# Competition Distortions in India – A Dossier

**(CDI-14: October-December 2011)**

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.**

Herewith please find the CUTS Competition Distortions Dossier #14 which carries several policies pertaining to trade policies, procurement policies and several others that have the potential to limit market competition. The Dossier also illustrates the impact of effective competition witnessed in the recent cuts in petrol prices induced by a fear of competition from rivals.

The dossier covers issues pertaining to restrictive import policies harming the granite industry as well as the potential adverse impact on consumers and foreign players of the continued antidumping duty on caustic soda.

Furthermore, the dossier narrates specific instances of distortion of the competitive neutrality principle (in the coal and railways sector) that forms one of the founding principles of the forthcoming National Competition Policy of India. The Minister for Corporate Affairs, Dr Veerappa Moily has recently announced that the Policy will be adopted by March 2012.

CUTS has spearheaded the adoption of a National Competition Policy since 2005 and actively participated in the policy discourse. We are grateful to everyone in the government who have heeded our calls as well as involved us in the preparation of the Policy as we eagerly await its adoption this year.

Competitive neutrality may be distorted through many policies in the way they are formulated or in the manner that they are implemented that advantages the public sector over the private players. As OECD reports have pointed out, "when there are no mechanisms in place to promote and guarantee competitive neutrality, most SOEs enjoy unearned competitive advantages."

Among other issues, the dossier also highlights the need to provide a regulatory framework to address the anticompetitive impact of grant of state aids and subsidies as flagged by Dr Joseph Wilson, Member, Competition Commission of Pakistan.

Quite recently, Ashok Chawla, Chairman, Competition Commission of India has questioned the huge bail out aid to Air India but not to the bleeding private airlines, which is possibly a competition distortion.

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## A. Gains from Effective Competition

### 1. Petrol price cut was partly due to threat from pvt cos

Competition has finally arrived in the retailing of petrol. The recent price cut by state-owned IOC, HPCL and BPCL was prompted partly by fears that private refiners Reliance Industries and Essar Oil might step up retailing of petrol if the deregulated commodity is sold in the local market above international prices.

Although petrol has been deregulated last June, state-owned companies hesitated from raising prices in line with global prices before assembly polls in five states earlier in 2011.

The retailers' decision to revise petrol price frequently and not to carry forward profits or losses even by a fortnight is set to encourage private refiners to step up retailing operations, industry sources said....

www.financialexpress.com/news/petrol-price-cut-was-partly-due-to-threat-from-pvt-cos/877279/4

**Food for Thought**

*The recent fall of the global oil prices has helped in promoting competition in the retailing of petrol in India.*

*The price cut by the state-owned petrol retailers is the result of pressure they were facing from their private sector rivals. This could not have been possible without the fear of being undercut by private players as the public sector retailers were reportedly planning to use the fall in global oil prices to recoup old losses instead of passing the benefits onto the consumers through lowered prices. However, private players who were all set to increase their market shares by selling oil at cheaper prices managed to successfully exercise a competitive constraint on the public sector retailers who then had to comply with the price cuts as well.*

*This case illustrates well how threat of competition from rivals can yield positive outcomes and achieve consumer welfare. Despite deregulation of petrol prices, the government has often held back the price rise of petrol for gaining political mileage which has acted as a huge disincentive for the public sector and an entry barrier for the private sector players in the petrol market. This anticompetitive environment has never allowed private companies like Reliance Industries, Shell and Essar Oil to grow along with state-owned units as they certainly cannot continue with the loss making business for too long.*

*The present situation in which the retailers have decided to revise the prices of petrol according to the market condition and not to carry forward profits or losses even by a fortnight will definitely boast the morale of the private retailers to increase their business and enhance competition in the market through free and fair market process.*

## B. Distortion of Competitive Neutrality Principle

### 1. 'State aid/bailouts as subsidies harmful for competition in economy'

Dr Joseph Wilson, Member, Competition Commission of Pakistan (CCP) shared an interesting experience with the heads of the competition agencies that the use of state aid/bailouts as government subsidies for the public sector entities is harmful for competition in the economy.

Dr Wilson further informed that at present there is no specific provision dealing with State Aid within the Competition Law of Pakistan.

The bailouts/state aids while seems to be preserving employment and keep afloat a single entity, it, in effect, distorts competition in the industry of the aid recipient thereby affecting the whole industry and preventing it from growing.

www.brecorder.com/business-a-economy/single/672/189/1257429/

**Food for Thought**

*Giving the example of Pakistan, Joseph Wilson, Member, CCP has adroitly brought attention to the anticompetitive impact of state aids and subsidies on any economy and rued that their competition law does not cover this distortion.*

*State aid and subsidies promote productive inefficiency and go against the interests of the industry that competition process seeks to protect and promote. This is the reason why EU recognises the need to regulate state aid within its competition law regime, and also to promote a seamless internal market.*

*Studies have also been carried out in countries like South Korea and Mexico to analyse the effect of aid on various industries which clearly shows that productivity growth in industrial sectors targeted by state aid has been poor compared to productivity growth in untargeted sectors.*

*Further, the act of granting aid to few selected public sector units with a public policy objective is against the principle of competitive neutrality and disincentivises the private sector players.*

*It is, therefore, necessary to carefully monitor wasteful state aids and subsidies which can be a big menace to a country's economic governance regime.*

*India is fraught with examples of distortion of competitive neutrality and wasteful subsidies and bail out packages. It is time we looked into a regulation of such grants as well. One way forward is through the proposed National Competition Policy, which is expected to be adopted by the government in March 2012.*

**2. Coal India's monopoly has to go**

Coal supplies 55 percent of India's primary energy and coal-fired power plants produce 80 percent of our electricity. Yet year after year, paucity of coal results in blackouts and unscheduled power-cuts, holding back valuable industrial and agricultural production.

Far-reaching policy changes, needed to augment domestic coal availability, are being pushed under the carpet. There has been little attempt to revisit policies or the legal framework governing coal.

Allowing Coal India Ltd. (CIL) to set the price of coal and issuing notices for resuming captive coal blocks not commencing production are as far as policy interventions go. Clearly, the need is to significantly enlarge the quantum of coal mined.

The amended law, as a first measure, should provide for awarding of new mines for exploration and mining through competitive bidding. In this exercise, both public sector undertakings (PSUs) and private companies should be allowed to participate. Separately, regulations would need to be changed to permit foreign direct investment (FDI) in the coal sector.

www.financialexpress.com/news/column-coal-indias-monopoly-has-to-go/878332/7

**Food for Thought**

*Given the size of Indian economy and the pace with which it is growing, the demand for coal is expected to increase significantly in the years to come. This builds a case for increasing the supply of coal (through enhanced output) to match the burgeoning demand.*

*At present, CIL and its associated companies enjoy a monopoly over the production of coal in India. It has, for 38 years, enjoyed protection from competition. But the lack of competition in this sector has been seen to serve as a bane in previous years as CIL has not been able to increase its output which has led to the ever widening gap between demand and supply.*

*CIL's inability to increase the output of coal underlines the need to introduce competition in a grossly imperfect market structure fraught with severe monopoly power. To start with, the government should try to award new mines for exploration and mining through competitive bidding in which both PSUs and private companies should be allowed to participate. Government could also think about allowing FDI in coal industry which will further enhance competition in this sector. Inspiration can be drawn from the practice followed in oil and gas industry which has paid rich dividends to the country. Similar approach in the coal industry is highly recommended to overcome the present distortions of competitive neutrality principle and ensure a level playing field for private players' vis-à-vis the state-owned companies in coal industry.*

**3. Power ministry seeks withdrawal of import duty on coal**

The ministries of power and finance are likely to lock horns over a proposal to withdraw customs duty on imported coal. Apprehensive that the North Block may not be keen to entertain a proposal which entails revenue loss for the exchequer, the Power Ministry has moved to secure support of the Planning Commission on the issue.

"Global coal prices have shot up in the recent past by 35-40 percent and further, imposition of five percent customs duty has led to a steep rise in the cost of generation for imported coal based power plants, thereby making such plants commercially unviable."

The Power Secretary has cited shortfalls in coal availability from domestic sources to buttress his ministry stand on the issue.

www.financialexpress.com/news/power-min-seeks-withdrawal-of-import-duty-on-coal/878297/0

**Food for Thought**

*Power and Finance ministries are holding their position very firmly over the issue of withdrawal of customs duty on imported coal. None of them are ready to step back as both the parties want to protect their turfs.*

*The Finance Ministry is not at all in favour of removal of the customs duty on imported coal as it may lead to revenue losses. On the other hand, it is a dire situation for Power Ministry because sky rocketing international coal prices have started to make many power projects commercially unviable. An extra five percent customs duty on the imported coal is only adding insult to injury.*

*The current scenario is aggravated by the inadequate supply of coal from domestic sources. This has left coal based power plants with no other choice but to depend upon imported coal in order to continue with the production. Given the fact that electricity is one of the public goods, increase in the fuel cost cannot be passed on to consumers. This makes the situation much tougher for the power plants to survive.*

*The whole situation further strengthens the issue of lack of competition in the domestic coal market. CIL is enjoying monopoly over coal industry over the past many years, which has not allowed the domestic coal market to achieve its full potential causing enhanced import reliance for coal by the Indian power sector.*

*As mentioned before as well, it is time to infuse competition in the coal sector. Allowing private companies to gain an entry into the coal market would help, to say the least as well as help with the growing dependence on foreign markets for coal procurement.*

## C. Procurement Policy Related Competition Distortions

### 1. COFMOW (Indian Railways)

*(This is not a news item but an advertisement)*
Bid Invitation Notice No. OPB-400 Dated: 25.11.2011
Bids are invited on behalf of the President of India from experienced Indian Manufacturers or their Authorised Agents for supply of the following Machines:

**Bidder will be required to:**

1) Furnish a bid guarantee for the amount specified above for each tender. Any tender not accompanied by earnest money in one in one of the approved form given in clause 0601 of section-1 of Bid Document Part-1 shall be summarily rejected or seek exemption under clause 0609 of section1 of Bid Document Part1.
2) Keep their offers open for 180 days from the date of opening of bids.
3) Furnish contract Performance Guarantee Bonds for 10 percent of the contact value in the event of a contract being awarded to them. NSIC regd. Firms seeking exemption from PG Bond for items & up to monetary limit of their registration with NSIC should submit necessary documentary proof. NSIC registered firm should submit the PG bond if the monetary limit is less than the tender value.

**NOTE**: As per Ministry of Heavy Industries And Public Enterprises, Government of India's Office Memorandum dated 21.11.2007, there will not be Purchase preference for products and services of CPSE's w.e.f. 31.03.2008 except for preferential purchase policies framed for specific sectors, separately.

**Food For Thought**

*Despite extensive liberalisation, state-owned enterprises are still a significant force in India and receive preferences that might restrict competition by the private sector (as also apparent in some of the other stories reported in previous sections).*

*The note to the above tender is self-contradictory as it discourages purchase preference for products and services, but continues to conserve such policies framed for specific sectors separately. Furthermore, it implies that the purchase preference policies will continue which raises competition concerns in the bidding process.*

*Let us not forget that the purchase preference policies implemented in favour of central PSUs which were extended for three more years in 2005 had the effect of discriminating against the private sector players. Under the policy, Central PSUs could enjoy purchase preference if the price quoted by it fell within 10 percent of the lowest bidder's quote. Fortunately the policy was terminated by the government in 2008 and not extended further as before in an effort to create a level-playing field between private and state-run companies. The recent trend seems to be going back to ignoring the lessons learnt from previous mistakes that preference policies distort competitive neutrality and need to be completely abandoned to the best extent possible.*

## D. Trade Policy Induced Market Barriers

### 1. Anti-dumping duty on caustic soda imports

In a major blow to the Manufacturing Industry, the Finance Ministry has imposed an antidumping duty on the use of caustic soda till 2013.

The duty will be levied on all imports originating from Saudi Arabia, Korea and the US. While the notification issued by the antidumping directorate has not spelt out the duty amount, it has clarified that it would be based on the reference rate which is around US$400 and landed cost of the commodity.

Companies such as Hindustan Unilever, Procter & Gamble Hygiene and Health Care, Colgate-Palmolive, Godrej Consumers Products, Nirma, Reckitt Benckiser and Henkel SPIC (India) Ltd are some of the major consumers of caustic soda, besides the paper industry, textiles and pharma sector.

The decision of the Union Finance Ministry to impose an antidumping duty on imports of caustic soda, have failed to impress the domestic industry.

Despite representations by domestic soap makers, including Hindustan Unilever, that their requirements are not met by supplies from domestic companies and they have to resort to imports, the antidumping directorate has advocated that the duty is required to provide level-playing field for domestic manufacturers *vis-a-vis* imports.

www.business-standard.com/india/news/anti-dumping-dutycaustic-soda-imports/452680/

**Food for Thought**

*The World Trade Organisation (WTO) agreements prescribe remedial measures such as duties of antidumping and safeguards, which are often seen to have a protectionist flavour and are used to boost domestic industries even though they are necessary tools to deal with unfair competition and alleviate the suffering of domestic industries at the hands of foreign competitors. While in the shorter term, they may be useful to prevent foreign players from capturing the market, in the longer run, some of these actions may hinder competition by creating barriers to entry and also promote inefficiencies.*

*Recently, there have been many debates about the increasing use of antidumping regulations as an anticompetitive tool. For starters, there is always a potential for misuse of such measures by powerful domestic players who may deliberately use this to block entry by foreign competitors for fear of losing their own market share.*

*Caustic soda is a major chemical ingredient and domestic manufacturers have been suppressing a price rise for some time, since import was cheap. Now with this antidumping duty, it is apprehended that chemical manufacturers can increase prices which could trigger a price rise of its end products. According to industry insiders, companies that are dependent on imported caustic soda may have to shell out more. Domestic supplies of caustic soda may also get costlier. In the past one week, caustic soda prices have jumped by Rs 3,000 to Rs 4,000 per tonne.*

*The duties were levied after a sunset review by the antidumping directorate of a duty which expired in 2008. The sunset review obligation under WTO commitments require that all antidumping orders be terminated for five years after their initiation unless the importing country government makes a determination that revocation would lead to renewed dumping and material injury to the domestic industry.*

*If material injury is established along with incontrovertible facts of the exporters selling below the cost, duties are justified. If not, then imposition of duty would be a deliberative means to insulate domestic producers from foreign competition and artificially raise the costs to consumers.*

### 2. Import restrictions, Chinese dominance hurting granite sector

Granite industry in India has been severely impacted by restrictive import policy on natural stones such as granite and is unable to compete with China and other countries.

Surana, President, All India Granites and Stone Association has raised concerns that China imports natural stones from several countries, including India and re-exports them in the international market at prices which the Indian stone industry cannot compete with.

India leads in the production of natural stones with 35,342 million tonnes (27.91 percent share), followed by China (31,000 million tonnes – 23.48 percent), but it lags behind when it comes to exports. China exported 16 million tonnes of stone valued at US$3.04bn in 2010 as against India's export figures of about US$600mn.

"If the government is progressive, the industry will grow manifold and we can take on China easily," claimed Surana.

www.thehindubusinessline.com/companies/article2749627.ece

### Food for Thought

*Granite industry in India is facing great problems due to restrictive and unfavourable import policy for natural stones that are acting as entry barriers for Indian exports in the world markets for granite and natural stone.*

*Due to restriction on the import of granite, stone producing companies in India are not able to import it from other countries and re-export it after the process of value addition. On the other hand, Chinese companies are doing really well on this front as they have the advantage of a relatively liberal policy in their country. These favourable conditions in China allow the Chinese companies to import from countries including India and re-export them in international markets at prices which the Indian stone industry cannot compete with. China has exported granites worth US$3.04bn in 2010 as compared to India's export of worth US$600mn for the same period.*

*Such a restrictive policy is creating an entry barrier for Indian companies to access global markets and compete with players like China. If such a policy is relaxed, Indian domestic industry can flourish by taking over Chinese competitors in granite trade. It is interesting to note that this is not the case for diamond and other precious stone industry where the manufacturers may import raw materials and then export the finished goods.*

*On a slightly different note, such trade policy induced competition distortions are not unique to our country. For example the inverted duty structure in many sectors is another feature of India's import policy regime that has been hurting domestic rubber and other industries while favouring foreign players although this is more of a competition impediment in the domestic market unlike the case illustrated which is an issue of entry barrier in the global markets.*

## E. Others

### 1. Medical device makers unhappy with decision

Medical equipment makers have complained against the recent decisions of the Central Government Health Scheme (CGHS) and Employees' State Insurance Corporation (ESIC) to notify three different price points for procurement of devices.

What has irked the industry, especially domestic manufacturers, is the fact that devices with just one approval from the Drugs Controller General of India (DCGI), has been given the lowest procurement price, compared to the ones with approval from the US (Food and Drug Administration) and European regulators.

Speaking on the sidelines of a Federation of Indian Chambers of Commerce and Industry (FICCI) event on medical electronics, an executive said that aggrieved companies were approaching the public sector procurement agencies and the Health Ministry with their complaints.

www.business-standard.com/india/news/lowest-price-point-for-medical-devices-irks-industry/459488/

**Food for Thought**

*Decision making machinery of the government has again come under the scanner, and this time the controversy has started because of the idea of the CGHS and ESIC to come up with three different price points for procurement of medical devices.*

*The medical equipment makers are totally against this decision as they find this kind of practice highly discriminatory. What the domestic players are raving about is that the devices with the sole approval of the DCGI and of no other foreign regulatory authority, have been awarded the lowest procurement price, compared to those with approval from the US and European regulators. This decision firstly undermines the domestic drug regulatory regime by implying that the DCGI approval is not optimal. Secondly, in the absence of a clear rationale and justification for favouring foreign regulatory approvals it seems prima facie discriminatory and a regulatory barrier against the domestic medical device manufacturers. Thirdly, if without basis and justification, it influences consumer minds that are victims of asymmetrical information in the relevant market to choose foreign medical devices over purely domestic medical devices on baseless grounds.*