"CUTS" NOTE FOR FINANCE MINISTER ON THE OCCASION OF

THE PRE-BUDGET CONSULTATION ON 17TH JANUARY, 2012

Among several issues which will be raised by invitees, we wish to draw the attention of the Finance Minister on just three critical issues here, which *inter alia* require to be flagged in the Budget Speech to exhibit the resolve of the Government:

1. National Competition Policy
2. Road Safety
3. Financial Consumer Protection

1. National Competition Policy

The Ministry of Corporate Affairs has drafted and circulated a National Competition Policy[1] among central ministries and state governments after several consultations with stakeholders. The policy is designed to address and reduce impediments to competition in our policies, laws and regulations across the board. The Ministry proposes to bring this issue to the Cabinet and adopt the same after due process in the FE, 2012-13.

In our opinion, and articulation by the Corporate Affairs Minister, the Policy can unleash the 2nd wave of economic reforms in India and add to growth hugely.

The Policy has been proposed on the successful experience from Australia which had introduced it in 1995 and achieved 5.5 percent economic growth. Australia, also being a federal country, had to incentivise States to adopt reforms, as we have done in the case of VAT and also proposed in the GST. We also need to adopt a suitable financial incentive scheme to do so in India.

In fact, competition reforms can lead to jump in revenues and hence the Union Government has to share the same with the States through incentive schemes. In some cases the States can also benefit directly by such measures when introducing reforms. Annexed please find a case study from Rajasthan, when competition reforms were adopted in the State Excise Policy. The system of liquor vends was democratised in 2005-06 by allotting shops to single owners through a lottery system as against the earlier system of auctioning liquor marketing on a district wise basis to contractors.

Action desired: **Strong support from the Finance Minister for adoption of the National Competition Policy so that all central ministries and States adopt competition reforms.**

---

[1] http://www.mca.gov.in/Ministry/pdf/Draft_National_Competition_Policy.pdf

2. **National Road Safety Policy**

India has the unique distinction of being the worst country in the world in terms of the road safety scenario. Our deaths due to road accidents is over 1.3 lakhs per annum and the estimated cost is over Rs. 1,00,000 lakh crores or nearly 2.00 percent of our GDP[2].

The WHO has forecast that this will become the fifth largest killer by 2030. The UN has also adopted the decade of 2011-20 as the Decade of Action on Road Safety.

We do not even have a Road Safety Policy, while the issue straddles between the Ministry of Road Transport & Highways and the Ministry of Health & Family Welfare, thus we end up in situations that the left hand does not know what the right hand is doing.

The MORTH has also drafted a bill: National Road Safety and Traffic Management Act, but the same was sent back to the Ministry by the concerned Parliamentary Standing Committee because of certain infirmities. The same needs to be expedited and the National Road Safety Board be established without loss of further time.

Action desired: **Coordination between Health and Road Transport Ministries, and the adoption of the National Road Safety and Traffic Management Act and a National Road Safety Policy.**

3. **Financial Consumer Protection**

After the financial crisis in the west, one issue which has been flagged at the G-20 meetings by the global consumer movement is the need to enhance and strengthen financial consumer protection measures.

Each year the global economy creates an estimated 150 million new consumers of financial services. Most are in developing countries, where consumer protection and financial literacy are still in their infancy.

Indications of poor financial consumer protection are equally infectious and can have far reaching international consequences. The global community now recognises that a coordinated response is necessary to return stability to financial markets. The clear link between financial consumer protection and market stability means that strengthening the former is vital to ensuring the latter.

Financial inclusion is key to financial consumer protection. However out of 1.21 billion Indians, only about 40 percent citizens still have access to formal banking services. Only 38 per cent (32,000 branches) of the bank branches are in the rural areas.

Violation of data privacy; hidden or inflated charges or fees; unfair contract terms and conditions (including unfair variation of contract terms, interest rates or charges);

[2] http://articles.economictimes.indiatimes.com/2012-01-14/news/30627565_1_road-safety-week-road-accidents-international-road-federation.

undisclosed level of financial risk passed to the consumer; contract terms not explained clearly at point of sale; after-sale customer service falling below expectations; aggressive or invasive sales techniques; breach of contract by the service provider; failure to deliver the service; exclusion from service etc. are some of the common problems still faced by consumers of financial services in India as anywhere in the world.

To highlight one particular aspect, is the short changing of workers who are remitting their earnings from abroad. In total, money transfers from workers overseas contributed USD55 billion to the Indian economy in 2010. To put it into perspective, that's over twenty five times the amount of foreign aid or constituted around 5.00 percent of the national income. However migrant workers have to pay charges of 10 to 20 percent on each of these transfers, with the result that for every INR100 sent home their family may receive only INR 80 or 90. For instance Indian workers in Canada pay an average of 10.54 percent when sending money home.

There is an urgent need of a strong consumer protection mechanism, setting clear rules for financial institutions regarding their dealings with retail customers and to ensure that consumers receive information to allow them to make informed decisions, are not subject to unfair or misleading practices and have access to redressal mechanisms to resolve disputes.

While we appreciate the initiatives of the Government for financial inclusion and recent measures to protect the consumers of financial services, including the move to allow 'savings account portability', much more needs to be done to ensure fair, secure and stable financial services to the consumers.

Action desired: **The Finance Ministry to take stock of the existing financial consumer protection measures and establish institutions or strengthen existing ones, simultaneously networking with similar institutions elsewhere to provide higher standards of consumer protection to financial consumers.**

Pradeep S Mehta,
Secretary General,
CUTS International
psm@cuts.org
09829013131

CUTS intervention leads to rise in State revenues in Rajasthan

Following a research study on competition issues in India by CUTS, the Government of Rajasthan changed its excise policy, which led to a quantum jump in excise revenues. The revenue from excise nearly doubled in the next five years after the intervention. This is much more impressive than the increase in excise revenue collection which were in the range of two-four percent in the preceding few years. This increased revenue has also indirectly contributed to consumers getting better choice at better prices.

Backdrop

Often policies at the Central or state government levels lead to anticompetitive outcomes and regulatory failures at the local level but remain unaddressed due to lack of awareness and vested interests. However, concerns arise when government policies themselves create favourable conditions for the formation of cartels. In such cases, the government ends up paying a high price for its own policies with a resultant loss of state revenue. One such example is the state excise policy of the Government of Rajasthan.

The dominance of a select group of traders in the liquor trade resulted in a suppression of bids with the government losing revenue in the process, while consumers were denied good choice and also optimal prices. Let us clarify that we are not supporting liquor consumption by this advocacy but because consumers do buy liquor legitimately, their rights have to be defended; and that of the state, which lose revenues and thus have less money for developmental expenditure.

Till 2004-05 the State of Rajasthan followed the 'Exclusive Privilege System' for liquor sales. As per this system the state was divided into regions for liquor vending contracts. Contracts under each region gave the licensee-contractor the exclusive right to trade in liquor in the specified area for one year. In this system a number of malpractices developed and competition was restricted to a few contractors who had sufficient money and muscle power. Over time, it encouraged cartelisation, resulting in high prices and concentration of business in the hands of few licensees. Bids were also suppressed and state excise revenue remained almost stable in spite of the increase in demand over time.

CUTS Initiative

CUTS International in a research report published in 2005 on the need for a competition

policy for India[3] *inter alia* highlighted various anticompetitive outcomes and regulatory failures at the local level caused by state government policies. The report stressed that restrictive policy regimes are often characterised by entry restrictions which limit participation in the industry to a few participants. Smallness in numbers encouraged either monopoly or cartelisation and consequently industry outcomes which were inefficient and costly both to the consumer in terms of welfare and the government in terms of revenue losses.

"In 2005-06, for Excise Policy changes in State of Rajasthan, the basic precincts are based on the findings of the CUTS report entitled "Towards A Functional Competition Policy for India". This resulted in quantum jump close to 30 percent in excise revenue for the State. Against the backdrop of two to four percent per annum revenue growth for the immediate preceding seven years, it is certainly a quantum leap. The suggestions in the report obviously point out to this direction. Policy deficiencies for a full-fledged market play is essential to the designing of a policy regime."[4]

According to the Rajasthan Excise department officials, the government had successfully broken the monopoly of liquor contractors, who had witnessed an increase of 19 percent in the revenue during 2005-06.[5]

The CUTS report was presented to the Chief Minister of Rajasthan in a pre-budget consultation meeting in 2005. The state government was influenced by the report and made changes in the excise policy with a view to break the liquor cartel. The government also established the Rajasthan State Beverages Corporation Ltd. (RSBCL) to take over the role of purchaser and supplier of liquor, dispensing with exploitative middle men. Furthermore, in a significant departure from its earlier policy of exclusive privilege system, the government introduced a two-tier system of licensing – licenses for wholesaler as well as retailer – on the basis of a fixed license fee. The process of allotment was based on a lottery system. The new system provided liquor selling rights to a large number of vendors. The lottery system meant that the selected vendors were not necessarily known to each other. The large numbers selected meant that cartel formation and implementation had been rendered impracticable.

[3] "Towards Functional Competition Policy for India", Pradeep S Mehta (Ed), Academic Foundation and CUTS International, 2005

[4] Views expressed by Dr Shyam Agarwal, IAS, a senior civil servant in Government of India, having worked as Secretary in the Finance Department of Rajasthan in 2006, in a communication to CUTS

[5] "Rajasthan trims liquor vends in new excise policy", Business Standard, February 27, 2007

Tax Revenues and Excise Duties, Government of Rajasthan (Rs in Crores)

YEAR	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-2010	2010-11
State Tax Revenue	7246	8414	9880	11608	12841 (RE)	14562 (BE)	16742.29 [B.E.]	19020.86 [B.E.]
Increase in %	15.88	16.12	17.42	17.49	10.62	13.40	12.04	13.6
Revenue from Excise	1163	1276	1522	1591	1805	2170	2300.48	2859.35
Increase in %	1.82	9.71	19.26	4.55	13.45	20.22	6.00	24.29

Source: Rajasthan Excise Department: Budget for different years, Ministry of Finance, Government of Rajasthan

A graphical picturisation of tax and excise revenue figures are shown below on the last page.

These anti-cartel measures resulted in a significant jump in excise revenues from 2004-05 onwards. While there was a rise in revenue from excise by only Rs 113 crores from 2003-04 to 2004-05 due to a higher benchmark in the earlier year (see table), over the course of the next year excise revenues increased by as much as Rs 246 crores, following these anti-cartel measures. Again in the year 2010-2011 the revenues increased by as much as Rs 559 crores compared to the previous year which is almost 25 percent.

Other states

Rajasthan is not an exception; cartelisation had also been witnessed in other states like Andhra Pradesh, Tamil Nadu, Karnataka, MP and UP[6]. These states have since replaced the tender cum auction system by a system where liquor shops are allotted by a lottery system for a fixed licence fee. These states also saw a quantum jump in the excise revenue to the state exchequer. Recently, Haryana has also adopted the lottery system for allotment of shops from this year and the government is expecting a record revenue rise.

[6] Ostensibly due to political reasons the Excise Policy in UP has undergone change and reverted to the old system. Now there are selected contractors operating in the system and contributing to the revenues of the party in power for the privilege of exclusivity. http://articles.economictimes.indiatimes.com/2012-01-12/news/30619762_1_jaypee-group-manoj-gaur-business-houses/3.

New excise policy evokes good response in Haryana

Haryana's new Excise Policy for 2008-09 has evoked overwhelming response for allotment of vends to be carried out through open draw of lots. As many as 76,000 application forms netting about Rs 38 crore have been sold compared to 53,000 last year. The new Excise Policy is geared towards breaking of monopoly of a liquor cartel and making available good quality liquor at an affordable price. Initiatives taken by the Government have made investments in liquor vends more profitable and government is hopeful to generate a record revenue of Rs 1440 crores.

Source: The Hindu, March 07, 2008

Thus, gains have been considerable – more revenues for the government and more money

for purposes of development, lower prices for consumers and therefore higher consumer welfare. CUTS initiative shows how policy changes can be brought about to overcome the seemingly insurmountable problems posed by cartels.