Competition Distortions in India – A Dossier

(CDI-26: October – December, 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 present to you the Competition Distortion Dossier Edition No: 26 for the third and last quarter: October-December, 2014. As always, we have attempted to capture interesting stories ranging from trade, anticompetitive practices, reforms, development in various economic sectors and industries. The stories reflect a mix-bag of both good and bad policies affecting the economy.

In September 2014, under the Make In India campaign, the Modi-led National Democratic Alliance Government came up with a new Public Procurement Policy for Micro & Small Enterprises (MSEs) that mandates 20 percent of procurement of annual requirement of goods and services from MSEs by all Central public sector units. This emphasis on indigenous manufacturing by the present government has two folds of purpose: firstly, to foster innovation, enhance skill development and attract investments; and secondly, to boost economic growth so as to reach the ambitious target of 25 percent gross domestic product (GDP) by 2015. We welcome this initiative by the Modi government; however, such policy could also be viewed as a protectionist measure that may not be ideal from the competition policy perspective. Such a move has to be rationally analysed and applied, as lack of level playing field can distort competition in the market.

Instances of unfair competition were witnessed in a Supreme Court notice which invited quotations from only nationalised banks for a fix-term deposit by the Court, and where the Ministry of Railways favoured private manufacturers despite having its own manufacturing units, which are under-utilised. There are many other cases similar to these where the government violates the principles of competition. Therefore, we suggest the government to adopt a National Competition Policy to address various competition distortions that occurs due to such kind of policies.

Regarding sectoral reforms in the country, we appreciate the decision by the Supreme Court regarding de-allocation of illegal coal blocks and reallocating them in a transparent manner. We also appreciate the initiative taken by the government on deregulating diesel prices. This would not only attract fresh investment but also enhance competition in this sector, thereby benefiting the end consumers.

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A. Anticompetitive Practices

1. Bidding Anomaly Favours Nationalised Banks

The Supreme Court of India recently invited quotations from all nationalised banks in the country regarding the rates of interest they could offer for a six-month deposit of Rs 18,01,43,562 by the Court. The written tender would be followed by open bidding, in which the highest rate offered in writing by any participating bank would be taken as floor/reserve rate so that bidding could then be conducted for rates thereto higher. The bids would have to be given on the spot and the deposit would go to the highest bidder. In case the interest rate offered by more than one bank is the same, the deposit would be given to the bank having the highest net worth.

http://supremecourtofindia.nic.in/deposits/ca106.pdf

Food for Thought

The way the bidding process was described appears quite open and competitive, and would expectedly help the Supreme Court (SC) of India to get the highest amount of interest possible for their deposit. The only weak spot is that only nationalised banks were invited to submit bids, which means private/foreign banks are not eligible for participation.

The fact that the tender is open to only nationalised banks reflects an anomaly in the system that truly does not appreciate the benefits emanated from competition. Requesting quotation from nationalised banks would provide the SC with only a partial glimpse of the internationals rates. Further, private banks provide highly competitive interest rates coupled with high quality service.

Nationalised banks, such as Corporation Bank and State Bank of India usually provide an 8.95 and 8.25 percent rate of interest respectively, whereas private banks, such as Lakshmi Vilas Bank and Kotak offers 9.15 and 9.00 percent respectively. Moreover, small private banks, such as Catholic Syrian Banks, in order to attract deposits, would offer much higher interest rate of around 9.50 percent.

It is suggested that the SC undertake its bidding process in a more transparent and inclusive manner where invites are given to private/foreign banks along with nationalised banks to submit their quotations. The SC would then have wider choice and higher returns.

2. Railways Bypasses Own Coach Units

The Railways has been favouring private manufacturers by offering contracts to them for manufacturing coaches without fully utilising the capacity of its own manufacturing department. In addition to buying coaches from private manufacturers at 12 percent higher cost than incurred by its own manufacturing units, the Railways has also forced these units to share the design of coaches without any charge to private entities.

http://timesofindia.indiatimes.com/india/Railways-bypasses-own-coach-units-favours-private-players/articleshow/45154995.cms

Food for Thought

Railways are considered as the backbone of India's development. It is also said to be reeling under financial stress. One reform measure is thus to encourage private investment in the sector, so as to bring about modernisation and growth, as said by the present Prime Minister of India, Narendra Modi. However, this very measure is currently being misused.

Railways are said to be encouraging private players' participation in the manufacturing of coaches while investing huge money into setting up departmental coach manufacturing factories at the same time. If true, this is a sheer bad investment decision. Anomalies further arise since the railways' own costly production units are thereto never fully utilised while coach manufacturing contracts are being awarded to private companies, who lack experience and technical knowledge. The railways then try to correct its mistake by forcing its own departments to share design and know how free of charge. What's more, it was also said that once the private companies have got experience in the sector, the process would be tilted to give contracts to a few 'favoured' companies through 'tailor-made' tenders.

'Fair competition' and 'level playing field' are thus only superficial terms being misused by a few in the system, resulting in high costs to the nation, inefficiencies and corruption.

In order to improve the current situation, the government has to be neutral towards both its own manufacturing units and private players, creating a level playing field by giving equal opportunity for participation for all. In order to recover from present losses, the government must make better utilisation of its own resources. This would help cutting down extra expenses. It is also suggested that both the private and public sector can work together in form of public-private-partnership (PPP) which would strengthen competition in the railways. Hence, it is necessary to judiciously monitor the working of the sector which not only utilises its own resources but also boosts private participation to achieve modernisation of the railway sector in India.

B. Sectoral Reforms

3. Govt Unveils Norms to Allot Coal Blocks

After the SC of India held the allotment of coal blocks to be illegal, it has given the government a six-month period to work out the option for fresh allotment of these coal blocks that would avoid amendments to the Coal Mines Nationalisation Act of 1973 and bring ownership of coal blocks at par with other natural resources of the country. The details of this option have now been shared, which reportedly would allow the coal blocks to be brought into auctions at regular intervals as the government may decide, without requiring any approvals from Coal India Ltd. – the government-owned monopoly notified under the Coal Mines Nationalisation Act in 1975.

http://indianexpress.com/article/business/business-others/govt-may-bring-ownership-of-coal-blocks-on-par-with-other-resources/

Food for Thought

After the recent decision by the SC of India on coal blocks' de-allocation due to arbitrariness and legal errors, reallocating those blocks has been quite exigent for the government. As per the SC's judgment, preferential access of coal was provided to a number of private companies which made them quite profitable while India as a whole suffered loss. Therefore, for the re-allotment of the first set of 74 coal blocks out of the 200 plus de-allocated blocks, the government unveiled draft rules for re-allotment process.

These draft norms have provided equal platform for both private as well as public sector enterprises to take part in the competitive bidding process. It has also allowed participation of power plants that use imported coal. Fair and transparent competitive bidding would eventually boost more players into the sector, thereby curbing the abuse of dominance by the public sector enterprise: Coal India Limited. Through this draft, the government has upheld the principle of competitive neutrality, thereby infusing competition into the coal sector. Besides, the draft contains provisions that invite players competent in terms of experience and technology to participate in a competitive bidding process so that there is optimum extraction of coal. This would eventually favour competition and reinstate the

present situation. Furthermore, it provides for a limit on bidding for multiple coal blocks which would promote competition and guarantee allocation of mines to maximum number of interested end use plants.

To sum up, this draft norm is a step forward to reform the coal sector in the country. Several stakeholder groups found this draft overall to be quite good for the development of the economy. It would result in steady flow of capital into the power sector. Hence, while finalising the draft norms, the government must keep in mind norms that facilitate new bidders. Such norms would encourage further participation from private players in the coal sector.

4. Reliance, Essar Could Spell Trouble for State Fuel Retailers

The government's recent announcement of diesel deregulation could lead to increased shares by private players in the sector, instead of them being cornered as before. The three state-owned oil sellers in India – Indian Oil Corporation (IOC), Bharat Petroleum Corporation Limited (BPCL) and Hindustan Petroleum Corporation Limited (HPCL) – together account for around 98 percent of the fuel retailing market in the country at present. With deregulation of prices, the private retailers – Reliance Industries, Essar Oil and Shell India – would return to the market that has been the preserve of public sector players for almost a decade.

http://www.business-standard.com/article/companies/reliance-essar-could-spell-trouble-for-state-fuel-retailers-114102901398_1.html

Food for Thought

Diesel is one of the most used fuel products in various sectors, such as agriculture and the transportation industry which affects food prices, thereby having direct impacts on consumers. Therefore, the decision of the Central Government to deregulate diesel prices is a positive move as it would allow private retailers to expand their market share and bring in competition in the fuel retailing industry. Deregulation of diesel prices would give private firms, such as Reliance Industries and Essar Oil the freedom to decide on the price of their products.

These companies are also expected to enhance their investment, in terms of building/reviving outlets and increasing service quality, in order to attract customers and increase their sales. Intensified competition thus means better services and more competitive prices, as well as wider choice for consumers.

Until now, State fuel retailers, such as IOC, HPCL and BPCL have been dominating the market (with a combined market share of over 95 percent) due to the financial assistance received from the government. However, this assistance was not extended to private fuel sellers which led to the closing down of their retail outlets or slowed their pace of expansion.

Thus, by deregulating diesel prices, the government has let both the State and private fuel retailers to compete on a level playing field. Against the previous policy of uniform fuel prices, the private retailers can now set their own prices which would help improving their market position in India's fuel retailing sector. Such a reform would also help to control the fiscal deficit, thereby adding to increased economic efficiency.

5. 5/20 Policy Clips Wings of Indian Carriers

The present 5/20 policy introduced in 2004 is up for review and might get eliminated. This policy, which requires Indian airlines to complete five years of domestic operations and have a fleet of 20 aircraft before starting services abroad, has prevented the carriers from

claiming their rightful share in international passenger traffic. The Civil Aviation Secretary is in the process of examining the issue before sending recommendations to the Union Cabinet.

http://www.thehindubusinessline.com/industry-and-economy/logistics/520-policy-clips-wings-of-indian-carriers-assocham/article6627348.ece

Food for Thought

On November 10, 2014, the Minister of Civil Aviation released the Draft Civil Aviation policy, which mentioned review of the 5/20 policy. The 5/20 policy introduced by the Manmohan Singh government in 2004 required all Indian airlines to fly within the domestic sector for a period of five years and have a fleet of at least 20 airplanes before starting to fly abroad.

Such a policy hinders the growth of start-up airlines in the aviation industry as it limits the airlines to complete five years of domestic operation. It also stands in the way of investment from major corporations that seek to improve both the product and infrastructure of the aviation sector in India. The financials would have been better had domestic airlines been allowed to launch international routes earlier. Accordingly, this would have reduced excess capacity in the domestic market and improved aircraft utilisation.

Moreover, foreign airline companies that have fulfilled the 5/20 policy are at an advantageous position. In the process of investing in India, they have captured larger share in the international segment as compared to Indian carriers. Lifting of this restriction would surely permit air carriers such as Air Asia India, Go Air, Vistara and other prospective start-ups to operate overseas, leading to an increased number of players interested to invest in the country's aviation industry, making the sector commercially coherent.

Furthermore, as per the 12th Five Year Plan (2012-2017), improving air connectivity in tier-2 and tier-3 cities in India is one of the key priorities of the government. Since the regulatory prohibition against foreign airline investment in Indian carriers was lifted, three transactions have already been announced: Etihad's 24 percent investment in Jet Airways; Singapore Airlines' 49 percent stake in a green field joint venture with Tata Sons; and AirAsia's 49 percent equity in a start-up Indian franchise. Such arrangements would boost investment into the economy, thereby enhancing healthy competition in the aviation industry.

Please also see: http://www.cuts-ccier.org/Article-Aviation_sector_must_be_a_lot_more_competitive.htm

C. Trade Policy

6. Kerala Planters Seek Import Ban on Rubber, Tea, Cardamom

The Association of Planters of Kerala has appealed to ban the imports of tea, rubber and cardamom till domestic prices reach production cost. The tea industry, for example, is making a loss of above Rs. 25 per kg of made tea. The gross mismatch between the cost of production which is Rs. 110 and Rs. 120, while the average price of tea is less than Rs. 85 have brought the industry in a severe cash crunch. The situation with cardamom growers is no different. They have suffered a loss of Rs. 200 per kg due to cheaper imports and inferior quality of Guatemalan cardamom. Meanwhile, the rubber industry is incurring a loss of above Rs. 50 per kg of natural rubber produced. The reason for this situation is a combination of lower demand and oversupply in international market, lower prices, and unregulated imports by the government.

http://www.thehindubusinessline.com/industry-and-economy/agri-biz/kerala-planters-association-seeks-ban-on-tea-rubber-cardamom-imports/article6621831.ece

Food for Thought

Plantation crops such as tea, cardamom and rubber have seen drop in prices by 30, 50 and 40 percent respectively, causing severe difference between the cost of production and the price of products. Even though the current domestic supply exceeds demand, the government is still importing these products due to low international prices. This is causing the domestic industry to suffer further losses. Import of such products from foreign players while domestic players are running in loss has led to distortions in competition. The domestic planters have, therefore, appealed for a ban on the import of these plantation crop items.

Kerala has a significant portion in the four plantation crops of rubber, tea, coffee and cardamom of India. These crops together cover an area of about 7.02 lakh hectare, accounting for 34.4 percent of net cropped area in the state. Steep reductions in price would severely affect the sustainability of domestic planters and livelihoods of workers. Lack of support from the government would make the situation worse.

The World Trade Organisation (WTO) agreements allow the imposition of 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. Further, it is suggested that the government should undertake a cost-benefit analysis and formulate new policies that are pro-competitive in nature. This would encourage the participation of domestic planters, hence, boosting investment into the sector.

7. Local Power Firms Demand Cancellation of Projects Given to Chinese Cos.

According to the Indian Electrical and Electronics Manufacturers' Association (IEEMA), Chinese State-run firms had been awarded a number of projects to install Supervisory Control and Data Acquisition (SCADA) systems in 18 cities in India recently. This association of 800 Indian gear-makers has since written to the power minister in opposition of this idea, stating that such projects are under the direct administration of Chinese Central Government, which would cause serious threat to India's national security. IEEMA argued that equipments supplied and maintained by China can have hidden Trojans that are not detected by Indian agencies and can take control of Indian power grid partially or for some amount of time.

http://articles.economictimes.indiatimes.com/2014-10-07/news/54735945_1_chinese-equipment-ieema-transmission

Food for Thought

The Government of India has recently awarded a number of projects to Chinese state-run firm – Dongfang Electric Corporation (DFE) – worth Rs.73.40 crores to install supervisory control and data acquisition (SCADA) systems in 18 cities of Tamil Nadu, Rajasthan, Madhya Pradesh and Puducherry.

This is in the face of a negative growth rate of eight percent that the domestic electrical and electronic equipment's sector in India registered in 2013. While it is important to analyse whether good procurement practices were followed or not and how these Chinese suppliers are fulfilling local content requirements, the current situation could only be improved by enhancing participation from domestic players in the power distribution system. Encouraging domestic players would surely bring healthy competition in the equipment's industry would be in sync with the government's 'Make in India' campaign and would also enhance quality and efficiency in services. The overall sector could then witness growth if the government acts a bit more protectively. It is also suggested that domestic entities and foreign entities work together through several arrangements which would enhance the present power distribution system in India.

D. Mixed Bag

8. Get Account Holders Under *Jan Dhan* to Use RuPay Card

Holders of Basic Savings Bank Deposit Accounts (BSBDA), opened under the *Pradhan Mantri Jan Dhan Yojana* (PMJDY), have to be advised to activate their RuPay cards at the earliest, and operate them at least once in 45 days, in order to enjoy the Rs 1-lakh accident insurance coverage free-of-charge. This is a carrot-and-stick approach encouraged by the Finance Ministry to be used by top bankers. BSBDA holders can also avail other facilities such as deposit and withdrawal of cash at bank branches, receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments. However, the withdrawals have been limited to just four in a month, including ATM withdrawals.

http://www.thehindubusinessline.com/industry-and-economy/banking/get-account-holders-under-jan-dhan-to-use-rupay-card-finmin-tells-banks/article6541899.ece

Food for Thought

In August 2014, the Modi government launched a new financial inclusion scheme – the PMJDY – whereby every Indian family would have a bank account. It offers provisions that are beneficial for the poor families. When each family has a zero balance bank account, they would become a part of the economic cycle, which would eventually help bringing financial inclusion in the country. Under this scheme, the National Payments Corporation of India has come up with a new technology that allows account holders to transfer funds, and check balance through mobile phones. Special care has been taken for the poor by providing mobile banking through National Unified USSD Platform (NUUP). As per news reports, the PMJDY has collected Rs 1,16,500 crores in savings by end of December 2014 from 5.8 million people.

However, the government has also imposed certain conditions to avail the benefits offered under this scheme. Such contingent clauses, which include the account-holders' mandatory use of RuPay debit card at least once every 45 days to avail Rs 1-lakh accident insurance claim, are proving to be problematic. Firstly, it is not possible for poor families in remote areas to access their accounts every 45 days, and therefore they would lose out on availing other benefits. They would fail to avail the free-of-charge Rs 1-lakh accident insurance claim, and thus forfeit the very purpose of opening a bank account under this scheme. Secondly, limiting the withdrawal from ATM to four times maximum in a month has also put restriction on their freedom to access the benefits. Thirdly, this scheme is intended to provide timely and adequate credit to the vulnerable class. However, account holders have to wait for a period of six months since opening such accounts to avail a loan amount of Rs 5000. Fourthly, the exclusive use of the government's RuPay debit cards is anticompetitive as other card companies, such as Visa or Master can also be roped in to provide the services, and with better quality. These conditions therefore, are not adequately addressing the issue of consumer protection.

Even though the PMJDY scheme is much advanced and carries benefits, it is confining the consumers to avail such benefits by inserting numerous riders. The end consumers, i.e. the rural population, would not be in a position to overcome the hurdles set under the PMJDY. Limiting the number of withdrawals to four is also restricting the freedom of the consumer, thereby distorting competition. As this policy targets the weaker section and low-income groups, the government should make sure that it protects the interests of consumers by promoting and sustaining fair competition. This would enhance consumer welfare and increase the number of participation, thereby promoting healthy competition.

Please also see: http://cuts-international.org/cart/article-Future_of_Jan_Dhan_Yojana.htm

9. Procurement from MSEs Mandatory for Central PSUs

In order to elevate micro and small enterprises (MSEs), the government has recently announced that central public sector units (CPSUs) must procure 20 percent of products and services from medium and small scale industries (MSMEs). The MSMEs' contribution to India's GDP has stagnated in the last few years, estimated to be around 36.69, 37.97 and 37.54 percent respectively during 2010-11, 2011-12 and 2012-13. However, the sector is likely to receive a boost under the Modi-led National Democratic Alliance government, which launched its 'Make in India' campaign in September 2014 to attract investments and revive economic growth after sweeping to power in May.

http://www.livemint.com/Industry/jiNYAWihktbimvNWkeVL6O/Procurement-from-MSEs-made-mandatory-for-central-PSUs.html

Food for Thought

A new public procurement policy that involves MSEs has become effective from April 01, 2012 which would become mandatory by April 2015. However, till the end of September 2014, 32 out of 146 PSUs have complied with the mandatory 20 percent procurement of products and services. The government would also introduce provisions to take action against those PSUs that do not follow the mandatory provision.

The government introduced this policy as a part of 'Make in India' campaign to encourage local industries, particularly MSMEs, to participate and improve their financial condition. This ambitious plan by the government was to facilitate investment, foster innovation and enhance skill development to build manufacturing infrastructure. Such a policy by the government has given the MSMEs an advantage to participate in a level playing field which would surely boost investment into the economy and create jobs and entrepreneurs.

However, MSMEs being small industries may not have adequate technical knowledge and relevant skills which could ultimately have an impact on the quality of outputs. The compulsory procurement of goods and services thus could be viewed as a protectionist measure to rescue the MSME units from being shut down.

As per data available, the procurement made by PSUs from MSEs has declined from Rs 12,931 crore in 2012-2013 to Rs 3,799 crore in 2013-14. This indicates that there is either lack of quality outputs by MSMEs or failure on the part of PSUs to procure products. MSMEs being well aware of the 20 percent rule might produce inferior quality products and take undue advantage of the procurement policy. Therefore, it is suggested that rather than making it mandatory, the government should look for procedures to simultaneously enhance the quality of products by MSMEs. The government could also assist these MSMEs by providing subventions, which would help them deliver requisite outputs. Besides, to promote fair and healthy competition, MSMEs should be encouraged to participate in the competitive bidding process for the procurement by PSUs.

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