Competition Distortions in India – A Dossier

(CDI-10: October-December 2010)

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 10th volume of the CUTS Competition Distortions Dossier that we are producing to report and comment on policy induced competition distortions and benefits in India, as highlighted in the print media. From now on, we will produce it as a quarterly.

The highlight of this edition is the Bimal Jalan Committee report on governance and ownership issues of exchanges and other market infrastructure institutions (MIIs) in India, which has faced widespread opposition for dampening competition. As expected, this report has given rise to a heated debate and stakeholders are demanding to revamp this report altogether. Considering the upheaval brought by this report and its possible adverse affects on competition we have covered it in this dossier and have also provided a brief analysis. But the jury is still out.

We have always taken a view that competition is the best restorative force in the market which, eventually, ensures consumers' welfare. Although fixing or capping prices of commodities ensures reasonable prices, it impedes market growth and innovation in the long run which are otherwise ensured if prices are regulated by competition. This phenomenon is exemplified by the story on Pharma sector which is also covered here.

Other issues, which feature in this dossier, for their deleterious impacts on competition include government tenders for procurement which suit only foreign suppliers, opposition of existing banks to RBI for issuing licences for new banks, purchase of water pumps only from two suppliers instead of through competitive bidding, etc.

We also seek your assistance in bringing to our notice such practices of government, not covered in media, which compromise on competition, so that it can be covered in this quarterly Dossier.

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Acts by government resulting into competition distortion

There are certain practices of government which compromise competition in the market on a relatively small level. Take for example the case when government organises meetings, seminars etc. and the participants are directed to use the services of national carrier only, otherwise no reimbursement is made for transportation. Another example pointing the same concern when one is required to send mails to government departments using the government postal services only.

Although, affect of such practices on competition is very small, such acts reflect government's poor understanding on competition and its resolve to ensure the same. Various arguments have been given to justify such practices, but it has to be seen if they stand pragmatic scrutiny.

There must be other practices also which distort competition in this fashion. We request our readers to bring to our notice such practices and also opine on their positive and negative aspects.

A. Trade Issues

1. Raising the bar for new stock exchanges

A committee of experts under the chairmanship of former Reserve Bank of India (RBI) Governor Bimal Jalan and comprising seasoned capital market and finance professionals was asked to review the ownership and working of market infrastructure institutions.

Its report, submitted to the Securities and Exchange Board of India (SEBI) recently, effectively raises the bar for existing institutions and prospective entrants. SEBI has invited comments until December 31, 2010 from the public.

…There have been plans by newer players to start an exchange. An attempt by MCX, a commodities exchange, to start a stock exchange has been thwarted by the regulator. If the panel's recommendations are accepted, the doors will be practically shut for many new parties.

The committee report has, as its core recommendation, the provision that only banks, insurance companies and domestic public financial institutions with a net worth of ₹1,000 crore be anchor investors in a stock exchange, a position analogous to but not identical with promoters. The panel wants a widespread dispersal of shareholding in a stock exchange.

…The implications are: (1) based on the committee's report there will not be a rush for starting new exchanges. The bar has been set high and the returns capped; and (2) the report realises that there will not be an increase in competition.

…Anticipating criticism that its report will not help foster competition, the committee has suggested that market infrastructure institutions should reduce charges and pass on the benefits to all their users.

http://www.hindu.com/2010/12/06/stories/2010120658561600.htm

http://economictimes.indiatimes.com/opinion/editorial/Wrong-Mr-Jalan/articleshow/7007247.cms

http://www.peerpower.com/et/3149/Welcome-clarification

http://www.livemint.com/2010/12/21224050/Jalan-panel-report-sparks-off.html#

http://www.thehindubusinessline.com/2010/12/28/stories/2010122851551100.htm

Food for Thought

The report has caused huge furor in the country as its recommendations can thwart competition and growth in the area of market infrastructure institutions. Some of its suggestions are also quite odd which can take back the country to the pre-reform days and one wonders how these have emanated at all. Such thinking process can also spill over into other domains which can be quite retarding to our economic development.

However, a survey has shown that large number of small investors is wary of stock exchanges becoming private enterprises. They are more comfortable with stock exchanges being widely publicly owned bodies which can function with the larger public interest in mind.

However, the issue is being debated heavily even as we write this Dossier and the jury is still out. In the end, one hopes that better sense will prevail.

2. Banks' commission from govt business set to rise

Commissions earned by banks on government business are likely to rise with the RBI setting up a committee to review the existing payment structure.

…Bankers have made a case for increasing the commission to 15 paise per ₹100 for payments other than pension and to ₹100 per transaction in case of pension.

The country's largest lender, State Bank of India (SBI), has the major share in government business. As on March 31, SBI handled 58.8 percent of the Central Government's aggregate payments and receipts and 65.1 percent of the state governments' aggregate payments and receipts.

…Recently, the central bank asked state governments not to put their moneys in private sector banks. The wide network of state-run banks, especially in rural and semi urban areas, was seen as an effective means to carry out government transactions.

http://business-standard.com/india/news/banks%5C-commissiongovt-business-set-to-rise/410439/

Food for Thought

Raising the commissions earned by the banks on government business on one hand, and on the other barring the private banks to engage in business with government entities is utterly distortive of competition in the banking sector. It seems RBI's move intends to benefit public sector banks which lag behind in terms of quality of services offered. For example, the tax money that took two to three weeks to reach government coffers became possible in a few days with the entry of private banks. In electronic payments, funds are transmitted within a day. Earlier, banks charged more than 11 paise for transferring every ₹100 of tax collected and this dropped to a flat rate of ₹45 per challan.

CUTS had reported this issue of directing states to stop new business to private banks in its previous dossier. For more detailed discussion on this issue, please refer to the following link:

http://www.cuts-ccier.org/pdf/CDIDossier-Aug-Sep10.pdf

3. Dept adds riders, restricts new firms in medicine tender

Bending the rules governing procurement of medicines, the Directorate of Ayurveda in Ajmer, Rajasthan has added riders in its recent tender call to buy medicine worth ₹5 crore for state run hospitals. The move, it seems, was made to benefit a handful of companies, official sources indicate.

…Official sources say that though the purchase committee had decided to invite public sector undertakings (PSUs) and cooperatives, with Good Manufacturing Practices (GMP) compliance, for the purchase bid, later, in its advertisement it inserted a condition that the manufacturer must have a five-year experience, a condition which was not mentioned in the letter received from the Union Ministry of Ayurveda.

Of the existing PSUs and cooperatives that manufacture ayurvedic medicines, only eight have an experience of five years and more. Also, operations of most of these companies are managed by the same set of people. "The move is an attempt to prevent new players from entering the fray, the officials have colluded with them (manufacturers) to block new entrants by adding erroneous riders", an official source said.

…It must be noted that the government plans to procure ayurvedic medicines worth ₹14 crore in the second phase.

Daily News and Analysis, 25.09.10

Food for Thought

Imposing the condition that manufacturers must have five years of experience by Directorate of Ayurveda dampens competition, for this is in the nature of entry barrier.

The probable argument that this condition has been imposed to ensure the quality of medicines does not stand the scrutiny, as initially the purchase committee had decided to invite PSUs and cooperatives, with GMP compliance.

GMP is a set of norms to be followed by pharmaceutical manufacturers to ensure quality and safety of the drug products. India has been following GMP since 2005.

4. Govt imposes definitive dumping duty on polypropylene imports

The Finance Ministry has imposed definitive anti-dumping duty on polypropylene imports from Oman, Saudi Arabia and Singapore.

This duty would be valid for period of five years from July 30, 2009, the date of imposition of provisional anti-dumping duty, according to the Revenue Department.

…The petition seeking anti-dumping duty on polypropylene imports from Oman, Saudi Arabia and Singapore was filed by Reliance Industries Ltd (RIL). The other domestic producer, Haldia Petrochemical Corporation Ltd (HPCL), had supported the petition.
http://www.thehindubusinessline.com/2010/11/24/stories/2010112451850400.htm

Food for Thought

As we have maintained earlier, the case of levy of anti-dumping duty should be reviewed carefully because the sole justifiable motive behind anti-dumping duty is prevention of injury to domestic manufacturers through predatory pricing. Thus, imposition of anti-dumping duty is actually needed to promote competition in the long run.

If it is established that polypropylene products are being dumped, which means that either their selling price in Indian market are less than the manufacturing cost or the cost in the exporters' home market or the cost in the third market, then imposition of duty is valid. However, material injury to domestic producers needs to be established.

But, if there is no actual dumping occurring, then imposition of duty would be a means to insulate domestic produces from foreign competition and artificially raise the costs to consumers in India. Therefore, research needs to be conducted into whether dumping is actually taking place.

The other important aspect of such actions is that the complaint is brought forward by oligopolists who control the domestic market and are therefore wary of fighting price competition from abroad. In this case, Reliance has 70 percent share of the market while Haldia Petrochem has 15 percent market share with another six players sharing the balance 15 percent share of the market.

5. Price Control Won't Help Indian Pharma Industry

Pharma major Dr Reddy's Laboratories has opposed the Parliamentary Standing Committee recommendations on increasing the number of drugs under price control and cap on profit margins of all medicines.

"Price controls in the long run will never serve the purpose of the Indian Pharma industry", said K Satish Reddy, Managing Director, Dr Reddy's Laboratories.

The Parliamentary Standing Committee on Health & Family Welfare, in its report, suggested a series of measures like increasing the number of drugs under price control, a blanket cap on profit margins of all medicines and promoting the use of generic drugs to make it more affordable and accessible to the common man.

…"When there is so much of competition, when there are so many brands available, there is so much choice available at this point of time that has brought the prices down. So where is the need for government to step in again to say that when the prices have gone down that they still further control the prices by taking a cost plus model which is where the issue is", he said.

Reddy said it requires a lot of investment in drug research and the industry has to invest on their own as there is no government support.
http://news.outlookindia.com/item.aspx?694567

http://www.financialexpress.com/news/india-is-the-only-nation-to-adopt-costbased-price-control-system/175543/1

Food for Thought

Markets function best when the prices are left to the market, where free and fair competition prevails, instead of fixing them by government regulations. Fixing prices, though ensures affordability but at the same time discourages innovation.

India is globally recognised as the generic capital of the world for its high quality affordable drugs. To sustain this position and further grow research in this field pharma companies need huge investment. Thus, to cap the prices of drugs will cut down profits and thereby reduce availability of finance and discourage investment in research.

Also, it has been observed that drugs under price control either vanish from the companies' list or are sub-contracted. Reduction in prices by the regulator forces players to exit production resulting in the government with no choice but to depend on expensive imports. Similarly, drugs related to dreaded diseases such as TB and Malaria are no longer on the manufacturing radar of established players. Growth of counterfeits and seizures of sub-standard anti-TB products are result of such un-remunerative schemes.

On the other hand, it is evident that such a move by the government has been propelled by the public interest argument. The World Health Organisation (WHO) reported that one third of the world's population lacks reliable access to required medicines and the situation is even worse in developing countries, which are finding it increasingly difficult to finance medicines as expenditure on medicines has been growing steadily.

Therefore, through research it needs to be assessed as to what is the net result of fixing the prices of medicines, by weighing its negative affects on competition and medicinal research against its positive affects by ensuring easy affordability.

6. DoT tried to reverse TRAI's spectrum priority queue

The telecom department has controversially attempted to reverse recommendations by the Telecom Regulatory Authority of India (TRAI) and place new entrants like Tata DoCoMo and Uninor, which are yet to receive start-up airwaves in many circles, first in the queue for airwaves.

TRAI had recommended that these companies be placed last in the queue in the priority for awarding airwaves. Spectrum is the airwaves on which all mobile communications travel and is the lifeline for mobile phone companies.

…Besides, existing procedures also state that the Department of Telecom (DoT) must refer the issue back to TRAI if it wants to make changes to regulator’s recommendations. The DoT move to reverse spectrum allocation queue to favour some companies comes at a time when the Centre has asked the Empowered Group of Ministers (EGoM) headed by the Finance Minister Pranab Mukherjee to took into TRAI’s recommendations on sweeping policy changes in the sector.

Earlier in 2010, TRAI proposed that the 4.4 MHz of start-up spectrum that new entrants hold be enhanced to 6.2 MHz for no additional cost, while adding that these players would be placed first in the priority for 2G spectrum allocation.
http://economictimes.indiatimes.com/news/news-by-industry/telecom/DoT-tried-to-reverse-TRAIs-spectrum-priority-queue/articleshow/6727166.cms

Food for Thought

The proposed step by DoT to allocate spectrum out of turn to new entrants like Tata DoCoMo and Uninor, is unfair. Other players in the telecom field such as Bharti, Vodafone, Idea etc. are awaiting additional frequencies for close to two years. In such a scenario, to pick up a few companies over others will effect healthy competition and the DoT should proceed on an equitable basis.

As it is the whole issue is under heavy debate in the country for the scandal of allocating spectrum for 2G licences in an arbitrary manner. The Comptroller and Auditor General (CAG) has estimated the losses to the treasury as exceeding ₹1.76 lakh crores.

B. Other Issues

1. Banks oppose granting new licences to business houses

Banks have opposed the idea of corporate houses being given banking licences due to “unsatisfactory past experiences”.

In their feedback to the RBI’s discussion paper on new licences in August, banks said it would also create an uneven playing field due to the large capital buffer that would be available to banks sponsored by industrial or business houses.

Banks do not in favour non-banking finance companies (NBFCs) promoted by industrial houses entering the banking sector, either. “Banks were in favour of allowing only standalone NBFCs to promote banks and, at the same time, barring NBFCs sponsored by industrial/business houses”, RBI stated in the summary of comments it has received.

http://www.business-standard.com/india/news/banks-oppose-granting-new-licences-to-business-houses/419414/

http://www.thehindubusinessline.com/2010/12/24/stories/2010122454210600.htm

Food for Thought

Entry of new banks in the banking sector will promote competition. Also, with their huge capital and managerial talent industrial/business houses can lead to higher scale of operations thus ensuring better outreach and services.

On the other hand, combining banking and commerce implies that there would be a lot of connected lending, as we had seen in the past. The ownership structure of large industrial groups may open opportunities for regulatory arbitrage. In cases where the apex entity of a financial conglomerate is an unregulated entity, there could be gaps in risk assessment and supervision.

Therefore, systemic risks involved in allowing industrial/business houses in banking sector can be assessed and measures to curb the same be devised through appropriate regulation which can create arms length relationships between the owners and management or through diffused ownership because any expansion in banking sector will help promote competition.

2. National permit system for trucks breaks down

Within eight months of its introduction, the new national permit system for trucks and goods carriers has run into rough weather in north-eastern states, Punjab and Jammu & Kashmir with the six state governments refusing to implement it unless given additional grants for computerisation and other research and development initiatives required.

… All the states had agreed to switch to the new system in April this year. Under the new permit system, truckers have to pay a one-time fee of ₹15,000 which allows them to operate all over the country without paying each time they enter a state. Each state has to maintain a record of how many permits they have issued and upload this data on the national system, which is linked to the state register. The consolidated fee collected is distributed amongst the states as per the average share of remittance received over the last three years. So far, the truckers had been paying ₹5,000 to the home state for a license permit and another ₹15,000 for permission to operate in three other states.

http://lite.epaper.timesofindia.com/getpage.aspx?articles=yes&pageid=2&max=true&articleid=Ar00202&sectid=1edid=&edlabel=ETBG&mydateHid=10-12-2010&pubname=Economic+Times+-+Bangalore+-+Political+Theatre&title=National+permit+system+for+trucks+breakdowns&edname=&publabel=ET

Food for Thought

One time payment of ₹15,000 for transport permit will not only ensure seamless and cheaper transportation across the states but also promote competition by encouraging new players in the transportation market and conservation of fuel if trucks need not stop at border check posts unnecessarily. At present, the requirement to take multiple transport permits serves as a regulatory barrier, increases economic and environmental costs and hinders growth of this sector. Thus, the need is to ensure that this provision is uniformly implemented by all the states at the earliest.

3. Bonanza for whom?

The Tamil Nadu government, in October 2010, declared that farmers would be given motor pump-sets for irrigation, free of cost. The farmer will have to buy a pump-set with a four-star energy saving rating and the cost will be reimbursed by the electricity board, provided he had registered for supply of free power. However, the catch is that the pump-sets have to be bought only from two specified companies.

Rues a farmer: "A pump-set with four-star energy saving rating costs ₹6,000-8,000, but the ones specified by the electricity board officials cost more than double that".
http://www.thehindubusinessline.com/2010/11/29/stories/2010112950490900.htm

Food for Thought

Tamil Nadu government's directive to purchase the pump-sets only from two specified companies is anti-competitive and irregular. This directive not only impedes the market process but also result in huge financial losses to the government, as the pump-sets are available at half prices in the market. The right course of procuring the properly rated pumps by farmers would have been through non-payment of subsidies if the same did not comply with the standards.

4. CPI raises danger of foreign software in strategic sectors

The Communist Party of India has urged the government to look into the reported irregularities in the award of contracts in defence, energy and communications, through tenders with specifications designed to suit foreign companies.

"The tendering specifications too, smack of corruption, and are designed in a manner that only foreign software products qualify for the bidding process. Even if Indian IT (Information Technology) companies and system integrators are allowed to bid, the tender specifications are designed in such a way that these companies need to import software manufactured by foreign companies and supply it to the government and public sector organisations", CPI Parliamentary party leader Gurudas Dasgupta said in a letter to Prime Minister Manmohan Singh.

Citing three instances, a high security project for computerised maintenance of Indian Air Force aircraft and other equipment; Enterprise Resource Planning (ERP) software for Coal India and Department of Posts, he said the consequences of having data and security of the public sector, defence and other government establishments relying on foreign software, could be alarming especially since source code and intellectual property rights of these products remain with the foreign vendors.

http://www.hindu.com/2010/12/20/stories/2010122055740200.htm

http://m.economictimes.com/PDAET/articleshow/7175250.cms

http://www.thehindubusinessline.com/2010/12/28/stories/2010122851551100.htm

Food for Thought

Technical specifications in tenders if deliberately included to suit only particular (foreign) suppliers not only smack of corruption (as alleged by CPI) but also curbs competition from other (domestic) IT companies.

The allegation that the tender favoured foreign firms by giving "highest score" to companies with maximum turnover and profit, and maximum number of customers is a serious one. Such criterions, prima facie, thwart competition from smaller (which can be mostly domestic) but efficient companies. Also, there seem to be no off-setting benefits, as domestic IT companies despite having limited reach can offer equally efficient or even better products that too on cheaper rates.

Further, foreign IT companies catering to defence forces such as Air force and Navy may also jeopardise our strategic interests. The right course, for the government, should be to promote research and development to build the capacity of the domestic IT companies; this will ensure long term benefits in terms of their competitiveness vis-à-vis foreign suppliers and will also protect our strategic interests.

Therefore, through scrutiny of terms and conditions of the tenders, it needs to be evaluated if there were any reasons to make imports favourable from foreign firms which could off set aforementioned negative repercussions.

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