

Competition Distortions in India – A Dossier

(CDI-27: January – March, 2015)

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.

Introduction

The biggest competition reform-related news, before we end this period, is the release of the Bibek Debroy Panel's far reaching report on Restructuring Railways (<http://tinyurl.com/k76c3p5>). It has suggested sweeping reforms to promote competition, including suggesting inter alia that private players should be allowed to run trains. Comments on the report are invited by April 30, 2015.

On the other hand in the road transport sector is the draft Road Transport and Road Safety Bill, 2014 which would be a game changer in promoting better transport and road safety. It encourages private operators to operate bus services in all areas of the country without any restrictions. We have been advocating for this since long. However, Shri Ramalinga Reddy, Karnataka State Minister for Transport, speaking at the National Road Safety Council meeting in Delhi on March 01, 2015 argued: "The Bill does not envisage how the interest of State Transport Undertakings will be protected". Shri V. Senthilbalaji, TN Transport Minister spoke in the same vein. Fostering competition in the bus transport sector has been stressed by the Supreme Court as well (<http://tinyurl.com/o2u9fak>). Various sectors including civil aviation have been opened up to private competition which has helped the economy and consumers. However, people privy to the bus transport sector believe that private operators would continue to ply all over the country offering a viable alternative to state transport undertakings, in an illegal manner. The authorities turn a blind eye, for obvious reasons.

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A. Sectoral Reforms

1. Direct Benefit Transfer will be a game-changer: Crisil

The government introduced the Direct Benefit Transfer (DBT) to reduce the subsidy level by eliminating intermediaries and structural costs associated with procuring, distributing and storing grains. Under the DBT scheme for food subsidy, the government would be able to save around ₹25000 crores.

Funds would be directly transferred to beneficiaries' accounts, enhancing transparency in distribution of funds. It would cut down on wastages, leakages, duplication of accounts as the beneficiaries' account would be connected through Aadhar card, thereby enhancing efficiency in the system. This scheme also offered beneficiaries the choice to use the subsidy amount thereby encouraging discretionary spending.

www.financialexpress.com/article/economy/dbt-is-direct-benefit-to-govt/44275/

Food for Thought

Launched in January 01, 2013, the DBT scheme is being taken forward by the present government to transfer subsidies, scholarships and other welfare benefits directly to the bank accounts of beneficiaries. Under DBT, once a beneficiary joins the scheme, he would get access to goods at a market price and receive the subsidy amount directly in his bank account. Also, a particular sum would be deposited in advance to the beneficiary's bank account, as he becomes associated with the scheme.

DBT has been supported by the present government which would eventually allow phasing out of inefficient product subsidies that lead to leakages. This requires Aadhar card to be linked with the bank account of beneficiaries for the purpose of reducing fake and duplicate beneficiaries. This would take out intermediaries from the scenario, thereby eliminating costs associated with procuring, distributing and storing grains as subsidies and benefits of welfare schemes would be directly transferred to the beneficiaries' bank account.

Also, elimination of intermediaries from this system would enhance transparency regarding distribution of funds. This would also boost clarity in the distribution of benefits, eventually leading to opening more bank accounts. This has surely catalysed vigorous competition in the market. This scheme also empowers the consumers to decide and option to choose on how to use the subsidy amount thereby enhancing discretionary spending.

To conclude, it is submitted that introduction of DBT and its proper implementation would increase the circulation of money in the market, which would thereby significantly increase the gross domestic product of India. This scheme introduced by the government can prove to be an efficient way to ensure healthy competition in the market as well as ensure that every rupee from the government reaches the beneficiaries.

2. Govt may tap SMEs to stock proposed low-cost drugs

The Chemical and Fertiliser Ministry has been working to revive the generic medicine store *Jan Aushadhi* that miserably failed after its introduction in 2008 by the previous government. It has planned to source drugs from the small and medium pharma manufacturers and distribute it through 3,000 stores. This proposal would not only develop and increase the domestic pharmaceuticals manufacturers in India but also make timely availability of low cost medicines to the Indians living below poverty line and protect their lives.

Presently, the government is also planning to enhance manufacturing of Active Pharmaceutical Ingredients (APIs), the main ingredient in a medicine, in the country which would eventually increase manufacturing these products in India.

www.business-standard.com/article/economy-policy/government-to-procure-drugs-from-smes-for-the-proposed-low-cost-drug-stores-115021900834_1.html

Food for Thought

The Jan Aushadhi campaign brought in 2008 has been reintroduced in 2015 by the Modi government. Due to gradual erosion of domestic manufacturing capacity and disruption in supply of drugs in the Indian pharma sector there has seen an increase in import of drugs from foreign firms especially from China. Hence, there was a need for the domestic market to provide quality, unbranded generic medicines available to the consumers, particularly the poor at a concessional rate. The Centre would procure medicines in bulk from public as well as private drug manufacturing firms and rebrand them under 'Jan Aushadhi'. 504 essential medicines have been listed for the treatment of cardiovascular, respiratory, diabetes and gastroenterology diseases. It also intends at improving the functioning of Bureau of Pharma Public Sector Undertakings of India (BPPI) for better co-ordination among state-owned pharmaceutical undertakings for increasing production of drugs listed in Jan Aushadhi stores.

The present government has been very keen on encouraging small and medium-sized enterprises (SMEs) to access market and manufacturing bulk drugs as well as reviving the generic medicine store, Jan Aushadhi. Overall, such an initiative is pro-competitive in nature as it encourages small and medium scale players to compete fairly with other public as well private players, thereby ensuring healthy competition in the market.

The government has provided an umbrella brand for generic drugs which is aimed at enabling consumers to make that choice. This assistance from the government would surely encourage domestic firms to actively participate and invest in this sector, eventually leading to a competitive market. However, there are concerns on whether the government would be able to maintain and monitor quality of all products sold under this brand since these would be procured from various private and public firms. It is, therefore, suggested that the government must not compromise on the quality, efficacy and safety of the drugs and conduct regular monitoring to enhance fair and healthy competition in the market.

B. Trade Policy

3. Steel producers seek higher duty on Chinese imports

The domestic steel companies have appealed the government to increase the import duty on steel imports. The steel industry has witnessed sharp decrease in their profitability. The present situation might go worse costing hundreds of jobs in the months ahead due to lack of support from the government.

In 2014, India imports from China went up by 1.58 million tonnes depicting an increase of 128 percent. The Indian Steel Association has also requested the government to allow protection to domestic manufacturers. They have also, urged the Finance Ministry to apply protectionism measures such as imposing anti-dumping duties to stem the surge in steel imports.

<http://timesofindia.indiatimes.com/business/india-business/Steel-producers-seek-higher-duty-on-Chinese-imports/articleshow/46257875.cms>

Food for Thought

In 2015, India has become a net importer of steel which has put an adverse impact on the domestic steel producers. In order to survive competition from the foreign steel entrants, they are compelled to reduce their prices or offer discounts on finished products which is much lower than their cost of production. During April 2014-January 2015, the total import of steel amounted to 8.1 million tonnes against 4.8 million tonnes during the same period in 2014, depicting a heavy growth of 69 percent. Steep reduction in prices has severely affected the survival of steel producers. Lack of support from the government would make the situation worse. Import of such products from foreign players while domestic players are running in loss has led to distortions in competition.

Being a core sector, steel industry reflects the overall economic growth of an economy in the long term. The domestic steel producers have, therefore, urged the government to impose higher import duty and put in place anti-dumping measure to stem the surge in steel imports.

The World Trade Organisation (WTO) Agreement encourages countries to impose countervailing measures and other safeguard actions, such as imposition of additional duties as lawful measures to boost domestic industries and balance the interest of consumers and producers. The domestic industry is overburdened due to high level of logistics and freight costs to Indian Railways.

Hence, it is suggested that the government must undertake a cost benefit analysis and formulate policies, necessary to uplift the present state of domestic steel producers. Looking into their unfortunate state, the government is suggested to encourage domestic production by giving preference to domestically-produced steel and its products. Such protection to local manufacturers would cease Chinese steel imports into India, thereby uplifting the current state of the steel manufacturers.

4. Customs duty cut in electronics to spur local production

The government has decided to reduce the customs duty for components such as magnetrons, used in microwave ovens, refrigerator compressor parts, backlights for light-emitting diodes (LEDs) and display panels for organic light-emitting diodes (OLEDs) which would eventually reduce the assembling costs marginally, appliance and electronics companies.

This is a significant move as such a decision by the government would help spur local production. TV manufacturers are positive about the customs duty waiver of 10 percent on OLED display panels, which would encourage companies to assemble these domestically. Similar steps by the government would definitely motivate producers to consider assembling these products indigenously, being pocket-friendly for consumers.

www.business-standard.com/article/companies/customs-duty-cut-in-electronics-likely-to-spur-local-production-115030400010_1.html

Food for Thought

The Budget 2015-16 introduced a series of cuts in customs and excise duties to promote domestic manufacturing in India. Custom duties on components used in electronic products such as LCD/LED TV panels, microwaves, frost-free refrigerators were dropped with the intention to encourage the indigenous producers to compete in the market.

Although, this is an optimistic change for the economy, it is not substantial enough to bring in sudden change in the electronics sector. Companies in the electronics sector depict that such steps by the government would not lead to any major investments since goods are too

small to make local manufacturing feasible. The cut in exercise duty on inputs used in LED lights, fixtures and lamps to six percent from 12 percent would have limited impact since this category is comprised of two to three percent of total ₹12000 crore lighting market in India.

There are companies who would still prefer to import products from foreign companies rather than manufacturing components in India as the former one is a better deal in terms of costs. Interestingly, LG India is the only company that manufactures microwave ovens in India while others import from Thailand and China.

It is, therefore, suggested that simply reducing the customs duty in the electronics would not make the 'Make in India' policy a success. The government has to look beyond, into various other aspects such as hurdles faced by domestic manufacturers as well as foreign manufacturers to establish manufacturing units in India. There is a need to ease regulations for doing business in India and provide a level-playing field for electronics component manufacturers to invest in India, enhancing healthy competition in the market. This would eventually develop a market for components of electronic goods which would not only boost investments into the economy but also contribute towards the reduction in the overall cost of electronic products in India.

5. As margins pinch, paper industry seeks anti-dumping duty on imports

Presently, the pulp and paper industry in India is facing the problem of dumping of cheaper imported paper from China and Indonesia. Due to margins pressure and growing input costs, Indian paper is not given a preference. This has forced domestic manufacturers to offer lower costs. However, increase in raw material costs has an adverse impact on the domestic producers. Hence, the Indian Pulp and Paper Technical Association (IPPTA) has urged the Centre to impose anti-dumping duty as a protection to bring these imported paper products on a par with domestic manufactured paper and sort out the anomaly.

www.thehindubusinessline.com/economy/paper-industry-wants-dumping-duty-imposed-on-cheaper-imports-expresses-concern/article6982725.ece

Food for Thought

India is the fastest growing pulp and paper market in the world with six percent demand growth. However, the ₹40,000 crore paper and pulp industry is currently facing difficulties to enjoy a stable position in the Indian economy. Paper manufacturers are suffering from losses due to escalation in input costs especially with rise in price of raw material, i.e. domestic wood. To make the situation worse, rupee depreciation has also increased the cost of importing chemicals and pulp etc. This has led to the import of wood chips from international market as they offer pulp at much lower rates.

The domestic manufacturers, struggling to stay in the competition are forced to lower their costs even though the cost of production has seriously escalated. They have failed to sustain the loss incurred and lack of financial assistance from the government has had an adverse impact on their survival. Importing paper and pulp from foreign players while domestic players are suffering losses lead to distortion in competition.

Interestingly, the Indian government regards the paper industry as one of the 25 high priority industries in the country. It is, therefore, suggested that the government must impose protectionist measures, such as imposing anti-dumping duties on China, imposition of additional duties as lawful measures to protect as well as promote interests of local manufacturers. The government could also encourage participation from local manufacturers thereby keeping a check on supply of paper by foreign entities to India. Such a preferential treatment would help the indigenous producers compete in the domestic market, hence, boosting investment into the sector.

C. Miscellaneous Reforms

6. Medical devices: the struggle to thrive in India

In India, the pharmaceutical sector imports over 70 percent of the estimated ₹30,000-crore med-tech sector. There is a need to introduce a caveat that certain products have to be domestically manufactured, which would eventually lower the expenditure borne by consumers. Domestic manufacturers also deal with an inverted duty structure which defeats the 'Make in India' sentiment.

The India pharma sector is at a nascent stage and lacks recognition. Therefore, certain technologically advanced high-risk devices such as cardiac defibrillators or dialysis machines are imported. An appropriate regulatory framework would help companies move from import towards manufacturing in India. The government needs to have a "Buy India" policy to ensure that companies manufacture in India.

www.thehindubusinessline.com/features/pulse/medical-devices-the-struggle-to-thrive-in-india/article6815786.ece

Food for Thought

The ambitious Modi government introduced 'Make in India' campaign to encourage domestic manufacturing of products. Conversely, the pharma sector has been ignored during the budget released in February, 2015. There was clear reduction of budget allocation for health sector. Even inverse duty structure which dampens manufacturing in this sector was not eliminated despite representations. To make the situation worse for the domestic industry, there were no specific initiatives proposed by the government to promote research and development (R&D) in the Medical Devices and Pharmaceuticals segment. Lack of support from government has made the condition worse for medical device manufacturers operating within India.

Surprisingly, India heavily relies on foreign imports, i.e., around 70 percent of its medical devices and equipments are outsourced from other countries, such as the US. The numbers depict an attractive market opportunity for global medical device manufacturers. However, the government has failed to tap the potential of home grown manufacturers in the pharma market, which clearly shows biases by facilitating foreign investments. The government has failed to put regulatory supervision or introduce policies to encourage participation from the domestic players to invest in this sector. This would eventually distort healthy competition in the relevant market. Ultimately, lack of support from the government might lead to dominance by foreign firms.

7. Foreign Firms Producing in India May Get to Sell Online

Foreign investors setting up manufacturing facilities in India would be able to access the country's rapidly growing online market in order to raise the share of manufacturing in the country's gross domestic product (GDP). The proposal came eight months after it was announced in July 2014.

This would also attract overseas capital into the languishing manufacturing sector. It would also encourage Indian brand manufacturing entities such as Fabindia to expand to online platforms while making the sector lucrative for foreign investment. To ensure consistency in policy and prevent tax issues later, the government defined manufacturing as mentioned in the income tax law.

http://articles.economictimes.indiatimes.com/2015-03-14/news/60111624_1_cabinet-note-foreign-investment-dipp

Food for Thought

The government has made a constructive attempt to attract foreign firms to invest in India. As per the proposal, foreign investors that are willing to access the country's rapidly growing online market have to establish manufacturing facilities in the Indian domain. Foreign companies would be very much interested to invest in multiple sectors and take benefit of the online platforms as well. Opening the market for foreign players would bring huge investments into the India's economy.

Currently, the Indian online markets are at its peak, and indigenous companies such as Micromax, Flipkart, etc., that enjoy 100 percent Indian labor are quite hopeful to see a new dawn. Even for companies like Fabindia, such a move would act as an advantage as they are already making around 80 percent products of their own. Further, to keep things transparent, the term 'manufacture' has been defined as given under the Indian Income Tax Act.

This move by the government would also give a boost to the Indian companies that produce their goods domestically. Surely, it would enhance healthy competition among companies, leading to production of better quality products at an affordable price. The government through such an initiative has encouraged both domestic as well as foreign companies to fairly participate, thereby helping the market to develop and expand.

To conclude, such an initiative by the present government would allow home-grown companies such as FabIndia who are either into manufacturing or in retail business and willing to make their online presence. This would also attract several companies that are not heading towards China to choose India as their platform to produce goods and services due to the huge market base, cheap labour and low transportation cost. It is also suggested that domestic entities and foreign entities could work together through several arrangements which would develop the present online market in India.

8. India needs to become competitive in infrastructure, tax policy: Jaitley

The government has been emphasising on easing the entry barriers for global corporations to participate and invest in India's economy. The Finance Minister Arun Jaitley on similar lines has also stressed on relaxing norms to make India globally competitive, attracting multinational corporations towards promoting growth in the country. High economic growth is necessary to create jobs thereby raising resources of the government to eradicate poverty.

India aspires to become a profitable economy where the revenues of the government are so large that it can actually bring up the standard of living of poor.

<http://economictimes.indiatimes.com/news/economy/policy/india-needs-to-become-competitive-in-infrastaructure-tax-policy-fm-arun-jaitley/articleshow/46646174.cms>

Food for Thought

The current government is making efforts to reform India's economic environment to attract investment. For the same reason, Jaitley has advocated the need to ease entry barriers for global entities by relaxing policies, taking mature political decisions, better process emancipating accurate results and providing transparency. The Budget (2015-16), presented by him, also emphasised on the welfare of labour, agricultural productivity and increasing farm incomes, power, digital connectivity, skilling our youth, efficient and better work culture in the government.

This would also liberalise the market and encourage global corporations to participate in various sectors, ensuring a competitive market. This would eventually lead to high economic

growth. Such efforts to attract more overseas capital would play a significant role by reducing the levels of poverty in the country through boosting employment opportunities. Increase in investments would benefit states to improve the standard of living of the poor. Foreign investments in sectors such as processing, retail and manufacturing (labour intensive) would certainly have a positive impact on the growth of India's economy. Such capital can be utilised to uplift the remorse state of poverty in the country.

The economy is likely to grow at 7.4 percent in the current financial year and is expected to accelerate to 8-8.5 percent in the next financial year. The former National Democratic Alliance government had relaxed foreign investment norms in various sectors including insurance and defence. The present government has also been active and passed the Insurance Bill and raising the foreign investment limit in the Insurance sector to 49 percent.

To conclude, such measures would depict India as an ideal market and expect high returns from the point of investment. The government has to take further steps, such as reducing tax policies, simple procedures to encourage foreign firms to not only invest for one-time purpose, but also grow in India and help achieve double digit economic growth.

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