

Competition Distortions in India – A Dossier

(CDI-13: July-September 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.

List of Contents

Good News: Pro-competitive steps

1. [NCP Discussions: Competition Policy to be the second biggest reform initiative after the 1991 economic reforms says Dr. Veerappa Moiley](#)
2. [IRDA issues final guidelines on portability](#)
3. [Prepaying on home loans to cost less](#)
4. [Panel urges States to amend APMC Act to remove 'barriers'](#)
5. [Government plans to cut \\$9-billion subsidy on kerosene and cooking gas](#)

Competition Distortions

a. **Procurement policy related**

6. [MDL-Pipavav deal: Has stand of competing bidders been vindicated?](#)
7. [Highway developers approach competition panel against NHA](#)

b. **Distortion of Competitive Neutrality**

8. [Government Asks PSU Banks to Open More Branches in North East](#)

c. **Trade policy related**

9. [Auto Parts Industry Opposes FTAs On Account of Inverted Duty Structure](#)

d. **Other barriers to entry**

10. [Tyre industry may see shortage in the number of players after quality-control order](#)

1. Competition Policy to be Second Biggest Reform Initiative

Union Corporate Affairs Minister Dr M. Veerappa Moily has said that the announcement of the National Competition Policy will be the second biggest reform initiative after the 1991 economic reforms.

Dr Moily said that he hoped that the Cabinet's nod will be obtained by the end of this year to pave way for the New Competition Policy next year.

He opined that "Ideally, the policy should precede the law, but it is a good idea to have a policy, even if the Competition Act is already in force".

He said, while the Competition Law is for enforcement, the Policy is for infusion of principles and promoting competition culture in the country.

<http://www.thesynergyonline.com/breakingnews.htm>

Food for Thought

India has enacted a competition law regime that regularly checks and seeks to rectify anti-competitive behaviour of enterprises statutorily through the implementation of its legislative provisions. Even though much still needs to be done towards implementation of the law, there is a system in place to acknowledge and address such activities that distort competition and challenge the economic growth of the country.

Contrary to this, challenging the distortions induced by government erected institutional barriers to competition is not a simple application of the existing domestic laws. This is so because in most government policies such as trade remedial measures, procurement policies, price-fixing policies and other policies implemented in public interest that have the effect of weakening competition, the distortive component (which cannot be challenged by the existing competition legislative framework) is accompanied with significant policy objectives and justifications.

To address such policy distortions, there is crucial need for a holistic competition policy. An example is a policy package that consists of a relaxed industrial policy, liberalised trade policy, conducive entry and exit conditions and is associated with reduced controls and greater reliance on market forces. Such a policy package would be well-equipped to address the competition distortions mentioned above. It is good that the effort is moving forward.

2. IRDA issues final guidelines on portability

Health insurance portability will be a quick affair now. Insurers will have to share the data on policies to be migrated within seven days from the date of request.

This has been mandated by the Insurance Regulatory and Development Authority (IRDA) in its final guidelines on the portability, communicated to the insurers by a circular.

Health insurance portability is to come into force from October 1.

...The portal would be the key for portability as information sharing on a policyholder's data is routed through it.

With this data, the credit for pre-existing diseases can be given to customers immediately if they are migrating to another insurer.

<http://business-standard.com/india/news/health-insurance-portabilityoct-1/146798/on>

Food for Thought

Health insurance consumers will be able to change their service providers, as the insurers are finally ready with the long-awaited portability norm in the insurance sector after the telecom sector. However it will be limited to non-life insurers, which will allow policy switch with respect to all individual policies, including family floater policies.

According to the new guidelines, consumers will get credit for the time already spent for covering pre-existing diseases (PED), along with bonus accrued to them from their past insurers. This comes as a respite to policyholders who bear with deficient service for fear of losing their PED cover. Health insurance portability which was slated to start in July finally came into effect as on October 1.

This is a splendid example of an initiative that would enhance competition in the market place and enhance consumer welfare. Much like the mobile phone portability, now that one can switch service providers without compromising on policy terms, there will be enhanced competition among players in the market helping customers get better prices and/or quality services.

3. Prepaying on home loans to cost less

Home loan borrowers soon may not have to pay any penalty for prepayment of loans linked to floating rate of interest. Banks currently charge anywhere between 1% and 3% of the principal amount if customers want to pay back the loan amount before the agreed term ends. However, for fixed-rate loans, banks will continue to charge the prepayment penalty. Bankers say that by charging for prepayment, they can manage their asset-liability gaps better and stop borrowers from shifting to other banks.

<http://www.indianexpress.com/news/prepaying-to-cost-less/844301/1>

Food for Thought

With the removal of the prepayment penalty, customers would be able to shift loans to other banks if they get a better interest rate which would enhance competition among banks. The decision is part of the 10 action points to improve customer service at banks, which was released by the RBI after the Annual Conference of Banking Ombudsmen held in Mumbai on September 5, 2011.

This would put pressure on banks to improve their customer services and offer better schemes and interest rates in order to retain customers. This is similar to what we hope to see in the insurance sector with the advent of insurance portability and the mobile phone portability in the telecommunications sector. The measures undertaken stimulate competition in the respective sectors and consumers gain in the process with better quality of service and lowered costs.

Readers might recall that this issue was also challenged under the Competition Act, but the consumer lost the case. It was a very poor order.

4. Panel urges States to amend APMC Act to remove 'barriers'

A panel of State ministers has asked the State Governments to amend the APMC Act at the earliest to create "barrier-free national market" and encourage private investment. A committee of State ministers on agriculture marketing, headed by the Maharashtra Minister of Cooperation, Mr Harshvardhan Patil, has asked "the States to amend the Agricultural Produce Market Committees (APMC) Act on the line of model act and notify the rules at the earliest."

<http://www.thehindubusinessline.com/industry-and-economy/agri-biz/article2436638.ece>

Food for Thought

Submitting the first report of the Committee to the Union Agriculture Minister, Mr Sharad Pawar, the committee said that the amendment to the Act is necessary to establish a "barrier-free national market" to the farming community. The Committee has recommended incentives to states for bringing out pro-competitive reforms. For instance, it has suggested states to waive off market fee on fruit and vegetables with the Union Government compensating the loss to APMC and single-window unified single registration for traders or market functionaries across the states. Such a recommendation by the Ministry of Agriculture is in line of "competition payments" or incentives to states for implementing competition reforms

5. Government plans to cut \$9-billion subsidy on kerosene and cooking gas

The government plans to strictly enforce its plan to cut the \$9-billion subsidy on kerosene and cooking gas, and will penalise states that oppose reform, government officials said.

The finance minister Pranab Mukherjee led Empowered Group of Ministers (EGoM) has decided to pay direct cash subsidies to the poor who would be hit by the price hike after the subsidy cuts. The success of the direct kerosene scheme depends on state governments. "Incentives will be given to states who would promptly implement the scheme, those who are reluctant, would face cut in kerosene quota," one official said. The EGoM has asked the finance ministry to prepare a package of incentives.

http://articles.economictimes.indiatimes.com/2011-09-14/news/30154448_1_cash-subsidy-direct-cash-kerosene

Food for Thought

This is another example of competition payments recommended by the Empowered Group of Ministers that are being offered to bring about subsidy cuts in kerosene, an initiative to create a more level playing field by correcting the competition distortive and efficiency threatening nature of subsidies. The scheme would basically mean selling kerosene at market price and compensate the poor through direct cash transfers. The scheme will be launched in seven states next month and extended to the rest of the country by April 2012.

Like most schemes, its success would depend on the implementation efforts of states. Much would depend on how willing states are to facilitate direct cash transfers to beneficiaries and therefore the Committee under the leadership of finance minister Pranab Mukherjee has indicated incentivisation efforts for states that undertake these reforms and implement the scheme promptly.

One crying need to enable such direct payments to the poor is by expediting financial inclusion measures and Aadhar identity cards to enable the payments to be made to the poor without any medium in between.

6. MDL-Pipavav deal: Has stand of competing bidders been vindicated?

The Defence Ministry's decision of put on hold the Mazagon Dock- Pipavav joint venture in many ways vindicates the stand of competing bidders about total lack of transparency in evaluation, besides non-disclosure of the selection criteria.

...While there is little doubt that MDL has chosen Pipavav Shipyard after evaluating the strengths and capabilities of all the competing bidders. What is baffling is the haste in which

the decision was taken within a fortnight, without waiting for the submission of the detailed business plans of all the yards it had sought.

Given the absence of a joint venture policy, it could be said that MDL cannot be faulted for keeping the evaluation parameters close to its chest, while negotiating with the shipyards for over six months before deciding in favour of Pipavav Shipyard.

One of the bidders indirectly pointed this out when he said that the presence of a former MDL Chairman and Managing Director on the Pipavav Board could have tilted the scales in its favour as he would have strategically prepared the detailed plan to align with the MDL's requirements.

The domestic ship building industry is at crossroads. Global business is just about looking up after the recession.

The availability of assured business on home turf from the Government was an opportunity that it should not have missed.

Moreover, a joint venture with the State-owned shipyard would open avenues for export, as the yards could showcase their expertise at home.

<http://www.thehindubusinessline.com/industry-and-economy/logistics/article2490845.ece>

Food for Thought

The MDL-Pipavav joint venture if allowed to pass through would be an arbitrary decision as sufficient information was not disclosed about the selection criteria. What raises suspicions is the haste with which the decision was taken even before all the bidders had had a chance to submit their plans and proposals. This brings to light a very critical issue of the absence of a joint venture policy in the absence of which it becomes easier to rig such deals due to lack of accountability and transparency. It is an issue of corporate governance as well, because of the presence of a member on the board with links to Mazagon Docks Ltd.

It is important to note here that Joint Ventures can very well have anti-competitive effects just as mergers however the regulations on combinations under the Competition Act are not clear on their treatment. Other jurisdictions have specific regulations to deal with joint ventures on the other hand such as the EU and the United States which provide for specific regulation of full-functional joint ventures.

Clarity should be provided regarding the coverage of creation of full-function joint ventures (as presently not notifiable in view of definition of enterprise and de minimis thresholds of target companies under the Competition Act of 2002. Creation of new joint ventures, where the joint assets or turnover meet the applicable thresholds, currently do not appear to be covered under the Act.

In light of the above and given that the issue pertains to national security, there has to be greater scrutiny of such joint ventures. Therefore, there is crucial need for a policy to ensure transparency and accountability in such deals so that there is little scope to play favourites. Readers may also note that a Government Committee looking into amendments in the Competition Act has made recommendations to cover joint ventures under the definition of combinations.

7. Highway developers approach competition panel against NHAI

Highway developers have approached the Competition Commission of India (CCI) against an NHAI move to restrict the number of bidders for engineering procurement contract (EPC) projects to be developed in Uttar Pradesh.

In other words, financial bids from top seven bidders in the technical score list will be invited. This is evident in the tenders for two projects to be developed under the EPC mode.

...The National Highways Authority of India (NHAI) has stated in the qualifying tender document for these two projects, "The Authority (NHAI) expects to short-list up to seven pre-qualified Applicants for participation in the Bid Stage. The Authority, however, reserves the right to increase the number of short-listed pre-qualified applicants by adding one additional applicant."

The highway builders lobby body – National Highways Builders Federation (NHBF) – has recently written to the CCI against this move. The NHBF argues that the clause "goes against the prevailing Competition Act".

<http://www.thehindubusinessline.com/todays-paper/tp-logistics/article2510052.ece>

Food for Thought

Such a provision in the procurement bids is restrictive of competition as it limits the number of players that can enter the market. Even if this provision is to ensure quality, it is highly restrictive and limits the range of suppliers in the relevant product market thereby affecting competition. Furthermore, the provision is rather arbitrary as it states that the NHAI reserves the authority to add one additional applicant to the short-list. This provision has the potential of being abused by competing players who may indulge in malpractices to get that one tender.

The sector is significantly affected by cartelisation, restricting the number of players through such bids will only aggravate the same. There is a definite need for tightening of the rules governing procurement of these bids. This is not the first time such a clause has made it to the NHAI bidding process. In September 2008, a similar clause – which sought to restrict the number of bidders to five was also introduced but dropped later. Similarly, it was revealed in a study titled "sub-prime highways" by Gajendra Haldea that there has been no clear procedure or accountability for evaluating the reasonableness of the bids of the NHAI and approving the same.

It is important to note here that since this is a case of a distortive policy adopted by the NHAI and not an anticompetitive practice that can be brought under the Competition Act, this may not make for a persuasive case as a violation of the provisions of the Act per se. As mentioned at the beginning, these distortions are of the nature that arise from the policies formulated and implemented by government bodies and would find justice under the National Competition Policy framework instead of the Competition Act.

8. Government Asks PSU Banks to Open More Branches in North East

The government has issued a directive to public sector banks to open branches in every unbanked block in the North East by September next year. The seven sister states – Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland and Tripura – are home to 70

unbanked blocks and 55 under banked districts as banks have generally shied away from this economically backward terrain mired by insurgency.

The government has written to the chairpersons of public sector banks to prepare individual plans for improving bank penetration in the North East. Two senior banking executives confirmed having received such a letter from the ministry of finance.

http://articles.economictimes.indiatimes.com/2011-10-04/news/30242594_1_public-sector-banks-usaha-thorat-committee-branches

Food for Thought

Such a directive by the government is a welcome step to set up banks in unbanked and under banked areas in the North east region, particularly to promote financial inclusion. However for the government to solely approach the public sector banks (PSUs) to do this seems to be discriminatory as it has ignored the private sector banks. This is yet another instance where public sector banks have been discriminated against the private banks.

In fact given the circumstances, it is important to take steps to promote competition in this sector and ensure that there are more players instead of issuing orders that promote the entry of some and ignore the others. This kind of treatment is a violation of the principle of competitive neutrality and constitutes a case for reverse competitive neutrality.

Lessons may be drawn from the telecommunications sector in this instance where it has been recommended to utilize universal service obligation (USO) fund to provide subsidy to those that provided telecom and IT services via satellite in rural and hilly areas. Universal service is an economic, legal and business term used mostly in regulated industries, referring to the practice of providing a baseline level of services to every resident of a country. To fund the telecom USO, India has set up a fund which may be used to provide assistance to the service suppliers. A similar fund may be used in this case where banks are being asked to open branches in the less profitable regions of the country. The fund can be created out of unclaimed deposits lying with our banks.

9. Auto Parts Industry Opposes FTAs On Account of Inverted Duty Structure

India is on the verge of signing the final deal with European Union countries to encourage Free Trade Agreement (FTA) but on the other hand, severely hit domestic manufacturers have already started raising their voice against the agreement.

Heavy Industries minister, Praful Patel has organized a meeting between the two nodal automotive associations of India, and ACMA. Patel has offered to extend his full support to the industry.

The senior members at ACMA have raised their voice against the issue and have said that the agreement which is now under negotiation for few years is yet to be finalized by June 2012. As per them, the agreement would result into an inverted tariff structure of the industry.

<http://business-standard.com/india/news/auto-parts-industry-opposes-ftas/450483/>

Food for Thought

A major concern with the auto component industry is with respect to the inverted duty structures in this sector resulting from the Free Trade Agreements that India gets into thereby affecting domestic manufacturers especially small and medium enterprises.

An inverted duty structure refers to a situation where the duty on the finished product is lower than that on raw materials and intermediate products. This is a distortion when the higher duty on raw materials results in production costs that are higher than the selling price of the imported finished product and hurts the domestic manufacturer who relies on the raw materials for production.

Inverted duty structures arise when such agreements are signed between countries which has its own tariff levels while the multilateral trade agreement under the WTO has different tariff obligations for a country. Negotiators and policy makers do not carefully examine the same together with the consequence that such distortions arise. There have been major instances where the components attract zero duty though there have been tariffs on raw materials.

This concern has been flagged by the industry to the government so as to negotiate as such in the drafting of its FTA with the EU which has been going on for a couple of years. It is critical that such issues get the consideration that they deserve in India's FTA with EU or any other FTA. This is not the first time that such distortions have arisen due to inverted duty structures in other FTAs, such as with Thailand on TV picture tubes etc.

10. Tyre industry may see shortage in the number of players after quality-control order

The tyre industry may see a shortage and an increase in prices following a quality-control order issued by the department of commerce last month.

According to the order, no domestic tyre manufacturer, seller, distributor, importer or store keeper will be allowed to sell pneumatic tyres and tubes without the Bureau of Indian Standards (BIS) mark or without obtaining the certification.

According to industry sources, the tyre manufacturing industry has come to a standstill, since there is a huge amount of unsold inventory that cannot be sold without the BIS mark. Although data on the existing stock is not available, sources said, the total number of tyres manufactured in 2010-11 is around 57.2 million and the industry has witnessed an annual growth of 5-60 per cent across segments, including trucks, mopeds, cars, jeep and tractors.

They said it would take time to get BIS certification for pneumatic tyres — a rubber tyre filled with air under pressure — because manufacturers will have to set up necessary infrastructure at the factory to meet the demands under BIS. The control order, however, exempts tyres imported by original equipment manufacturers to sell in the replacement market.

Sources said the tyre industry uses 70 per cent of natural rubber grown in India and is already plagued by rising costs of the raw material. They added that the demand for natural rubber is continuing to increase — especially in the booming automobile markets in Asia — and there is a decline in supplies. The Indian tyre industry has called for the government to allow duty-free import of 200,000 tonnes of rubber to help bridge the gap between India's natural rubber production and demand.

<http://www.business-standard.com/india/news/tyre-industry-may-see-shortage-after-quality-control-order/440824/>

Food for Thought

The new order seeks to ensure high quality among the domestic manufacturers of tyre. However, it has anti-competitive dimensions because it ignores the raw materials and inventory that cannot be sold without BSI mark. Besides it would take time to establish the necessary infrastructure to meet with the new standards.

These act as market barriers for the existing companies to continue operating in the market. As a result, it would have the impact of lesser suppliers in the tyre industry. The cost of production would also rise as new infrastructure has to be set up and additional quality standards have to be met. The apprehended consequences of such an order may be seen in terms of loss of consumer surplus through higher prices and producer surplus since the increase in prices would not cover adequately the losses suffered by them of inventory lying useless and unused.

Thus there is need to carefully weigh the benefits of improved quality with the anti-competitive outcomes of such an order before a blanket application of the same.

Disclaimer: This information has been collected through secondary research and CUTS C-CIER is not responsible for any errors in the same. The press clippings used here have been suitably adapted/ summarised to convey their essence to the reader without any distortion of content.