in multi-brand retailing in Delhi. The reasoning provided by the AAP government for adopting such a major policy reversal is that FDI in retail would increase choice of consumers only at the cost of large-scale job losses.

The Central Government permitted 51 percent FDI in multi-brand retailing in September 2012 and implementation of the policy was left to the states. As many as 12 states, mostly Congress-led, including Delhi and Rajasthan, agreed to allow global retailers to open supermarket chains. Other states include Maharashtra, Karnataka and Andhra Pradesh.

The argument put forth by the AAP government for not allowing entry of global chains such as Walmart and Tesco in India does not hold merit. Several studies on this issue have proven the fact that unorganised retail no longer expands employment and paving way for organised retail would help in creating millions of job for youths in India. Further, such move would also impede the process of infusing competition in retail industry ultimately affecting the consumer interest by keeping them deprived of better services and choices of products.

Moreover, while the entire economy is in the process of opening up with introduction of second generation of reforms on the verge, state governments should not try to stall the reforms taking place in retail industry only, just to fulfill their political interest. It would be sheer negligence on the part of state governments if they do not allow FDI in retail as it

² http://circ.in/pdf/CIRC_RegTracker_December_2013.pdf

would not be possible to insulate retail sector from the strong wave of liberalisation, in the long run.

In the meanwhile the new BJP government in Rajasthan too has reversed the policy of FDI in retail on the grounds that small retailers will get adversely affected.

At CUTS, we do not agree that small retailers cannot be protected against big retailers and it needs good regulatory regime in place. As it is domestic big retailers are expanding their presence all over, so why deprive consumers from more competition. Please see Issue Note for Parliamentarians at: [http://www.parfore.in/pdf/1-2012FDI in Multi-brand Retailing-Adequate Safeguard is Key to Success.pdf](http://www.parfore.in/pdf/1-2012FDI%20in%20Multi-brand%20Retailing-Adequate%20Safeguard%20is%20Key%20to%20Success.pdf)

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