Time for a Functional Competition Policy and Law in India

Mainstreaming competition principles into policy and legal framework is pro-development

By

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Chapter I
Market-oriented economy: The Potential

Over the past one and a half decade, the overall approach to economic management in India has been revised towards greater market orientation. Wide-ranging economic reform measures have been undertaken, with the government assuming the role of a facilitator rather than a controller. Economic reforms have been undertaken in policies relating to industrial licensing, foreign trade, foreign investment, technology imports, government monopolies and ownership, financial sector, etc.

Underlying these reforms is a renewed confidence that market forces and the individual decisions of consumers and businesses, can make a greater contribution to economic and social development than an inward-looking centralised economic system. The thrust of the economic reforms has been to allow for more competition.

These efforts towards ensuring a competitive economy have got a further impetus with the Government of India making 'competition' a serious policy issue. Extracted below are relevant excerpts from the President's Address to the Parliament on 7th June, 2004:

> "Competition, both domestic and external, will be deepened across industry…"
>
> "…government will devolve full managerial and commercial autonomy to successful, profit-making companies operating in a competitive environment".
>
> "…government believes that privatisation should increase competition, not decrease it".
>
> *The National Common Minimum Programme adds*: Indian industry will be given every support to become productive and competitive.

The major objectives of these reform measures are to promote sustained high level of economic growth, enhance productivity and attain international competitiveness, and generate employment opportunities. There is now an increased recognition that market forces play an important role in helping achieve these objectives.

In order to modernise the Indian industry and make it more competitive, reforms have led to the virtual abolition of industrial licensing requirements with a view to promoting domestic competition, facilitating allocation of resources through the market mechanism, encouraging entry and investment, achieving better capacity utilisation and economically viable scales of production. These relaxations of the regulatory apparatus are expected to make the industrial sector more competitive.

One of the key challenges today is to get rid of abject poverty that deprives a large section of our population a dignified life. An important approach to poverty reduction is to link the poor to the markets and make the markets work for the benefit of the poor people. As stated in the World Development Report 2000-01,

> *"Markets work for the poor because poor people rely on formal and informal markets to sell their labour and products, to finance investment,*

> *and to insure against risks. Well-functioning markets are important in generating growth and expanding opportunities for poor people".*

Jobs are an important route to poverty reduction. Competitive markets are more likely to provide the poor with opportunities to be employed or start their own small businesses. This is because competition creates an enabling environment to unleash creative energies of entrepreneurs and productive forces of society, and thereby expand opportunities for gainful employment. Therefore, market-oriented economic reform is expected to help achieve the policy objective of generating more employment opportunities.

Further, competitive markets facilitate wider choice of goods and services for consumers at lowest possible prices and best quality. Competition creates environment for firms to minimise their costs and pass on the cost reductions to consumers. In this way, consumers, especially the poor, can get value for money.

> *On one occasion, a poor villager complained that he can now get a good drycell for Rs 2 each, which he had been purchasing for Rs 6. These cells were of Chinese make, and are now available in India because we have had to free imports of consumer goods. A trade policy measure enabled prices to come down and the poor villager and several like him were able to save Rs 4, a big amount for those who earn less than Rs.15 a day.*

Competition, therefore, empowers the poor, creates opportunities for new firms, including small businesses, to enter markets and grow, puts pressure on existing firms to innovate, ensures lowest possible prices for consumers and better quality products.

Anyhow, it should be borne in mind that well-functioning markets is one of the factors that determine the fulfilment of the policy objectives. For instance, reduction of poverty might require framing concrete targeted programmes aimed at helping the poorer sections – a process exclusive to functioning of markets. Similarly, competitiveness depends significantly on other factors such as investment in human capital and infrastructure.

Be that as it may, well-functioning market is a key factor that can make a significant contribution towards economic development. The point is that a market-oriented economy has the potential to deliver goods, if it functions properly and is allowed to do so.

This raises certain issues:

- What factors hamper the proper functioning of markets?
- What measures are required to make the markets function well?
- Has the Government of India taken appropriate measures to facilitate the proper working of the market process?
- If not, what measures are required to ensure proper functioning of markets?

We probe these questions in this paper.

Chapter II
Competition Policy & Law required to realise the potential

Competitive market ensures efficiency resulting in best possible choice of quality, lowest prices and adequate supplies to consumers. This outcome emerges because of the following three conditions:

- *Competition*: there are a large number of producers supplying the same product, or close substitutes, and no single producer dominates the market place
- *Full information*: all consumers are fully informed about the options that the market offers them
- *Low switching costs*: the costs a consumer faces in switching from one option to another is not high enough to deter this switch

Anyhow, the real world contains a number of instances where markets do not satisfy any one or more of these conditions. In such situations, competitive markets may not exist or yield desirable outcomes. The factors responsible include situations where:

1. Market players adopt unfair means to restrict competition and hurt other players and the consumers
2. Markets fail due to externalities, imperfect or asymmetric information, and economies of scale and scope
3. Government policy that paved the way for greater market-orientation in the first place, might itself be inadequate in ensuring proper functioning of markets

The first two factors require some form of intervention in the market process. The third factor requires fine-tuning the government policy and its implementation to facilitate the working of markets.

Below we review each of these factors in some detail and outline the measures required to address them.

Market players adopt unfair means…

Distortions to the market process arise, when, firms, while competing with one another, adopt restrictive or unfair practices. This relates to fixing prices with rivals, setting price which is lower than cost in order to throw out competitors from the market, taking advantage of a monopoly position and charging unreasonable price, refusal to buy or supply, and the like.

> *Consider the example of the poor villager again, in a different setting. Let's assume there is only one shop in the village from where villagers can buy dry cells and there is no alternative shop till several miles. Taking advantage of the situation, the shopkeeper (who is expected to sell the dry cells at Rs.2), might sell the dry cells at a price higher than Rs.2 (may even charge more than Rs.6, the original price) and corner the extra money. The shopkeeper's unfair behaviour, would thus not allow benefits of trade liberalisation to pass on to the villagers. In order to ensure benefits flow to consumers, the behaviour of the shopkeeper needs to be checked.*

There is now a growing realisation that the shift towards market-oriented economy does not mean 'invisible hand' will work to allocate resources efficiently and produce competitive outcomes, as the potential benefits are often thwarted by market-distortionary practices.

In view of this, proper institutional arrangements need to be in place to check such behaviour of marker players. It is, therefore, not surprising to see that while increasingly more countries have undertaken market-oriented economic reforms, at the same time more and more countries have either enacted a competition law or scrapped their old laws to enact a new one. India, for instance, has framed the Competition Act, 2002, to replace the now outgoing Monopolies and Restrictive Trade Practices (MRTP) Act, 1969.

Competition law, therefore, is intended to put a check on restrictive or unfair business practices by firms in the market. It lays down legal principles and institutions that govern the behaviour of firms in markets including restrictive trade practices, merger scrutiny, provisions to deal with abuse of dominance, cartels etc. A competition law, in general, consists of provisions with respect to behaviour and structure of firms in the market; institutional and enforcement design; and competition advocacy.

When market fails…

Consider, for example, the electricity sector. There are three distinct activities in the industry: generation, transmission and distribution. Significant scale economies arise in these activities characterised by high ratio of fixed to total cost, declining average and marginal costs with increasing volumes, and increasing returns to scale. In case of the distribution segment, for instance, this means that the entire market (say, an individual city) can be more cheaply supplied by a single electricity distributor. The problem is that consumers (domestic as well as industries) are locked into this single producer, now in a monopoly position. Therefore, potential benefits from low-cost scales of production can easily be wiped out in the absence of competition. In such circumstances, there is need to regulate the behaviour of the electricity distributor through, for instance, regulating electricity tariffs, to prevent any monopolistic exploitation. Based on this premise, sectoral regulation is required to facilitate competitive outcomes.

The rationale for regulation differs for financial markets from that of utilities (e.g. electricity, telecommunications) and also for transportation. Regulation of utilities is mainly justified because of natural monopoly or locational monopoly for airports and seaport. In the case of financial markets, regulation is required due to information asymmetry, systemic problems and fiduciary responsibilities, whilst in the case of public passenger transport the rationale for regulation is to prevent destructive competition.

An important factor that calls for regulatory intervention in sectors being opened up for other players is 'access to essential facilities'. For example,

- Telecommunications (access to telecom network is one issue which cannot be left to market forces, and a regulator is needed to ensure non-discriminatory and reasonable interconnection arrangements)
- Electricity (access to transmission and distribution network cannot be left to market forces, and a regulator is required to ensure proper arrangements for access)

- Oil & gas (access to transmission and distribution pipeline requires a regulator to ensure non-discriminatory and proper access)
- Transport (seaports, civil aviation, railways) – again access to the network or an essential facility (e.g. railway tracks) needs regulatory intervention

Another reason for regulatory intervention is that while the market can be expected to bring about equilibrium between "demand" and "supply", it will not be able to ensure a balance between "need" and "supply". From a social point of view, it is desirable that all consumers, regardless of their income status, have access to certain services, for example, electricity. This requires regulatory intervention to promote equitable outcomes. Sectoral regulatory policies, through mandating universal service obligation on the service providers, ensure supply of services to the poor and disadvantaged consumers, at a reasonable price even if it means incurring a loss.

Regulation in certain sectors thus becomes imperative to ensure competitive outcomes. Markets and sectoral regulation are, therefore, complementary instruments. The latter is required to compensate in some way the failings of the former.

What is Regulation?

Regulation here does not refer to the mesh of complicated and opaque rules, which have stifled entrepreneurship and innovation in the past. The regulation referred to here is a set of transparent, consistent, and non-discriminatory rules that create a competitive and dynamic environment in which market players can thrive. In its absence, anti-competitive practices and regulatory failures may not allow the market process to yield desirable outcomes.

Distortions arising from government policies and practices…

Distortions in the market process may also arise from the policies and practices of the government. While the Government of India has undertaken market-oriented economic reforms with great fervour, distortions remain in the policies itself or in their implementation. For instance, the last decade has seen significant relaxation in quantitative restrictions, reduction in tariffs and an easing of the exchange control regime. Nevertheless, the operation of key elements of the trade policy regime has several anti-competitive dimensions. For example, anti-dumping measures are increasingly used to protect competitors; inverted duty structure (i.e. higher import duty on raw materials vis-à-vis that on finished products) exists for several products adversely affecting domestic manufactures. There are many more examples (see Annex 3).

Therefore, while framing policies or implementing them, there is a need to envisage the impediments these would create to the market process. These impediments need to be properly articulated, acknowledged and measures taken to minimise their adverse effect on the functioning of markets. In order to do this, policies and practices need to be formulated and scrutinized on the touchstone of competition. This requires certain guiding principles to formulate policies and practices in a liberalised regime.

…Competition Policy and Law required

The likelihood of market-distortionary practices, situations of market failures and government induced anti-competitive outcomes, as outlined above imply that appropriate measures need to be taken to ensure the market-oriented economic regime results in competitive outcomes.

What emerges is that appropriate competition principles and rules (competition law and sector regulatory laws) need to be framed and implemented, and supporting institutional infrastructure put in place for a market-oriented economy to deliver goods. These measures come under the umbrella of 'Competition Policy', which seeks to check private and government imposed impediments to proper functioning of markets and facilitates pro-active steps to create an environment in which markets function better and yield desirable outcomes.

"Competition Policy" therefore involves:

A. Competition law prohibiting anti-competitive conduct by businesses
B. Sectoral regulatory laws to check situations where market fails
C. Government policies that enhance competition in local and national markets (such as liberalised trade policy, relaxed foreign investment and ownership requirements, regulatory reforms)

The implementation of Competition Policy requires the assessment of a wide range of policy instruments, which goes beyond the traditional legislative prohibitions. The different government policies that may encourage or adversely affect competition and hence consumer welfare, particularly, in the context of the present globalising environment include:

1. Trade policy
2. Industrial policy
3. Privatisation/Disinvestment policy
4. Foreign Direct Investment (FDI) policy
5. Fiscal policy
6. Intellectual property policy
7. Labour policy
8. Consumer policy
9. Small-scale sector policy
10. Regional development policy
11. Environment policy

Some of the policy instruments, such as competition law and sectoral regulatory laws have an obvious direct effect on competition, while the policies listed above affect the general economic environment and ultimately the general climate of competition in the country. Competition policy, thus, requires a seat at many policy-making tables.

The assessment of the various policy instruments is done on the touchstone of 'nine principles' of Competition Policy. These principles provide guidelines to different branches of the Government and agencies at all levels in maintaining the appropriate competition dimension, while taking any action or decision, which would have an impact on the economy and consumers.

The 'Nine Principles' of Competition Policy are:

I. Foster Competitive Neutrality between public and private sector enterprises
II. Ensure Access to Essential Facilities
III. Facilitate easy movement of goods, services and capital
IV. Separate policy-making, regulation and operation functions
V. Ensure free and fair market process

VI. Balance competition and Intellectual Property Rights (IPRs)
VII. Ensure transparent, predictable and participatory regulatory environment
VIII. Notify and publicly justify deviation from competition principles
IX. Respect for international obligations

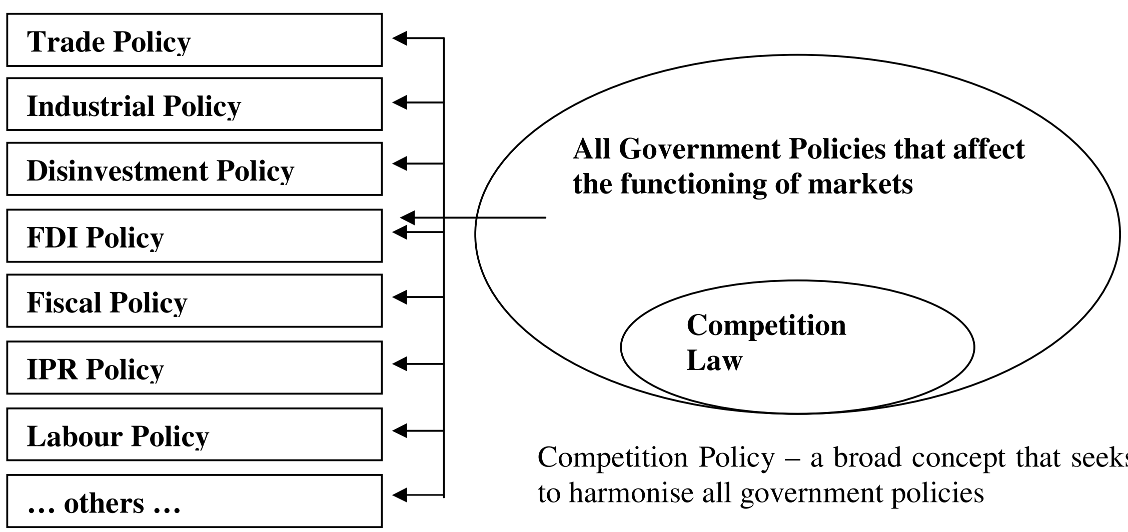
Competition Law vis-à-vis Competition Policy

Competition policy and competition law are distinct concepts, as observed from above discussion. Unfortunately, most of the policy community considers both terms as synonyms and interchangeable, which is not the case.

Competition Law is but a subset of Competition Policy (see figure 1). Besides encompassing the law, Competition Policy includes sectoral regulatory laws and the various government policies that enhance competition and consumer welfare.

Competition law is, therefore, quite narrow in its scope, whereas Competition Policy is much more broad and comprehensive in its scope.

Competition Policy vis-a-vis Competition Law



Competition Policy – a broad concept that seeks to harmonise all government policies

What the paper contains:

Competition Policy and Law (including competition law and sectoral regulatory laws) is required to ensure the market process helps accelerate our progress towards achieving the various policy objectives.

With this backdrop, the paper presents the current state of Competition Policy and Law in India and suggests appropriate measures to make it effective.

Chapter III
Competition Law in India: Is it effective?

The Experience with MRTP Act…(In)effective

India has had a competition law: the Monopolies & Restrictive Trade Practices (MRTP) Act since 1969. The Act was enacted to prevent concentration of economic power, control monopolies, and prohibit monopolistic and restrictive trade practices. Unfair trade practices, a consumer protection provision covering deception, misleading claims and advertising etc, was brought in through an amendment in 1984.

However, the MRTP Act did not deliver as expected. This was partly because the Act was created at a time when all the process attributes of competition such as entry, price, scale, location, etc were regulated. The MRTPC had no influence over these attributes of competition, as these were part of a separate set of policies. What a paradox! The MRTP Act was enacted to check the various competition concerns that resulted from the then control regime, but had no say in changing the very elements of that regime.

Another reason for its inadequacy in dealing with anti-competitive practices was the absence of proper definitions in the Act. A perusal of the MRTP Act will show that there is no definition nor even a mention of certain offending trade practices which are restrictive in character. Some of the anti-competitive practices such as abuse of dominance, cartels, predatory pricing and bid-rigging were not specifically mentioned in the Act. The MRTPC was also unable to take any action against any of the international cartels that attracted the attention of other competition authorities. Even the provisions on mergers and acquisitions (M&As) were deleted from the MRTP Act, consequent to the 1991-amendments.

A key reason for the ineffectiveness of the MRTPC was that it was poorly resourced. The inadequacy of the budget allocation was compounded by the need for the MRTPC to seek government's permission to incur expenditure beyond certain limits. This severely curtailed its independent functioning. The independence of the MRTPC got further impaired due to the discretionary power of the government to appoint senior level officers.

Therefore, weaknesses in the structures of the MRTP Act and the composition of the MRTP Commission were among the key reasons for ineffectiveness of the MRTP Act.

It was in 1991 that widespread economic reforms were undertaken and consequently the march from a "command-and-control" regime to a regime based more on free market principles commenced its stride. The economic reforms undertaken since the early 1990s significantly changed the economic environment in the country. Major amendments were made to the MRTP Act in 1991 but even these were considered inadequate to deal with the emerging economic order. In view of this, India adopted a new competition law, the Competition Act, 2002 to replace the MRTP Act.

Competition Act…New Wine in a New Bottle

The new competition law, the Competition Act, 2002, is arguably a better piece of legislation as compared to its predecessor, the MRTP Act. The new law provides for a modern framework of competition. It focuses on four core areas:

i. Anti-competitive agreements
ii. Abuse of dominance
iii. Combinations regulation
iv. Competition advocacy

Explicit definitions and criteria have been specified to assess whether a practice has an appreciable adverse effect on competition. One distinguishing feature of the Act is that it emphasises on behavioural approach to examine competition in the market as against the structural approach followed by the MRTP Act. The regulation of M&As has returned to the scope of Indian competition law, although the new law sets rather high turnover thresholds for combinations to fall under its purview.

The new law has extraterritorial reach. This provision is based on what is known as the *'effects doctrine'*. Thus, actions or practices taking place outside India but having an appreciable adverse effect on competition in the relevant market in India would come within the ambit of the Act.

By including provisions on competition advocacy, the Act extends the mandate of the CCI beyond merely enforcing the law. Introduction of competition advocacy function is to create a culture of competition in the country and increase awareness amongst various stakeholders about competition policy and law.

The Act is, however, facing a challenge even before becoming fully operational. Writ petition has been filed in the Supreme Court, challenging, the constitutional validity of the Act, and the appointment of a bureaucrat to head the Commission. Pursuant to the litigation, the Government has proposed to amend the Competition Act, 2002 *inter alia* bifurcating the body into two: Competition Commission and a Competition Appellate Tribunal.

Be that as it may, there are several concerns, which are likely to impair the effectiveness of the Competition Act.

Competition Act 2002…Concerns? Measures Required?

- Autonomy of the CCI…undermined

There are certain provisions in the Act, which undermine the independence and autonomy of the CCI. These include grant of money at Government's discretion, and the power given to the Government to supersede the CCI on grounds of, for example, public interest. CCI is also bound by directions of the Government on questions of policy. These provisions severely affect the independence and autonomy of the CCI and need to be reviewed.

√ *The discretion enjoyed by the Government in providing budget to the CCI should be removed. Instead, the Parliament itself should approve the budget for the CCI.*
√ *The power to supersede the Commission severely undermines the independence of the Commission and should be removed.*
√ *The issue of policy directives by the government should be qualified by including an enabling provision for a wide consultation process. Government should be required to place in the public domain the comments received from the Competition Authority and other stakeholders, and provide reasons for the issue of the directives.*

- Provisions to make CCI accountable…inadequate

The provisions discussed in the context of autonomy of the CCI, mainly aim at keeping a check on CCI's functioning by limiting its independence. However, this is not a good approach of making an independent authority accountable, as it reduces its effectiveness.

Under the existing provisions, Parliament has an oversight over any rules and regulations made, to carry out the provisions of the Act. CCI is also made accountable by requiring it to submit an Annual Report of its activities, which is laid before the Parliament. Besides, appeals against CCI's order/decision lie with the *proposed* Competition Appellate Tribunal and the Supreme Court. Though these mechanisms exist, they are not likely to be very effective.

√ *The supervisory role of the Parliament needs to be improved*
√ *CCI should also be made accountable through an independent review by external agencies and peer review by competition authorities from other countries*

- Interface between the CCI and sectoral regulatory agencies…ambiguous

The Competition Act implicitly recognises the overlap between the functions of sectoral regulators and the CCI in competition matters. Accordingly, the Act and the draft amendment bill provide for a sectoral regulator to make a reference to the CCI on such matters. Unfortunately, such reference is voluntary in nature i.e. purely at the discretion of the sectoral regulator.

As per the draft amendment bill, where any reference is made to the CCI, regulators have to give speaking orders. Thus, even though CCI's advice is not binding on the regulators, they will have to provide a 'reaction' to such advice received from the CCI. This would put a check on the way regulators use CCI's advice. This amendment is a significant improvement from the earlier provision in the Act, which allowed the regulators to take decision as they deemed fit.

However, by leaving the consultation process 'voluntary', the improvement introduced in the draft amendment bill would be ineffective. Considering that regulators have to give speaking orders on a reference made to the CCI, they will have no incentives to refer the matter to the CCI in the first place itself, given the discretion they would enjoy. Such inadequacies in the Act will create conflicts between the competition authority and the sectoral regulators and lead to inconsistent decisions and forum shopping.

√ *Consultation between sector regulators and competition authority should be 'mandatory'. This refers to regulators seeking CCI's advice on competition matters as well as the CCI seeking regulators' advise on issues that have implications for the regulated industry*
√ *The CCI should proactively participate in discussions on competition-related issues before sectoral regulators*
√ *Government should establish a concurrency party between the CCI and sectoral regulators, so that there is better coordination among them to ensure that competition concerns are addressed properly*
√ *In view of the likely overlaps between the CCI and various sectoral regulators, a Common Appellate Tribunal should be established for the CCI and sectoral regulators.*

This will ensure convergence in application of competition and regulatory laws on issues where there is overlap and discourage forum shopping. The jurisdiction of the common appellate tribunal should be restricted to issues of law

- Provisions to deal with Intellectual Property Right (IPR) abuses…weak

The Act recognises that the bundle of rights that are subsumed in intellectual property rights (IPR) should not be disturbed in the interests of creativity and intellectual/innovative power of the human mind. It accordingly, exempts reasonable conditions forming a part of protection or exploitation of intellectual property rights.

However, "what is reasonable?" is not explicitly mentioned in the Act. Secondly, the Act is silent about the remedies, if *unreasonable* conditions accompany IPR licences and limit competition. Compulsory licensing and parallel importing are two key remedies of great importance and a competition law cannot remain silent in this regard. However, in India, the IPR laws such as the Patent Act or Copyright Act or Trade Marks Registration Act have over riding powers over the Competition Act in matters related to IPR abuses. For instance, in cases where an anti-competitive outcome arises from the exercise of the rights by the patent holder, the Patent Amendment Act (2005) provides for issue of licenses to stop such anti-competitive activity. However, the role of CCI to examine such matters does not find any mention.

Competition law is a useful tool to discipline licensing agreements that restrain marketing and product development, and consequently have an anti-competitive effect. Accordingly, competition law in several countries cover abuse of IPRs. Competition law is best suited to decide whether there is an adverse effect on competition from the use of IPRs.

√ *The Act should explicitly mention what constitutes 'unreasonable' conditions. An indicative list of unreasonable conditions should be given, such as, patent pooling; tie-in arrangements; prohibiting licensee to use competing technology; an agreement to continue paying royalty even after the patent has expired, fixing the prices at which licensee should sell, etc.*

√ *The Act should specify the remedies that are available, in case of abuse of IPRs. In this context, competition law should override IPR laws.*

- Criteria for defining 'Exemptions'…subjective

The Act provides for exemptions to mergers and abuse of dominance on certain grounds, such as 'Economic Development' and 'Public Interest'. However, there is no definition of these terms. In the absence of clear definition/criteria, relevant provisions will be open to varying interpretations, based on the subjective interpretation of 'economic development' and 'public interest'.

√ *The Act should lay down the criteria under which such exemptions will be granted*

√ *Such exemptions must be publicly notified*

Chapter IV
Emergence of Sectoral Regulators: Prospects? Challenges?

Till recently, government-owned monopolies operated and regulated the infrastructure services under various laws. With the introduction of reforms and liberalisation of the Indian economy in 1991-92, private participation was allowed, initially in power and telecom and subsequently in ports, roads and civil aviation.

Contrary, to well-established practices, regulatory reforms were not part of the original agenda for sectoral reforms in India. Only when the first wave of privatisation and liberalisation failed to arouse sufficient private interest, it dawn on policy makers that independent sectoral regulation was essential to build confidence among private investors to assure them that their interests were protected. Besides, unregulated privatisation meant that public monopolies would turn into private ones, especially in sectors having natural monopolies or limited competition. Moreover, existence of several companies supplying the same area would result in an inefficient multiplication of cables, transformers, pipelines etc.

Accordingly, independent regulatory bodies have been set up in telecom (Telecom Regulatory Authority of India), power (Electricity Regulatory Commissions at the central as well as state levels), and seaports (Tariffs Authority for Major Ports). The process of setting up regulatory agencies in several other sectors (civil aviation, oil & gas) continues. These agencies have been set up to carry out several functions *viz.*, balance conflicting interests, promote competition, facilitate investment, democratise decision-making, ensure overall development of the sector, etc.

Sector regulators have also been established for capital markets (Securities and Exchange Board of India) and insurance (Insurance Regulatory and Development Authority), while the Reserve Bank of India has been regulating the banking sector for a long time. These agencies have objectives different from those performed by regulators in the infrastructure sector. Thus, while the RBI is more concerned about systemic stability, the concerns of SEBI are investor protection and information disclosure.

Be that as it may, for the present context, what matters is whether these agencies have been given sufficient mandate to implement their brief and whether they are allowed to perform their functions – an issue common to all the regulators. Surely, independent regulators will be governing a sizeable part of the economy and public services in the coming years; therefore institutional efficacy would have a bearing on the quality of public life.

- **Inconsistent and incoherent approach in regulatory laws**

Regulatory agencies have been created without due consideration to consistency and coherence in approaches across various sectors. Instead, the design of regulatory framework has been largely left to the relevant line ministries. As a result, the scope, or functions, of regulation differ widely across sectors.

Strangely, good provisions in a regulatory legislation do not find place in another. For instance, the Electricity Act does not leave space for government, not even the judiciary, to modify the regulator's decision on technical grounds. On the contrary, TRAI's sole job is to advise the government. While in the case of TAMP, the government can modify the regulator's order on tariffs. This demonstrates the isolation in which government departments formulate regulatory laws.

Diversity in Regulatory Approaches: A Glimpse

Electricity regulatory agencies are expected to facilitate investment and growth, and advise government on policy matters. They are even empowered to adjudicate on sectoral competition issues, such as abuse of market dominance, cartels, etc. In contrast, the amended TRAI Act has effectively reduced the telecom regulator to a mere advisor. The regulator publishes consultation papers, organises stakeholder consultations and submits recommendations to the Department of Telecommunication (DoT). Implementation of such recommendations is entirely subject to the latter's discretion. On the other hand, TAMP is only a tariff regulatory authority on the lines of a tariff commission, and is not a regulator of seaport activities.

The Petroleum Regulatory Board is on the cards and there are reports about setting up of similar bodies to regulate civil aviation and transport sectors as well. Since no holistic framework exists to ensure consistency and coherence across the board, it is most likely that these bodies will end up adding to the diversity in regulatory legislation.

Such diverse approach has led to a situation where there are as many regulatory models as regulatory bodies. This has created unnecessary confusion and is affecting the credibility of independent regulation per se.

√ *There is a need to put in place an overarching framework covering aspects such as the degree of regulatory independence, financial autonomy, functional overlaps, interface with government and other agencies, and accountability to guide formulation of any sectoral regulatory body*

√ *The Law Ministry should be the nodal agency to examine various draft regulatory legislation, which originate from various ministries. It would regulate the regulatory law making and ensure the desired degree of uniformity across the board*

- **Line Ministry and Regulatory Agency…Ambiguity in Relationship**

The primary question in the regulator's relationships with the government is a clear delineation of responsibilities and an understanding of each other's positions. Regulators should be given a reasonable degree of freedom to effectively discharge their duties under the statute. This independence, however, cannot be absolute — it must be subject to the laws of the land and the policy of the government.

Regulatory laws often require the government to issue 'policy directives' to regulators. Such directions need to conform to the objectives of the relevant regulatory legislation and should be confined only to policy matters and not relate to administrative and technical matters. Unfortunately, most often regulatory laws do not define the scope of these policy directives. Leaving the term 'policy directive' vague and subject to arbitrary interpretations has given rise to conflicts and confusions.

Presently, in some cases, the line Minister is made answerable to the legislature even for functions that have been transferred to the regulator. This makes the line ministry continue to want to perform the same functions and interfere in the domain of regulator, which impairs regulatory functioning and consequently, its efficacy. A mechanism needs to be developed to make the regulators directly accountable to the legislature. Furthermore, having appropriate processes in place to facilitate consultations between the line ministry and the regulator is required to avoid a possible compromise on regulatory autonomy. The manner of consultations between the Reserve Bank of India (RBI) and the Ministry of Finance is a good model: the RBI holds consultations with the Ministry of Finance on a regular basis, at formal and informal levels, without compromising its autonomy.

Line Ministry vs. Regulatory Agency: Turf War Continues…

The Department of Telecommunications (DoT) recently announced certain proposals (on Access Deficit Charges, one India call rate, inter-connection usage charges) to restructure the tariff regime in telecommunications, considering these to be policy issues. However, TRAI, the sector regulator has objected to these proposals on the grounds that tariff related matters fall under its purview. After TRAI's objection, the DoT contemplated exercising its powers under the TRAI Act of issuing 'policy directives' to the regulator. Although the Ministry finally refrained from doing so, this event highlights the need to clearly demarcate policy and regulatory issues.

In another similar incident, the Ministry of Power attempted to clip the wings of electricity regulatory commissions through amending the legislation. This was however shot down by the Prime Minister's Office.

- √ *Spell out clearly the objectives and scope of regulation and the powers of the regulator in the enabling legislation. Regulatory agencies should work within the framework spelt out in the legislation*
- √ *Provide a clear distinction between 'policy' and 'non-policy' issues*
- √ *Involve regulators in the evolution of policy*
- √ *The issue of policy directives by the government should be qualified by including an enabling provision for a wide consultation process. Government should be required to place in the public domain the comments received from the regulatory authority and other stakeholders, and provide reasons for the issue of the directives*
- √ *There should be regular consultations between the line-ministry and the regulator; the RBI-Ministry of Finance interface model could be applied wherever feasible*
- √ *A Parliamentary Committee on Regulation and Competition should be established as the reporting authority for all regulatory agencies. The Committee's domain should be confined to systemic issues only and not the individual decisions and orders of regulators.*
- √ *Multi-sectoral regulators, such as one for energy and another for transport, should be established to reduce the possibility of regulatory capture by individual line-ministry, and for efficiency*

- **Financial Autonomy Impaired**

Most of the regulatory bodies in India depend on the line-ministry for their budget. This is not a desirable practice as such provisions limit regulatory autonomy. The number and nature of staff, appointing consultants, market investigation, etc are activities that can be controlled through budget allocations.

TRAI, for instance, has been complaining of limited resources at its disposal that severely curtail it's functioning. Accordingly, the regulator sought government's permission to allow it to share a part of the license fees, as its independent source of funding. However, the proposal was shot down by the DoT. Interestingly, the insurance regulator (IRDA) and the capital markets regulator (SEBI) are allowed to raise revenue in a similar way!

√ *Regulatory agencies should be allowed to generate resources on their own through a fee, cess, etc. wherever possible, and be allowed to spend it*
√ *The financial requirements proposed by the regulator should be linked with their work plan for a certain time period (say, the next 3 years) and approved by the parliament*
√ *Regulators should be given the liberty to hire required staff on contract and appoint consultants in a transparent manner*

- **Selection/Appointment and Removal at the discretion of line minister**

Selection and appointment of regulators is one of the most crucial aspects that need to be addressed upfront. There has been a tendency in recent years to appoint retired bureaucrats and judges to regulatory bodies without ascertaining their suitability. This is an unhealthy practice and needs to be curbed. Indeed, attracting young talent is the key to making these institutions work in a desirable manner.

Equally important is to provide protection against a possible discretionary dismissal. This would go a long way to ensure functional autonomy to regulators. For instance, in the year 2000, the then government amended the TRAI Act and in the process, reconstituted the Authority, which is considered as a rather weak institution. This demonstrates the vulnerability that ‘independent’ regulatory institutions face in India.

√ *Constitute a Committee consisting of eminent people to select regulators for various regulatory agencies at central and state level*
√ *Applications should be invited against pre-determined selection criteria*
√ *Regulators should be given a fixed tenure of 5 years with a maximum age limit of 60 years for appointment*
√ *The prevailing practice of sinecure needs to be discouraged. The bottom line must be to encourage experts and young professionals to join such positions*
√ *Offer attractive compensation to draw young professionals to join regulatory bodies*
√ *Department of Personnel, Government of India, should be designated as the Administrative Ministry for regulatory bodies, responsible for release of appointment letter and other administrative matters*
√ *Regulators and their staff should be provided with short-term training, prior to induction*
√ *Member of a regulatory agency should be removed only in case of a proven guilt or inability established in a judicial probe by a sitting judge of the Supreme Court. The proposed Parliamentary Committee on Regulation and Competition should initiate such probe, whenever necessary*

- **Accountability to Parliament/Legislature…ineffective**

Accountability goes hand-in-hand with autonomy. The existing regulatory legislations require regulators to submit an annual report of their activities before the parliament. However, this provision is not sufficient to hold regulators accountable in an effective manner. Expecting the Parliament to devote the amount of time required for in-depth analysis would not be realistic. Some regulatory agencies do not even submit their reports on time. The Committee on Papers Laid on the Table of the Lok Sabha observed in its report for 2004-05: "*TRAI has* *been a habitual defaulter in the matter of timely laying of their Annual Reports and Audited Accounts*".

In any case, such provisions provide only for *ex post* analysis (i.e. after the regulator has taken an action/decision); hence are partial in nature. Appropriate mechanisms need to be in place to cope with possible under-performance of regulatory bodies. This also requires ensuring accountability on *ex ante* basis (i.e. a mechanism for a transparent scrutiny of decisions/actions proposed by the regulator).

- √ *The proposed Parliamentary Committee on Regulation & Competition should be the reporting authority for regulatory agencies. Regulatory agency should submit an activity and outcome report to the legislature through this Committee; the Committee should call regulators for an explanation, only in case of systemic issues*
- √ *Create a Consumer Advocacy Fund to build the capacity of consumer/civil society groups to raise consumer concerns more effectively and act as a watchdog*
- √ *Provide for evaluation of regulator's performance through a peer/external review system against the given mandate*
- √ *Political parties and the government should give their feedback as stakeholders to the regulator whenever it is sought. Besides, they should participate in the open discussions/hearings conducted by the regulator.*

- **Proliferation of Appellate Tribunals**

Another approach for overseeing regulators' functioning is by providing for appeals in the relevant regulatory laws. This has, however, led to a disproportionate proliferation of appellate tribunals, though most of them do not have enough work and are an unnecessary burden on exchequer. It also fuels the undesirable trend of appointing retired bureaucrats/ judges to head these bodies.

Secondly, there is often an overlap between the functions performed by various regulatory agencies - between the competition authority and sectoral regulators, between electricity regulators and the proposed petroleum regulator and so on. Setting up an appellate body for each regulatory institution can lead to forum shopping and inconsistent decisions at the appellate level.

- √ *Establish a common appellate tribunal with regional benches for the CCI and sectoral regulators. A common tribunal will ensure convergence in application of various regulatory laws and set healthy conventions to ensure their harmonious application*
- √ *The law should provide for appeal against a regulator's decision before the Common Appellate Tribunal first and then to the Supreme Court. The appeal should be made on points of law only*

- **Protection of Consumer Interest…inadequate and ineffective**

Consumers have to be ensured a fair price for the services and a commensurate quality of service. Regulatory agencies in India are increasingly taking measures to ensure reasonable prices and quality of service. In addition, several regulatory agencies in India follow a consultative process to arrive at their decisions/ recommendations. This provides an opportunity to consumers and their organisations to provide feedback.

In practice, however, representation of stakeholders is not balanced and most often service-providers dominate such discussions. Consumer groups, by and large, lack the capacity and resources to effectively represent their views, though the system provides opportunity for that.

Consumer Impact Assessment: A Tool To Assess Regulatory Effectiveness

TRAI is one of the few regulators that has taken several steps to promote consumers interest, including providing a platform to consumer organisations to air their views. Consumer organisations working on telecom issues are registered as consumer advocacy groups with TRAI and annual meetings are organised with this group. TRAI, in consultation with various NGOs/ Consumer Advocacy Groups and telecom service providers, has also finalised a common charter for adoption by all the Telecom Service Providers. It's handling of tariff regulation has brought down the per call tariff rates in the country, and are amongst the lowest in the world – another boon for the consumers.

Despite low tariffs, 30 percent of mobile subscribers are willing to shift to an operator offering better service, according to a recent study conducted by the International Data Corporation. This is not surprising, as with growth, quality of service has taken a beating too. TRAI's data shows a significant increase in consumer complaints. Network congestion, call drops etc are common complaints. Interconnectivity between GSM providers and non-GSM or DOT systems appears to be intentionally sabotaged, and it takes many attempts to connect. Billing is another big problem.

One wonders, if this were the situation when telecom subscriber base has just crossed the 100-million mark, what would happen when it reaches the 250-million mark, as targeted by 2008. Even though the sector is competitive, service providers are not bothered about providing value for money. TRAI's data shows a significant increase in consumer complaints. The redressal mechanism is equally weak.

All our regulatory laws and arrangements recognise protecting consumer interest as one of its primary objectives. But the same is not as effective as it should be. It is time for TRAI and other regulatory bodies to judge their effectiveness from consumer perspective. This calls for doing a periodic 'Consumer Impact Assessment (CIA)', a tool designed to look at policies and practices from a consumer perspective.

CIA helps assess whether markets and public services are working in the interest of consumers. It greatly enhances accountability of the regulator to consumers. All policies, regulations and practices are assessed on the touchstone of eight consumer principles: value for money, access, choice, information, redress, safety, fairness, and representation.

√ *Resource and strengthen the consumer movement in India to participate effectively in the regulatory process and perform a watchdog role*

√ *All regulatory agencies should employ Consumer Impact Assessment for the corresponding policies, regulations and practices, including those that are in development*

- **Regulating the state-owned incumbent…A Test of Regulatory Efficacy**

Regulating the incumbent, especially the government-owned, is a challenging task not just in India but elsewhere as well. There are several instances across the sectors when regulators find themselves unable to enforce compliance of their directives by the state-owned incumbents. Public sector service providers hardly compete with each other for better economic efficiencies. Therefore, incumbent regulation is a tricky area in any sector.

As long as regulator remains vulnerable to the discretionary powers given to the executives of the related ministry to whom state-owned incumbents also report, it would be difficult to expect the regulator to ensure competitive neutrality between the state-owned incumbent and other private operators.

> *Consider the case of TRAI. It has been successful as an administrative regulator (helped resolve several legal issues that bogged down the sector) and in tariff regulation. However, TRAI's record is much less impressive in reining the market power of the state-owned incumbent: Bharat Sanchar Nigam Ltd. (BSNL), which has thwarted many decisions that are critical to maintaining a level playing field. For example, the decisions relating to accounting separation, asymmetric regulation, bundling of services, etc., which are critical for competition to thrive, remain unimplemented for a variety of reasons including litigation by BSNL.*

This issue is connected with regulator's relation with the government and the suggestions provided above will go a long way in empowering the regulator to effectively regulate the state-owned incumbent.

Chapter V
Central Government Policies/Practices: Impeding the Market Process

The basic philosophy behind and the common thread through the various reform measures has been the resolve of the government to liberate the Indian industry from the shackles of its various 'controls'. The thrust of reforms has been to allow for more competition and for the government to play the role of a facilitator rather than the controller of economic activity.

Policy documents released by the Government, often speak about the redefined role of the Government – for example, a 1993 document says

"At the Central Government level, priority should be accorded to eliminating remaining barriers to industrial production, investment and import of technology as quickly as possible. The Government's role should shift increasingly to restructuring unviable enterprises, ensuring fair business practices, safeguarding consumer interests and minimising the adverse effect of industrialisation on the environment."[1]

However, in spite of this kind of speak, a large overhang and backlog, from the past, persist in both attitudes and laws, which prevent the Government from construing and constructing policies that are structured to work in sympathy with market processes. Several policies and practices of the government are designed to distort the market process and competition – most often in the name of public interest, which invariably means some vested interest.

Consider the following examples (also refer Annexure 3 for several such examples):

- **Trade policy related distortions…**

The last decade has seen significant relaxations in quantitative restrictions, reduction in tariffs and an easing of the exchange control regime. Despite this, the operation of key elements of the trade policy regime has severe anti-competitive dimensions. For example, policies in relation to the operation of anti-dumping measures, inverted duty structure, etc.

Inverted duty structure adversely affecting domestic manufactures

One of the anomalies in the tariff regime is the higher import duty on raw materials vis-à-vis that on finished products (reverse tariff escalation), which leads to market distortions, adversely affecting domestic manufacturers. Certain examples of reverse tariff escalation are:

- The tyre industry, where import duty on natural rubber is 20 percent. However, the duty on imported finished tyres is only 10 percent. This has led to cheap unwarranted tyre imports, in particular from China. Profitability and market share of tyre companies has taken a hit *(Source: Business Standard, 01.04.2005)*
- The Vegetable Oil sector where crude palm oil, a raw material for manufacture of vanaspati, attracts customs duty of 65 percent *ad valorem*; while import of vanaspati itself (the finished product) attracts much lower rate of duty at 30 percent. This is encouraging large vanaspati import and hurting the domestic vanaspati industry *(Source: Business*

[1] Economic Reforms: Two Years After and the Task Ahead (1993) Government of India, Ministry of Finance Department of Economic Affairs

Line, 25.11.2004)

- In Petrochemical sector, suppliers of feed-stock like naphtha, natural gas (GAIL) and basic polymer (Reliance Industries) have a tariff protection advantage over producers of finished products like plastics and synthetic fibres *(Source: Financial Express, 28.05.2005)*

The reduction of trade barriers has been accompanied by a proliferation of anti-dumping (AD) measures imposed by India. In several of these cases, the anti-dumping authority accepted an increase in the foreign firms' market share (which was only to be expected in a period of trade liberalisation) as evidence of injury, even though the Indian industry's sales and profits were increasing at the same time. In almost all cases AD remedies have been used to protect Indian industries, and not to preserve competition. Moreover, AD measures have inflicted higher import costs on user industries, as it is mainly intermediate goods industries in the chemicals sector that have succeeded in obtaining protection.

- **Procurement related distortions…**

The government seems to be continuing with discriminatory policy to meet its commitment of a strong and effective public sector. The recent announcement to extend the purchase preference policy for central public sector enterprises for another three years is an example. Similarly, preference is given to public airlines and public telecom operator in procuring their respective services. Such preference to public units in the procurement of goods and services creates an uneven field for the private sector players and distorts the market process.

> *Recently the Finance Ministry made an announcement to put an end to the practice of giving preference to public enterprises in air travel and telecom services. However, this has not gone down well with BSNL, the state-owned telecom operator, which has objected to this, under the garb of needing support to provide services in rural areas.*

Quite often government procurement rules, which otherwise do not have any such preference clause, also result in anti-competitive outcomes due to the way in which they are implemented. For instance, the Parliamentary Standing Committee on Railways (2004), while discussing the question of procurement of concrete sleepers, observed:

> *The procurement of concrete sleepers has become a very sensitive matter, because a lot of unscrupulous existing manufacturers have formed a cartel to secure orders by unfair means or tempering with procedure and simultaneously keeping the new competitors out of the race. The Committee is constrained to notice that there exists a regional imbalance in the setting up of concrete sleeper manufacturing units. They also express their unhappiness that <u>new entrants are not encouraged</u>, which ultimately strengthen the cartel of old/existing manufacturers.*

In procuring 160 lakhs broad gauge sleepers, the Railways awarded contracts to the existing 71 firms, and ignored the 24 new firms entirely.

- **Pricing related distortions…**

Despite professing liberalisation and claiming to be the facilitator of economic activities, government continues to intervene in the pricing of several commodities that distorts the realization of competitive outcomes. For example, the current system of pricing coal weakens incentives for delivering better quality coal; the implementation of minimum support price system distorts prices of foodgrains in the open market (see Annex 4).

Lack of Transparency in pricing of Petroleum Products

The Administered Price Mechanism (APM) was formally dismantled with effect from 1 April 2002, after which the pricing of crude oil and petroleum products except for kerosene and domestic LPG sold through the public distribution system (PDS) was to be market determined. However, the factual position is that the public sector oil companies are collectively fixing prices of crude oil and petroleum products, and all price changes are approved by the Government of India prior to implementation.

Further, the current pricing policy includes several elements in the price build up that are debatable. The pricing mechanism uses import parity pricing even for products, in which India is the net exporter. This provides higher margins to the refiners.

Additionally, the government levies a cess on indigenously produced crude oil and natural gas. The Oil Industry Development Act, 1974 based on which the cess is being charged, states that "*the cess collected under this provision would be made available to the development of petroleum sector*". However, only a small fraction of this amount has been utilised for the purpose it is imposed. The Parliamentary Standing Committee on Petroleum and Natural Gas observed, "*there is no justification in levying the cess if the amount generated from it is not being utilized for the development of the oil sector*".

- **Distortions created by rules and regulations…**

There are several rules and regulations framed by the government agencies that distort the market process. For example, the clearances required for setting up a business and the time involved.

> *A study conducted by the World Bank reveals that in India, entrepreneurs on average go through 11 steps to launch business, which takes 89 days, as against a regional average of 7 steps and 35 days! In a sample of 155 countries, India was placed at the 116th position in terms of ease of doing business, much below even Pakistan, Sri Lanka and Bangladesh. What a shame!*

For all those who champion the cause of small-scale units and demand more protection for them, there is a flip side too, which should be taken note of.

Inspector-raj for small-scale industry

Small-scale units are burdened by the phenomenon of repeated visits by multiple inspecting agencies, each of which has excessive powers without sufficient transparency or checks on how to use them. As per an estimate, small-scale units have to comply with 22 Central enactments. A survey conducted by the Federation of Indian Chambers of Commerce and Industry (FICCI) in October 2004 revealed that, on an average, a factory/establishment is subject to 37 inspections a year, with some factories facing 67 inspections in a single year, the maximum number of visits being those of the Environment Officer, State Pollution Board officials and the Labour Officer. Some of the inspectors have wide ranging powers: 20 of them have powers of imprisonment, 12 for sealing the unit and 21 for stopping operations. The wide powers vested in the inspectors and the frequency of their visits has led to the phenomenon of Inspector Raj and proved to be a fertile ground for breeding corruption.

There are several anti-competitive outcomes that emanate from other rules and regulations of the government. For instance, the Essential Commodities Act, which applies to any commodity declared as essential by the Central Government provides for instruments like licenses, permits, regulations and orders for price control, storage, movement of produce, distribution, compulsory purchase by government and sale (levy) to government, etc. The Act gives too much of discretionary power to officials and has led to excessive control and intervention in the functioning of the market process.

> *Recently the Jute Commissioner based in Kolkata announced a price ceiling on raw jute. The action was taken because prices of raw jute were skyrocketing and it meant that prices of jute bags would also be heading north. Raw jute is still treated as an essential commodity and the Jute Commission's office used its special powers under the essential commodity clause to declare the price ceiling.*
>
> *The Essential Commodities Act is an instrument to <u>regulate market conduct</u> to safeguard the interest of producers and consumers and to raise the standard of agricultural markets. However, this intervention of the Jute Commissioner was not designed to regulate any anti-competitive behaviour but purely to benefit users of raw jute at the cost of producers of raw jute. This intervention is against the principles of free market. Under normal circumstances, prices of commodities fluctuate depending on the demand and supply conditions and such interventions only bring back the specter of control raj. (Business Line, 21.12.05)*

…National Competition Policy required

These brief resumes of the policies followed in India – the examples can be almost infinitely multiplied – are all characterised by some element of a maladroit understanding of the market process. Though the government has adorned the role of a facilitator, it continues to intervene in the functioning of the market and violates the principle of 'ensuring free and fair market process'. This should not be misinterpreted as a suggestion that all issues pertaining to the environment, trade, taxation, industry, labour etc. be 'resolved' by the market.

The point is that as policy outcomes are sought to be generated, it is a persistent practice, in India, to do so without bearing in mind that policies need to be framed and implemented in sympathy with the market process, and not in a manner so as to stall the process.

√ *Assess all government policies and practices on the touchstone of the 'Nine Principles' of Competition Policy. Thus, for instance, a prior competition assessment, before privatisation, would lead to a more effective outcomes.*

- √ *There may be conflicts between objectives of competition policy and those of other policies (e.g. environment policy may lead to entry barriers) but there is a need to make an impact assessment to identify the dimensionality of the impact. Once these impacts are acknowledged, one can take measures to deal with them.*
- √ *All government policies/practices should have an explicit statement about the likely impact of the policy on competition and the market process*
- √ *Government should evolve a system of 'competition audit/assessment', which could be applied to all existing and future policies*
- √ *The government should adopt a National Competition Policy that would provide guiding principles in framing government policies and practices and will provide a declared intent to the government's resolve of promoting competition in the market*
- √ *Establish a National Competition Policy Council with the Prime Minister as its chairperson, Chief Ministers of the states, and members drawn from business, consumer organisations, media and academia to guide the implementation of the National Competition Policy in the country*

But, won't the Competition Law suffice?

On the issue of adopting Competition Policy, some policy makers and opinion leaders raise questions at the very need of such a policy on the grounds that we now have a new competition law. However, it needs to be realised that

- *First*, 'competition law' and 'competition policy' are two distinct concepts (see figure 1)
- *Secondly*, the market distortionary practices that emerge from any government policy or practice are beyond the scope of competition law.

A competition authority cannot take any action against distortions arising, for example, from anti-dumping measures, government procurement policy and rules, etc. It also cannot carry out an *ex-ante* assessment of government policies and practices.

At best, the competition authority, through its 'competition advocacy' function can advocate with the government to change its policies and practices to facilitate the working of the market process. Under the Competition Act, the government can seek the opinion of the Competition Commission in framing any major public policy or reform. However, the effectiveness of this provision rests solely at the discretion of the government.

Instead, a strong policy advocacy is required to rationalise the role of the government, such as its intervention promotes functioning of markets, rather than impede it. There is need to take pro-active steps to promote competition, which requires a declared intent from the government of its resolve to promote competition and fair practices in the market – something beyond the scope of a competition law. Hence, the need for a National Competition Policy!

Not surprisingly, the need for a National Competition Policy was stated in the mid-term appraisal of the 9th Five-Year Plan (1997-2002). Para 66 of Chapter 32 "Direction of Reforms" of the document mentions:

> *"there is an urgent need for articulating a National Competition Policy (NCP) in India. The NCP should fully reflect the national resolve to accelerate economic growth, improve both the quality of life of the people of the country and the national image and self-respect…The competition*

> *policy should aim to bring about a spirit and culture of competition among enterprises and economic entities to maximise economic efficiency and to protect and promote consumers' interest and society's welfare and improve our international competitiveness."*

The need for a National Competition Policy has been felt for quite some time. Does it really matter whether it was a different government, who said it but did not do anything about it? Even the present coalition government considers 'competition' a serious policy issue. Its National Common Minimum Programme, *inter alia*, states:

> *"The UPA government believes that privatisation should increase competition, not decrease it. It will not support the emergence of any monopoly that only restricts competition. All regulatory institutions will be strengthened to ensure that competition is free and fair. These institutions will be run professionally".*

Other Countries with Competition Policy

Adoption of a National Competition Policy would not be unique to India. Several countries have adopted a Competition Policy, including

- *Australia* (National Competition Policy adopted in 1995 by federal and provincial governments throughout Australia; consists of a set of policy reforms ensuring that the same competition principles and rules apply throughout the economy)
- *Hong Kong* (Comprehensive Competition Policy Framework adopted in 1997; Government bureaus state competition implications of major policy submissions; and review existing regulations)
- *Mexico* (National Programme for Economic Competition 2001-06 adopted; Cooperation mechanisms established to facilitate coordination of competition policy with industrial, regulatory, trade, and consumer protection policies)
- *Botswana* (Draft Competition Policy presented to Parliament; Seeks to ensure coherence between Competition Policy and other Government policies and laws)
- *Fiji* and *Uzbekistan* are other countries that have adopted Competition Policy, while *Mozambique* and *Malawi* are in the course of adopting one.

Empirical evidence confirms that a well-designed and implemented competition policy promotes economic growth by ensuring better allocation of resources, as highlighted by the case of Australia.

> *A study carried out for the Australian economy[2] estimates the expected benefits from a package of competition promoting and deregulatory reforms (including improvements in the competition rules) to induce an annual gain in real GDP of about 5.5 percent, besides having an increase in real wages, employment and government revenue.*

[2] http://www.unctad.org/en/docs//c2em_d10.en.pdf

Chapter VI
State Government Policies/Practices: Distorting Competition at Sub-National Level

Liberalisation has reduced the degree of control exercised by the Center in many areas, leaving much greater scope for state-level initiatives. Therefore, state-level policies and practices deserve much closer attention than they receive. Similar to Central Government policies and practices, there are several policies/practices of state governments that too result in anti-competitive outcomes and regulatory failures at the sub-national level. Unfortunately, these issues are most often ignored, partly because of lack of awareness and partly due to vested interests.

Distortions created by rules and regulations…

The overall policy environment and the quality of economic governance are important factors determining the growth potential of a state. For instance, entrepreneurs setting up an industrial unit in most states typically need as many as 30 permissions from various departments, each of which subjects them to the triple vicissitudes of the *inspector raj* – harassment, delay and corruption. It is important to note that the high transaction costs of cumbersome procedures are borne primarily by small businesses, which is precisely the group which most state governments are otherwise keen to promote.

In the federal set up that we have chosen, States vie for the largest slice in the industrial pie. There is competition between States to attract maximum investment. In their pursuit, States put out packages for industrial promotion, wherein incentives like sales tax holiday, electricity duty waiver, etc. are given. There are examples of state governments adopting licensing/auctioning terms and conditions that are anti-competitive in nature.

Grant of mining rights distorts competition in the steel sector

Several states, where iron ore mines are located, (e.g. Orissa, Chhatisgarh, and Jharkhand) have decided to give iron ore mining rights only if the steel plant is established in their respective states. This raises a serious competition issue. This policy has deprived steel makers in the country outside these states, the right to bid for mining leases and thereby makes the iron ore mining segment of the steel industry less competitive.

In a federal constitution, all citizens are equal irrespective of state of origin, and common mineral rights belong to all citizens, not merely those of one state. Hence tying a mine only to local state industries is discriminatory against citizens of other states, and unconstitutional.
(Source: Firoz, A.S., "Competition Scenario in Indian Steel Industry" in *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005; discussions at the FunComp e-group Forum)

Another area is the state excise policy (revenue generation in liquor and other intoxicants), which is purely under the state jurisdiction and generates the second biggest revenue in the states. In states where liquor groups comprising large geographical areas are auctioned for specific period, number of malpractices and monopolies build up during the course of time. In this system, competition is restricted to few parties who have sufficient money and muscle power to carry out the business. During the course of time, it encourages cartelisation at the time of auction resulting in concentration of business in the hands of few licensees. As a result, bids are suppressed and state revenues decline.

Procurement related distortions…

Several states have some government order or regulation, which gives preferential treatment in purchase to units situated within the State. Most often the policy is targeted to protect and support small-scale sector units, which are presumed to be less competitive vis-à-vis large/medium industries. In the context of the overall development policy of the state, such policy may be desirable. However, the concern arises, when the policy creates conditions for formation of a cartel of local manufacturers, which is solely dependent on government's patronage. In such cases, state government ends up paying higher price for a product, which is often of poor quality. Moreover, with a captive market where there is no quality control and no threat of competition, the enterprises may become uncompetitive.

Barbed-wire Association in Rajasthan

As per an earlier Rajasthan Government policy, a certain quota of barbed wire was to be procured from local manufacturers. This is supposed to have led to formation of a 'cartel' under the name of Rajasthan Barbed-wire Manufacturers Association in mid-80s. This association hiked the prices, and with an implicit arrangement allocated the total requirement of barbed wire amongst its members. Consequently, poor quality barbed wire was procured at a high price, with almost no quality checks at the Government end. Local manufacturers depended solely on Government's patronage rendering them uncompetitive. With the changed Government procurement policy, local units closed down and the association broke up.

Another area of government procurement where there are cases of collusion is construction contracts undertaken by the government. The construction sector is scandalously infested with collusive bidding. The mafia appears to dominate in most such businesses and indulge in all types of anti-competitive practices in collusion with politicians.

During the last five years, all state governments have spent about US300bn (Rs.15,00,000 crores) on civil works. All these works are awarded through a system of competitive bidding. However, in several cases contractors collude and there is a tender mafia at work. As a result of these distortions, competition is subverted and the bidding system fails to produce efficient results, even in cases where rules and procedures are properly followed. There is now a trend towards awarding works in much bigger packages, which effectively rules out small contractors from bidding, thus restricting competition and further facilitating collusion. Considering the mind-boggling amount that is at stake, one can imagine the huge impact it has on state finances.

In Chennai, a flyover scam had rocked the state assembly in 2001, where contractors pooled up to share the contract for laying cables at a considerable cost to the taxpayer. But nothing much came of it.

Angered by the malicious process, the Rajasthan Public Works Department (PWD) Minister announced in the assembly on July 20, 2004, that he would break all cartels, so that smaller contractors can bid for *contracts. Subsequently, nothing happened, and it is now business as usual.*

Realising the drain on government finances due to such practices, some state governments have taken steps to streamline the entire system. For instance, state governments of Andhra Pradesh and Rajasthan have instituted e-procurement schemes to tackle the menace of bid rigging and bring transparency in the entire procedure.

Easy movement of goods and services…???

While there is a general declaration in the Indian Constitution that trade and commerce should be free, the Centre and the States have the power to regulate. While mandating free trade within the country, the Indian Constitution, nevertheless provides that restrictions can be imposed by Parliament on internal trade (and similarly by state legislatures on trade within their territory) as may be required in "the public interest".

Distrustful of the market, restrictions have been imposed on trade and commerce in the country through regulations in various forms, invoking "public interest". Complaints from Indian industry, especially the transport sector, relate to issues of taxation (both Centre and State), regulation by States on the movement of goods, frequent stoppages and delays under administrative rules and inspection agencies. As a result of excessive taxation and delays, transportation and transaction costs increase, which further increase the final cost of the product, distorting competition in the domestic market.

…required competition assessment of state governments policies and practices

Governments at state level, most often, either themselves follow anti-competitive practice or by their policies encourage such practices. Market distortions are rampant at the state level, and lack of healthy competition and fair-trading in the marketplace affects the economy and state finances adversely.

- √ *There is a need to do strong policy advocacy to rationalise the role of state governments*
- √ *State governments should make a competition assessment of their policies and practices*
- √ *By promoting competition and effective regulation, state governments can protect consumer interest as well as increase their own revenues*
- √ *There is need for state governments to benchmark their policies and practices in line with the 'Nine Principles' of Competition Policy*
- √ *Establish State Competition Policy Councils with the Chief Minister of respective states as its chairperson, Chief Secretary, and members drawn from business, consumer organisations, media and academia to guide the implementation of the National Competition Policy at the state-level*

Chapter VII
Competition Abuses at Local Level: Local Problems need Local Solutions

The services sector at the local-level is to a very large extent unregulated or inadequately regulated. This facilitates various competition abuses, denying users of services value for money and cause huge losses to the economy. The absolute volume of such losses is set to increase with ever increasing contribution of the service sector to the economy.

Competition abuses at Consumers' End…

The main objective of market-oriented economic reforms is to promote competition as a means to ensure efficient allocation of resources in an economy, resulting in the best possible choice of quality, the lowest prices, and adequate supplies to consumers. Consumers come in contact with providers of goods and services at millions of places spread over length and breadth of the country. However, while there may be adequate competition at the level of manufacturers, this may not be true of the distribution network, through which the goods pass to reach the consumers. Similarly, in several service sectors there are millions of providers operating at local level. Hence, monitoring and maintaining competition or ensuring competitive outcomes in such sectors becomes difficult and competition abuses become rampant at local level.

> *Munna Lal has been bitten by a dog. He gets a prescription from his doctor for anti-rabies shots and a tonic. The patient leaves and the doctor takes out his little black book and makes a mark in it – one more bottle sold, one more commission earned. Several doctors have turned into drug-peddlers of sorts. They push the brands and receive handsome commissions in return. But what is particularly worrying is that no one knows how legitimate these firms are.*

Tied-selling in health services, whereby service providers' influence/force the patients to buy specific brands of medicines from prescribed shops or get diagnostic tests done from prescribed laboratories is a common practice in India. Service providers on their part argue that this practice ensures maintaining uniformity or quality, especially where authenticity of medicines or reliability of diagnostic tests are a concern. Although there is regulatory mechanism to ensure genuine medicines in the market, the enforcement is weak. In the area of diagnostic testing, the regulatory framework is almost non-existent. Thus, regulatory failure in enforcing relevant regulations in health service delivery is a primary reason for the existence of tied selling.

There are several such competition abuses in the delivery of services at consumers' end. For example:

- Tied sales by schools where school children are made to buy books, uniforms and stationery from the school or other designated shops at exorbitant prices
- Local cable operators abuse their monopoly by increasing subscription rates at will
- In most towns, taxi and auto drivers demand lump sum payments, even when meters do exist. The charges vary depending on location and also sometime with the category of consumers.
- Service sectors like barber shops; pan-biri shops etc. form unions and dictate selling prices, which are often above the printed price also.

The basic problem is poor enforcement, which in turn is due to lack of political will. Most often, service providers at the local level resort to these practices because of the need to grease the pockets of enforcement agencies at the local level. In many cases, non-compliance costs are lower than compliance costs, as penalties fixed are unrelated to the extent of violations.

Competition abuses affecting business…

Similarly, there are services provided at the local-level and used by businesses that are anti-competitive in nature.

For instance, in the transportation of goods via trucks, most of the trucks plying on Indian roads are under single ownership and there are few large-fleet operators. Although there appears to be competition, given the large number of truck owners, the fact is that about 5000 cargo operators handle the entire cargo in the entire country. These cargo operators cartelise and decide the freight and there is no competition at their level.

There are also instances of cartelised operation of truckers' union around major production sites and factories. Truck operators' cartel result in higher transport costs, since trucks bringing in goods charge two-way fare, as they are made to return empty, while transportation costs on out-going goods are about 40 percent more.

Truck Operators' Cartels: A Snapshot

- In case of Baddi, Himachal Pradesh, the Baddi Nalagarh Truck Operator Cooperative Transport Society, has monopolised the movement of goods from the state. Controlled by the local MLA, the truck union charges 30 percent higher on the Baddi-Delhi route and 15-20 percent on the Baddi-Mumbai route. Trucks coming in with supplies go back empty, because they are not allowed to pick up freight, which only adds to the cost.
- In the case of Orissa, the Angul Truck-owners Association, a Government registered body operating at the National Aluminium Co. Ltd.'s factory charges as much as 200 percent more for transportation of ingots under the obliging eyes of the authorities. Such official cartels are known to exist in other parts of Orissa also like in Sukinda Mines, Paradeep Port and Balasore.
- In Punjab's Derabassi, truck unions have drafted their own tariffs, increasing costs of production for local units, thus rendering them uncompetitive. A cartel of around 500 truck operators has been troubling the area, since Derabassi's inception as an industrial town in 1987. In Sirhind, near Mandi Gobindgarh, such unions stalled industrial growth, resulting in industry to flourish in nearby Khanna and Amloh.
- Similarly in Makrana in Rajasthan the cartel of truck operators' union killed the marble business. The Union was charging tariffs almost 35-40 percent higher than the prevailing market rates. This led to an increase in transportation costs of marble from Makrana and the usual harassment of dealing with a monopolist union. The harassment grew to such proportions that several marble-sawing plants moved to Kishangarh on the Jaipur-Ajmer National Highway No. 8.
- A similar situation now exists in Bikaner, Rajasthan where the truck operators' union is creating problems in the smooth movement of minerals from the area. Due to obstruction in the supply, the ceramic tile industry, which uses these minerals as raw material are facing hardships, and even closure.

…establish State Competition & Regulatory Authority (SCoRA)

While market-oriented economic reforms have been undertaken to promote competition and fair-trading in the market place, the examples given above bring out a different picture. Both consumers as well as businesses are exposed to myriad abuses in the delivery of services at local level.

Considering the huge size of our country and the extent of anti-competitive practices that are prevalent at the local level, there is clearly a need for establishing local-level agencies. Competition Act will not bring the desired outcomes if it is implemented from Delhi, or enforced through regional benches. The regional benches will only hear complaints of local nature, whereas the need is to follow a pro-active approach by monitoring local-level practices, enforcing relevant laws, and taking up local level issues with relevant sectoral regulatory authorities. In the specific case of cable TV service, the Telecom Regulatory Authority of India (TRAI) has already called for strengthening local level enforcement mechanism.

India has the Consumer Protection Act 1986 (COPRA), to provide redressal to consumers. However, getting grievances redressed is not enough and there needs to be a mechanism through which number of complaints that consumers encounter on a daily basis can be brought down through raising industry standards. As a matter of fact, a very small fraction of aggrieved consumers actually file complaints against such providers in consumer forums.

Under the circumstances, a state-level competition and regulatory authority is strongly required to check local level competition abuses. The proposed authority should also take up advocacy with existing agencies/departments at the state-level to highlight their market-distortionary policies and practices and get these addressed through the State Competition Policy Councils.

√ *Create State competition and regulatory agencies (SCoRA), backed by appropriate laws to resolve local level market abuses and regulatory failures of systemic nature and play a pro-active role in promoting fair practices*

Chapter VIII
The 'Nine Principles' of Competition Policy in the Indian Context

In the beginning, we outlined the need to adopt the 'Nine Principles' of Competition Policy to complete and enhance the process of deregulation and liberalisation. This will facilitate sustained high level of economic growth, enhance productivity and efficiency resulting in best possible choice of quality, lowest prices and adequate supplies.

From the foregoing discussions in the previous chapters, it is observed that due to several distortions in policies and practices, India is far from achieving the desired outcomes as expected while initiating economic reforms in 1991. We review the current state of these policies and practices from the perspective of the 'Nine Principles'.

I. Foster Competitive Neutrality between public and private sector enterprises

According to this principle, a level playing field between Government and private sector enterprises needs to be ensured. It is required to be adhered in both ways. That is, if government businesses compete with the private sector they should not have any special advantages, such as preferences in government purchases. By the same token the private sector should not have any advantages not available to other private businesses or government businesses. In India, this principle is violated in both ways.

Competitive Neutrality: Is it Fostered?

In favour of public enterprises, against private enterprises

- In the Delhi and Mumbai airports, the state-owned Indian Airlines has a full terminal to itself, while the private-sector competitors are all cramped in one. This is despite the fact that Jet Airways alone has a higher market share than Indian Airlines. Besides, private airlines are not allowed to establish hangars for major maintenance overhauls at airports and consequently have to outsource maintenance activity to high cost locations abroad.
- RajCOMP is a state Agency established by the state government of Rajasthan, as a consultancy organisation in the field of information technology. By virtue of its status, all state government departments, and state PSUs approach RajComp for their IT related work. Therefore, development of e-governance applications, MIS, procurement of computer hardware, etc related to government departments are all entrusted upon RajComp and it has acquired a monopoly in providing IT services to the state government and its agencies.

In favour of private enterprises, against public enterprises

- As per the existing policy of the Government, shipping arrangements of all PSUs are centralized in the Chartering Wing of the Ministry of Shipping (popularly known by its telegraphic address Transchart in shipping circles). This policy, however, creates a disadvantageous position for PSUs vis-à-vis private sector, as the latter have the freedom to hire any ship. Some PSUs have asked for removal of this clause. However, the shipping ministry continues to follow the same chartering norms.
- For almost four years, public sector airlines have been trying to procure aircrafts to expand their fleet. Until recently, their proposals had been doing the rounds of the government departments in search for a final approval. The delay over aircraft acquisition has adversely affected the ability of public carriers resulting in foreign airlines utilising

70 percent of their entitlements, whereas Indian carriers are utilising only 30 percent. For no fault of theirs, it has been suggested that the private airlines be allowed to use the bilateral traffic rights, not utilised by the public sector carriers. Had the state-owned airlines been allowed to acquire more aircrafts, there would have been no unused bilaterals in the first place.

II. **Ensure Access to Essential Facilities**

This principle governs the access of third parties to infrastructure facilities of national significance that cannot be duplicated in an economically viable way, but access to which is necessary to ensure effective competition in a downstream or upstream market. For example, creation of an access regime to an electricity transmission grid in order to create competition in the electricity generation and distribution markets. However, in India, there are several cases where the access regime is thwarted by actions of the government.

Is Access to Essential Facilities Ensured?

- Interconnection in Telecom, in particular to BSNL network is still unresolved. TRAI, the telecom regulator has issued Interconnection Regulation to ensure efficient interconnection between service providers. However, BSNL, the state-owned incumbent challenged this regulation before the appellate body, which ruled against the regulator saying that it has limited powers to fix the terms and conditions of interconnectivity. Due to this ambiguity, interconnection has not kept pace with the exponential growth in telecom services leading to increase in inter-network congestion and poor quality of service to customers.

- In early 2005, the government made an announcement to allow private operators in the movement of container trains, signalling an end to Container Corporation of India's (CONCOR) monopoly. However, an enabling policy framework to facilitate operation of other players is still absent. With the entry of other operators, access to railway tracks and also to engines to pull the wagons need to be facilitated. This requires an access regime to ensure railways do not squeeze out competition from other operators.

III. **Facilitate easy movement of goods, services and capital**

While there is a general declaration in the Indian Constitution that trade and commerce should be free, the Centre and the States (especially the former) have the power to regulate. While mandating free trade within the country, the Indian Constitution, nevertheless provides that restrictions can be imposed by Parliament on internal trade (and similarly by state legislatures on trade within their territory) as may be required in "the public interest".

Distrustful of the market, restrictions have been imposed on trade and commerce in the country through regulations in various forms, invoking "public interest". Complaints from Indian industry, especially the transport sector, relate to issues of taxation (both Centre and State), regulation by States on the movement of goods, frequent stoppages and delays under administrative rules and inspection agencies. As a result of excessive taxation and delays, transportation and transaction costs increase, which further increase the final cost of the product, distorting competition in the domestic market. Most complaints concern the road sector, which is primarily in the private domain.

IV. Separate policy-making, regulation and operation functions

In the changed circumstances, separation of the policy formulation function from regulation becomes imperative to offer a level-playing field to competing service providers. Unfortunately, temptation to command and control still prevails within line-ministries, often leading to turf wars, reflecting the state of immaturity of the regulatory framework in India.

Policy versus Regulation: Ambiguity and turf war

- Government's role as licensor, policy-maker and service provider in telecom sector creates serious conflicts of interest. For instance, the Department of Telecom (DoT) recently announced certain proposals for restructuring the tariff regime in telecommunications, considering these as policy issues. However, TRAI objected to these proposals. After TRAI's objection, the DoT contemplated exercising its powers under the Act to issue 'policy directives' to the regulator. Although the Ministry finally refrained from doing so this event highlights the need to clearly demarcate policy and regulatory issues.

- In the present dispensation, Port Trusts that are both owners as well as service providers are called upon to introduce competition or put out some of their facilities for private handling and face competition from them. This, in fact, gives ports, as owners as well as service providers, an opportunity to discriminate against competing service providers.

V. Ensure free and fair market process

The economic reform measures seek to promote free, fair and contestable markets. However, in India, even after liberalisation and economic reforms, most often government policies are framed and implemented in a manner to protect the welfare of some market players rather than promote competition. This is observed from the chapters on Central Government Policy and State Government Policy.

Distortions to the market process arise in various ways:
- Government procurement rules that favour public sector enterprises or small-scale units
- Certain elements of trade policy measures are anti-competitive in nature (e.g. anti-dumping that favours domestic firms; inverted duty structure that favours producers of intermediates as against manufacturers)
- Government intervention in pricing of certain commodities distorts the market process (e.g. pricing of coal has weakened incentives for delivering better quality coal; there is lack of transparency in pricing of petroleum products)
- Several rules and regulations framed by the government hinder the proper functioning of the market process (e.g. although pricing freedom has been given to coal producing companies, the distribution of coal is still controlled by government agencies, and only they are allowed to sell coal directly to consumers)

End of Cotton Monopoly Procurement => End of distress for Farmers

The Maharashtra Cotton Monopoly Procurement Scheme was enacted by the state legislature in 1971. The scheme empowers the government of Maharashtra to acquire all raw cotton produced within the state. The scheme was devised to support cotton farmers through assured prices for their produce, however, its effect on their welfare is debatable. The scheme has adversely affected the quality of cotton produced in the state. As there is monopoly procurement, no modernization took place in ginning and pressing industry. The prices received by farmers were based on the discretion of graders who decided the quality of the cotton. This power of the graders, who unlike private traders, had no interest in being judicious about quality aspect led to large scale corruption and worked as disincentive for farmers to produce quality cotton. As the prices fixed by the government were higher than the open market prices, it became difficult for the government to pay the farmers. Under the increasing burden of losses the state government scrapped the monopoly nature of the scheme in 2002. With this, positive changes are seen on the ground. New ginning and pressing units are being set up. The existing ginning and pressing units are being modernized. Farmers are becoming quality conscious as now they also deal with private traders who pay as per the quality of cotton.

VI. Balance competition and Intellectual Property Rights (IPRs)

The bundle of rights that are subsumed in intellectual property rights (IPR) need to be preserved in the interests of creativity and intellectual/innovative power of the human mind. However, the existence and the exercise of intellectual property rights may generate anti-competitive effects through the monopoly power granted to the holders of the rights.

What is called for is a balance between unjustified monopolies and protection of the property right holders' investment. In view of this, the Competition Act does not permit any *unreasonable condition* to form a part of protection of intellectual property rights. In several countries, IPR *per se* is not considered violative of the competition law, but its abuse is certainly covered. The WTO Agreement TRIPS also requires Governments to enact suitable legislation to cover the abuse of IPRs.

However, in India, the Patent Act has over-riding powers over the Competition Act, in matters relating to abuse of IPRs. The Patent (Amendment) Act 2005 provides for granting of license to remedy an anti-competitive practice emanating from the exercise of its right by a patent holder. The role of the Competition Commission to examine such matters does not find any mention. Compulsory licensing and parallel importing are two key remedies of great importance and a competition authority cannot be kept out in this regard. Unfortunately, in India this is precisely the case!

VII. Ensure transparent, predictable and participatory regulatory environment

Over the years, market-regulatory agencies i.e. competition authority and regulators in certain sectors have been set-up in India. These agencies carry out several functions viz., balance conflicting interests, promote competition, facilitate investment, ensure overall development of the sector and so on. In order to ensure success, it is important that the regulatory environment is transparent, predictable and participatory. However, most often the government interferes in the functioning of regulatory agencies in a manner that violates this principle.

Government Plans to Recharge Power Regulators with a New Team

The government is reportedly mulling a plan to remove all electricity regulators at the Centre and in the UPA-ruled states as part of a plan to institute a new regime. A new team of power regulators is likely to be selected to purge the 'existing inefficient regime'. The poor regulatory environment is stated to be of major concern to private investors in the power sector.

However, the poor regulatory environment in power sector is not due to the inefficient functioning of power regulators, but primarily because of government's continuous interference in their functioning. How can more investment come in power plants in a situation where the principal buyers, the state electricity boards, are bankrupt? The Electricity Act 2003 sought to introduce 'open access'. However, despite the legislation, the situation on the ground hasn't changed, as the state governments are delaying the process.

The plan to replace the regulators in the UPA ruled states would have an adverse impact on the regulatory process in India and set an unhealthy precedent, as it may be followed by other ruling parties in future. There is evidence to show that the removal of the Chairman and members of TRAI in 1999 resulted in a slowing down of private investment in the telecom sector till the new Authority became functional. What is the guarantee that another government would not find this procedure inappropriate and seek to change it all over again?

The example given in box is not an isolated incident. In the brief history of independent regulation in India, on several occasions, the ministries concerned have tried to `clip the wings' of the so-called `independent regulator'.

VIII. **Notify and publicly justify deviation from competition principles**

A perusal of the various examples given in this document gives the impression that most often, the deviation from competition principles is undertaken to protect 'public interest' - an issue that is open to weird interpretations, and ultimately the policy ends up protecting some vested interest.

True, for reasons of economic or social welfare, there might arise a need to deviate from competition principles. For instance, providing access to essential services for citizens, especially the disadvantaged, cannot be achieved through competition and this might require cross-subsidisation. However, it is important to publicly notify and justify such deviations and implement them in a transparent manner. Often certain policies that deviate from competition principles have laudable objectives, but the instruments used to achieve the objective leads to distortions.

Free Power to Farmers: Is it desirable?

This policy seeks to provide support to farmers in irrigating their fields. However, it has produced several undesirable outcomes, including misuse of electricity, poor recovery of user charges, depletion of ground water, and distorted the cropping pattern towards water-guzzler crops. Moreover, farmers end up getting lesser supplies than what is required. More than helping the poor farmers, this policy serves the rich class. Be that as it may, the farm sector in India requires government support, and the crucial issue is whether free electricity is among the most efficient carriers to extend government support to the targeted beneficiaries? The Government of Andhra Pradesh had announced the policy of free power to farmers in 2004 after the new government took over, but had to review the policy. According to the State Finance Minister "*the government wanted to review its policy of free power to farmers not due to monetary constraints but because it has led to many unexpected developments such as the increase in unauthorised power connections leading to overloading of the distribution system. The unexpected load on the system has resulted in increased failure of distribution transformers*".

IX. **Respect for international obligations**

Adherence to a national policy should be subject to non-conflict with international obligations accepted by the country. However, India seems to go too far in respecting international obligations and does not use the flexibilities that are available to check market abuses. Consider the WTO TRIPS agreement which empowers member countries to take necessary actions if intellectual property rights (IPRs) are abused to give effect to anti-competitive practices. However, the new competition law of India gives a weak treatment to IPR abuses. Instead, the Patents Act (amended in 2005 to ensure the domestic law complies with international obligations) overrides the competition law in matters of IPR abuses!

…adopt National Competition Policy as the *mantra*

The above assessment of the state of adherence to the 'nine principles' of Competition Policy does not bring out a rosy picture for India. Violation or non-adherence of these principles exists in several policies/practices adopted by the government both at the national and state levels. There is a lack of coherence in various government policies and practices. The guiding principles to frame government policies in the liberalised regime are missing, highlighting the state of 'policy vacuum'. It is, therefore, high time the government adopts a National Competition Policy woven around the 'nine principles' of Competition Policy, as the *mantra* for implementing economic reforms in the country.

Chapter IX
What Next?

Policy/Legislation related

√ Prepare and adopt a National Competition Policy to
- ❖ Hasten and complete the process of liberalisation and deregulation
- ❖ Provide a declared intent to the government's resolve of promoting competition in the market
- ❖ Rationalise the role of the government, so that it's intervention facilitates functioning of markets
- ❖ Provide guiding principles to different branches of the Government (Central as well as States) in framing government policies and practices

√ Conduct Competition Audit (assessment) to
- ❖ Assess all government (Central as well as states) policies and practices on the touchstone of the 'Nine Principles' of Competition Policy
- ❖ All government policies/practices should have an explicit statement about the likely impact of the policy on competition and the market process

√ Put in place an overarching legal framework to provide common guidelines for the establishment of market-regulatory agencies (i.e. competition authority and sector regulators)

√ Make necessary amendments in the Competition Act to
- ❖ Enhance functional and financial autonomy of the Competition Commission of India (CCI)
- ❖ Strengthen provisions to make the CCI accountable
- ❖ Provide for an effective interface between the CCI and sector regulators
- ❖ Strengthen provisions to deal with IPR abuses
- ❖ Lay down specific criteria for granting exemptions under the Act

√ Make necessary amendments in various sectoral regulatory laws to
- ❖ Spell out clearly the objectives and scope of regulation and the powers of the regulator in the enabling legislation
- ❖ Enhance functional and financial autonomy of regulatory agencies
- ❖ Ensure a certain minimum distance between the regulators and the line-ministry
- ❖ Strengthen provisions to make the regulatory agencies accountable

√ Protect consumer interest in the market-oriented regulator regime by
- ❖ Creating a Consumer Advocacy Fund to build the capacity of consumer/civil society groups to raise consumer concerns more effectively and act as a watchdog
- ❖ Making the CCI and regulatory agencies employ Consumer Impact Assessment to assess corresponding policies, regulations and practices from a consumer perspective

Institution/Agency related

√ Establish a National Competition Policy Council with the Prime Minister as its chairperson, Chief Ministers of the states, and members drawn from business, consumer organisations, media and academia to
  - ❖ Guide the implementation of the National Competition Policy in the country

√ Establish State Competition Policy Councils with the Chief Minister of respective states as its chairperson, Chief Secretary, and members drawn from business, consumer organisations, media and academia to
  - ❖ Guide the implementation of the National Competition Policy at the state-level

√ Create State Competition and Regulatory Agencies (SCoRA) to
  - ❖ Resolve local-level market abuses and regulatory failures of systemic nature and play a pro-active role in promoting fair practices

√ Establish a Common Appellate Tribunal to
  - ❖ Ensure convergence in application of competition and regulatory laws and set healthy conventions to ensure their harmonious application

√ Establish a Legislative/Parliamentary Committee on Regulation and Competition as the reporting authority for all regulatory agencies
  - ❖ The Committee's domain should be confined to systemic issues only, and not the individual decisions and orders of regulators
  - ❖ Regulatory agencies should submit an activity and outcome report to the legislature through this Committee

√ Establish multi-sector regulators, such as one for energy and another for transport to
  - ❖ Reduce the possibility of regulatory capture by individual line-ministry
  - ❖ Facilitate efficiency in regulatory functioning

√ Constitute a Committee consisting of eminent people to
  - ❖ Select regulators for various regulatory agencies at central and state level

√ Make the Law Ministry the nodal agency to
  - ❖ Examine various draft regulatory legislation, which originate from various ministries to ensure the desired degree of uniformity across the board

√ Make the Department of Personnel as the administrative department for all regulatory bodies, responsible for release of appointment letters and other administrative matters

√ Political parties and the government should give their feedback as stakeholders to the CCI and regulators whenever it is sought, and participate in the open discussions/hearings conducted by these agencies

Annexure 1

Myths & Realities

Competition Policy and Law is looked upon differently by different stakeholders. While policy makers consider it synonymous with competition law, business class take it as threat to their existing business. This chapter is an attempt to bring clarity about competition policy and law with regard to people's perceptions.

"Competition policy and law are tools for the rich and urban societies"

Many think that competition policy and law are tools for the rich and urban society, while some raise eyebrows on the efficacy of competition policy and law in a society which is illiterate and poor.

In order to address these misconceptions, we recount the tale of a poor peasant widow, who used the law to get redressal against another scourge of our society, the moneylender, and the collusion, which prevails, in our society.

> *Rukmini Devi, a poor elderly illiterate widow, lives in a village near Chittorgarh in Rajasthan. She had to sow her unirrigated 5-bigha farm in time, but did not have the resources to buy the seeds, fertiliser, etc. Fortunately, soft loans were available at the local cooperative bank situated at Rashmi, the sub-divisional headquarters under the government's integrated rural development scheme.*
>
> *In view of the frauds which are ubiquitous, illiterates are required to affix two passport-size photographs to the loan documentation. Rukmini approached one of the two studios to get her photo taken. When she went to collect the pictures, she was given one reason or the other for non-delivery. The other studio did not help, when approached. This meant that she could not obtain the soft loan. As a result she was forced to go back to the usurious money lender to get the money, because rain gods would not have waited for her loan. Both the studios acted in cahoots with the moneylender.*
>
> *Through a local consumer activist she complained to the local district forum under the Consumer Protection Act against the restrictive trade practice and the cartelised activity that the two studios were engaged in. She won the case and collected damages from the studio and the cartel was broken.*

This real life example shows how cartels can operate at all levels in the country and sap the people and the economy. It also shows that the poor do benefit from action against competition abuses, if they can access justice.

The same situation can be projected onto the larger national canvas. But new laws such as the Competition Act, 2002, alone cannot break cartels; we need commensurate policies to ensure that competition prevails, and the people benefit.

> *On one occasion, a poor villager complained that he can now get a good drycell for Rs 2 each, which he had been purchasing for Rs 6, and felt very indignant. These cells were of Chinese make, and these are now available in India because we have had to free imports of consumer goods. That was due to a trade policy measure that enabled prices to come down.*

A counter argument often heard is that the small units making consumer goods are closing down as they cannot compete against cheaper imports, thus workers are getting thrown out of jobs. If one looks at government data, in fact, the number of small-scale units, and resultant employment and exports, has actually been on the rise. Indeed, some units will shut down due to attrition, while many new ones will continue to be set up, perhaps in newer areas. If we just take a look at the ball-point pen industry, then we can see the change which has been brought about. True, many small and tiny units making shoddy and leaky ball-point pens have shut down, while big brands have now occupied the scene. But aren't ball point pens purchased by the poor also?

Examples of tied sales have also been seen. For instance, some bright bureaucrat thought of expanding the line of goods sold by ration shop dealers by adding razor blades, tea, etc. The intent was good, but the prices of these non-short supply goods were higher than the market prices. When the poor consumers did not buy them, the shops started tied-sales, i.e., one had to purchase a quantity of tea and razor blades if one had to pick up the required quota of wheat and/or kerosene. The practice was stopped when the consumer movement raised cain.

Another area where competition policy and law could be beneficial to the poor is by mitigating the adverse effect of strong intellectual property regime. By using the compulsory licensing provision, for instance, an exploitative situation in life saving drugs can be curbed.

So much about the goods sector. Let us look at the services sector. Sectoral regulatory policy/legislation in the utility sector is a good example of a competition policy measure meant to protect the interest of poor consumers. It does several things for the benefit of the poor, such as universal supply obligation, ensuring that firms supply services to the poor, even in far flung areas. Such policy ensures consistent supply at benchmarked quality and quantity and provides a window for public participation in policy formulation and tariff-setting. In turn it reduces corruption and makes available an easy redressal system for the poor to resolve their grievances.

In sum, Competition Policy and Law is required to increase overall efficiency and further welfare gains. It needs to be realised that competition law is not a luxury of the developed world, but one of the necessary tools for developing countries, in their fight against poverty. Developing countries should not be dogmatic about withdrawing from the markets as distortions and failures in markets are quite ubiquitous and the state needs to play a role in promoting a fair and orderly market.

"India already has a Competition Law, why then do we need a Competition Policy?"
On the issue of adopting Competition Policy, some policy makers and opinion leaders raise questions at the very need of such a policy on the grounds that we now have a new competition law. However, it needs to be realised that

- *First*, 'competition law' and 'competition policy' are two distinct concepts (see figure 1). Competition Law is but a subset of Competition Policy. Besides encompassing the law, Competition Policy includes sectoral regulatory laws and the various government policies that enhance competition and consumer welfare. Therefore, India has a competition law, but not a competition policy. And we require one.
- *Secondly*, the market distortionary practices that emerge from any government policy or practice are beyond the scope of competition law.

A competition authority cannot take any action against distortions arising, for example, from anti-dumping measures, government procurement policy and rules, state excise policy, etc. It also cannot carry out *ex-ante* assessment of government policies and practices.

At best, the competition authority, through its 'competition advocacy' function can advocate with the government to change its policies and practices to facilitate the working of the market process. Under the Competition Act, the government can seek the opinion of the Competition Commission of India in framing any major public policy or reform. However, the effectiveness of this provision rests solely at the discretion of the government.

Instead, a strong policy advocacy is required to rationalise the role of the government, such as its intervention promotes functioning of markets, rather than impede it. There is need to take pro-active steps to promote competition, which requires a declared intent from the government of its resolve to promote competition and fair practices in the market – something beyond the scope of a competition law. Hence, the need for a National Competition Policy! A 'Competition Audit' of all new and old policies will help the government (Central as well as the States) to promote competition.

Not surprisingly, the need for a National Competition Policy was stated in the mid-term appraisal of the 9th Five-Year Plan (1997-2002). Para 66 of Chapter 32 "Direction of Reforms" of the document mentions:

> *"there is an urgent need for articulating a National Competition Policy (NCP) in India. The NCP should fully reflect the national resolve to accelerate economic growth, improve both the quality of life of the people of the country and the national image and self-respect…The competition policy should aim to bring about a spirit and culture of competition among enterprises and economic entities to maximise economic efficiency and to protect and promote consumers' interest and society's welfare and improve our international competitiveness."*

The need for a National Competition Policy has been felt for quite some time. Does it really matter whether it was a different government, who said it but did not do anything about it? Even the present coalition government considers 'competition' a serious policy issue. Its National Common Minimum Programme, *inter alia*, states:

> *"The UPA government believes that privatisation should increase competition, not decrease it. It will not support the emergence of any*

> *monopoly that only restricts competition. All regulatory institutions will be strengthened to ensure that competition is free and fair. These institutions will be run professionally".*

Adoption of a National Competition Policy would not be unique to India. Several countries have adopted a Competition Policy, including

- *Australia* (National Competition Policy adopted in 1995 by federal and provincial governments throughout Australia; consists of a set of policy reforms ensuring that the same competition principles and rules apply throughout the economy)
- *Hong Kong* (Comprehensive Competition Policy Framework adopted in 1997; Government bureaus state competition implications of major policy submissions; and review existing regulations)
- *Mexico* (National Programme for Economic Competition 2001-06 adopted; Cooperation mechanisms established to facilitate coordination of competition policy with industrial, regulatory, trade, and consumer protection policies)
- *Botswana* (Draft Competition Policy presented to Parliament; Seeks to ensure coherence between Competition Policy and other Government policies and laws)
- *Fiji* and *Uzbekistan* are other countries that have adopted Competition Policy, while *Mozambique* and *Malawi* are on the course of adopting one.

Empirical evidence confirms that a well-designed and implemented competition policy promotes economic growth by ensuring better allocation of resources, as highlighted by the case of Australia. A study carried out for the Australian economy[1] estimates the expected benefits from a package of competition promoting and deregulatory reforms (including improvements in the competition rules) to induce an annual gain in real GDP of about 5.5 percent, besides having an increase in real wages, employment and government revenue.

"Competition policy and law allows foreign firms to come in and undermine domestic firms"

The effect of foreign entry into the market depends on the capabilities of domestic firms. If anything, competition law provides some protection to domestic firms from foreign firms that use anti-competitive practices to capture the national market.

In some cases, MNCs are able to supply products at lower prices than domestic firms because of economies of scale, better management and higher levels of efficiency in the production process. If this is the case, then consumers benefit unambiguously from the entry of foreign firms. However, in some cases, firms enter the market with artificially low prices so that they can capture market share from domestic firms, drive these firms out of business and raise prices after having achieved a monopolistic position. This is a case of predatory pricing and it comes under the ambit of a competition law. In such cases, 'competition law' is the tool that provides an avenue for domestic firms to protect themselves from unfair competition.

There are instances and experiences from various countries where multinationals had to pay heavy fines for their engagement in anti-competitive activities. One of these is the vitamins cartel where several leading and sophisticated drug manufacturers of the world were involved in a global conspiracy to fix prices of bulk vitamins. Action was taken against the cartel in the

[1] http://www.unctad.org/en/docs//c2em_d10.en.pdf

USA, Canada and Australia, as result of which over a billion dollar fine was levied on the perpetrators. Even Brazil, a developing country took action by getting cooperation from the US Justice Department.

However, India, could not take any action against the cartel. In fact, the MRTP Commission was unable to take any action against any of the international cartels that attracted the attention of other competition authorities. It did, however, respond to complaints against groups of foreign companies who had been selling at *low* prices, but these orders were set aside by the Supreme Court, which held that the wording of the MRTP Act did not give it any extra-territorial operation In this context, the new competition law (Competition Act 2002) is much better, as it has extraterritorial reach i.e. is based on the *'effects doctrine'*. Thus, actions or practices taking place outside India but having an appreciable adverse effect on competition in the relevant market in India would come within the ambit of the Act. Therefore, the Indian industry can look forward to seeking protection under the Act, when faced with any anti-competitive practice.

Annexure 2

Enhancing Competitiveness and Growth through Competition Policy & Law

Over the past one and a half decade, the overall approach to economic management in India has been revised towards greater market orientation. Wide-spread market-oriented economic reforms have been undertaken, with the government assuming the role of a facilitator rather than a controller. Underlying these reforms is a renewed confidence that market forces and the individual decisions of consumers and businesses, can make a greater contribution to economic and social development than an inward-looking centralised economic system. Accordingly, the primary objective has been to make market driven by competitive forces, so that there are incentives for raising productivity and improving efficiency, and thereby promoting economic growth.

Despite the several measures, the average annual growth during 1990s was a little more than 6 percent. As per Planning Commission estimates, the average growth rate in the tenth plan period (2002-07) is likely to be below 7 percent, well short of the 8.1 percent target. While contribution of services to GDP over the period 1991 to 2003 increased, that of agriculture declined and contribution of industry remained stagnant. This, in a scenario when economic reforms were expected to have a greater impact on the industrial sector. One of the major reasons for the low level of industry's contribution has been its inability to build and maintain competitiveness needed to meet the global challenges as well as to develop a larger domestic market through low cost production. The low levels of industrial growth has its adverse impact on employment generation, as well.

Faced with a similar situation, UK and the European Community had brought out white papers on Competitiveness in 1994. The backdrop was slow productivity growth and decline in relative economic performance of the UK and Europe. Both the white papers emphasised the need for ensuring fair competition in the market as an essential ingredient for enhancement and maintenance of competitiveness in the economy. These prescriptions apply to India as well.

In order to derive full benefits from its micro-economic reform programmes and ensure the development of a competitive national economy, Australia framed a National Competition Policy in 1995. This comprises a set of policy reforms adopted by the federal and provincial governments throughout Australia. The objective is to ensure that same competition principles apply throughout the economy and thereby encourage better use of the country's resources. A study carried out for the Australian economy estimated the expected benefits from a package of competition promoting and regulatory reforms (including improvements in the competition rules) to incur an annual gain in real GDP of about 5.5 percent[1].

Empirical evidence thus confirms that a well-designed and implemented competition policy promotes economic growth by ensuring better allocation of resources. Conversely, barriers to competition within an economy, whether due to governmental or private restraints, need to be curbed to enhance income and welfare.

In case of India, it is observed that though market-oriented economic reforms have been undertaken to stimulate competition and efficiency, government policies continue to be

[1] http://www.unctad.org/en/docs//c2em_d10.en.pdf

framed and implemented that most often thwart the market process. There are several examples of policy-induced anti-competitive outcomes, as outlined in this document.

What is required is to use modes that acknowledge the institution of the market and not by ignoring its presence or being antithetical to it. This requires certain guiding principles to formulate policies and practices in a liberalised regime and fill the existing policy vacuum. National Competition Policy for India is the need of the hour to provide a declared intent to the government's resolve of promoting competition in the market. It would help complete and enhance the process of liberalisation and deregulation, and rationalise the role of the government so that its intervention facilitates functioning of markets. Besides, competition audit (assessment) of all government policies and practices need to be carried out to reform those distorting the market process.

Annexure 3

Government (Central as well as States) induced/created anti-competitive outcomes

The Government (Central as well as States) policies and practices listed below highlight that they are all characterised by some element of a maladroit understanding of the market process. The point is that as policy outcomes are sought to be generated, it is a persistent practice in India, to do so without bearing in mind that policies need to be framed and implemented in sympathy with the market process, and not in a manner so as to stall the process. What is required is to use modes that acknowledge the institution of the market and not by ignoring its presence or being antithetical to it.

The policies/practices given below have been grouped as per the Principles of Competition Policy, discussed in this document.

I. Competitive Neutrality

1. PSUs required to compulsorily route their chartering requirements through Transchart

As per the existing policy of the Government, shipping arrangements of all PSUs are centralized in the Chartering Wing of the Ministry of Shipping (popularly known by its telegraphic address Transchart in shipping circles). The decision to set up such an agency was taken in pursuance of a Cabinet directive in December, 1957 for the purpose of liaison between the then Department of Transport and the Ministries of the Government of India who were concerned with imports and exports of Government cargoes.

Under present circumstances, this policy, however, creates a disadvantageous position for PSUs vis-à-vis private sector, as the latter have the freedom to hire any ship.

One exception to this rule was made recently when the Indian Oil Corporation (IOC) was allowed by the Union Cabinet to directly charter ships for crude oil imports instead of going through Transchart. However, other state-run refiners would continue to depend upon Transchart/Shipping Corporation of India for meeting their chartering requirement. IOC wanted to make its own shipping arrangement to reduce its freight bill and improve refinery margins as competitive bidding and negotiations help reduce the freight which accounts for about 10% of the value of imported crude.

Notwithstanding this exception, the shipping ministry in its draft maritime policy circulated to various ministries for comments, has not suggested any change in chartering norms of the ministry.

2. Route Dispersal Guidelines adversely affecting public sector airlines[1]

Route dispersal guideline is an administrative mechanism aimed at extending air transport services to regions/routes that are not necessarily commercially viable. This is one of the policy measures where government intervention has affected the competitiveness of state-owned carriers and their ability to compete effectively with the private operators.

[1] "Competition Issues in Transportation Sector", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005

The guidelines stipulate that all scheduled carriers fly at least 10 percent of their capacity on trunk routes in the north-eastern sector, Jammu & Kashmir, Andaman & Nicobar Islands and Lakshadweep (category-II routes). Since load factors in these routes are poor, it is a loss-making proposition. Anyhow, Indian Airlines is forced to fly 17 percent of its flights on these routes, incurring an extra annual loss of Rs 62 crore. This lowers Indian Airlines' competitiveness and restricts inter-airline competition.

Besides, 50 percent of trunk route flights have to be flown on Category III routes (that is, on non-trunk and non-category-II routes). On these routes too, IA is forced to fly a greater share of flights in comparison with private airlines. According to figures provided by airline officials, IA flies 74 per cent of flights servicing these smaller towns and loses Rs 134 crore a year, in the process.

Normally, routes that are not found to be commercially viable by major airlines can still be serviced by niche airlines with appropriate aircraft. Of late, Air Deccan – a private "no-frills" airline – is providing air travel to category III routes in a big way. In such a scenario, the route dispersal guidelines may need to be reviewed to ensure that they facilitate the emergence of specialised airlines.

3. Procedural delays affecting competitiveness of public sector carriers[2]

For almost four years, public sector airlines have been trying to procure aircrafts to expand their fleet. Until recently, their proposals had been doing the rounds of the government departments in search for a final approval. This now seems to be finally coming to an end with the cabinet recently approving the aircraft acquisition plan of Indian Airlines. The delay over aircraft acquisition has adversely affected the ability of public carriers to compete with private players.

The delay resulted in foreign airlines utilising 70 percent of their entitlements, whereas Indian carriers are utilising only 30 percent. It has been suggested that the private airlines be allowed to use the bilateral traffic rights, not utilised by the public sector carriers. However, the argument is not as simple as allocating unused bilateral traffic rights to private airlines. Had the state-owned airlines been allowed to acquire more aircrafts, there would have been no unused bilaterals in the first place.

4. Facilities and preferences given to public sector carriers distort market process[3]

In the Delhi and Mumbai airports, the state-owned Indian Airlines has a full terminal to itself, while the private-sector competitors are all cramped in one. This is despite the fact that Jet Airways alone has a higher market share than Indian Airlines. Besides, private airlines are not allowed to establish hangars for major maintenance overhauls at airports and consequently have to outsource maintenance activity to high cost locations abroad.

5. Access Deficit Charge to BSNL: distorts competition and technological development[4]

Regulations allow BSNL to receive an Access Deficit Charge (ADC), which seeks to compensate BSNL, whose fixed line rentals and call charges are considered loss-making operations that must be continued in public interest.

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[2] ibid

[3] ibid

[4] "Competition Issues in Telecom Sector", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005

The concept of ADC was enunciated at a time when it was recognised that the cross-subsidised system followed by basic telecom service providers (in which surpluses from long-distance calls were used to offset losses that resulted by offering services such as, local calls, monthly rentals, services to rural exchanges, at below cost) could not work, with competition eroding the margins available in the long-distance segment. Since number of fixed line subscribers far exceeded mobile subscribers at that time, any hike in their rental/tariff would have made basic telecom services unaffordable to many. Moreover, tele-density was low (4.2 in Dec'02) and the objectives of affordability and universal access were of great importance. Hence, ADC was provided to basic service operators to maintain the affordability of their services.

But, the circumstances have now changed: the number of mobile subscribers exceeds fixed line subscribers and the gap continues to grow. Thus, the circumstantial reason for placing an emphasis on basic telecom services for the purpose of ADC does not stand the test of time. Moreover, mobile tariffs in India are one of the lowest in the world. This calls for an equal emphasis on mobile services for the purpose of Universal service and Universal access. The larger question is to facilitate access to affordable telecom services, and any support to meet this objective should be available to both fixed as well as mobile services.

As things stand, against all norms of fair competition, BSNL receives ADC payments even though it refuses to undertake tariff revision that current TRAI regulations allow it to carry out. The perverse incentive to BSNL to adopt this approach is easy to see since the losses so incurred can be directly recovered from payments through ADC. BSNL thus does not face the risk of customer displeasure or of losing customers to competition in such an environment.

What's more, the objectives of providing ADC are no different from USO and there is a strong case for their merger. TRAI has been contemplating moving towards a revenue-based ADC regime and eventually merging the ADC and the USO. However, this is not acceptable to the DoT. Further, the Minister for Communications has gone on record saying that the ADC amount to BSNL must not fall below Rs.5000 crore annually. These developments have led to a rift between the DoT and the TRAI, and the matter is still unresolved.

6. End of CONCOR monopoly envisaged, but need to ensure competitive neutrality[5]

The announcement made in the railway budget of 2005-06 to allow private operators in movement of container trains brings an end to the monopoly enjoyed by Concor. Alongside, the government needs to eliminate practices that give undue advantage to Concor. For example, the Railways Act currently allows only the Government of India to fix freight and also restricts the Railways liability for losses. Unless these provisions are changed, private sector cannot effectively compete with Concor.

Furthermore, government follows a practice that preserves the monopoly position of Concor vis-à-vis movement of cargo by road. Movement of cargo by road involves either a down payment of import duties when taking delivery of the goods, or furnishing of a bank guarantee in lieu, which is a costly process. On the contrary, Concor is allowed to transport the goods, and import duties can be paid at the final destination, i.e. the inland terminal. Thus, container movement via road becomes that much more uncompetitive.

[5] "Competition Issues in Transportation Sector", op cit

7. Passenger transport on inter-state route reserved for state road transport corporations

The Motor Vehicles Act gives power to the State to exercise discretion for formulating a scheme for an area or route, excluding private operators from the field to render transport service. Private operators are totally prohibited to have corridor shelters and cannot enter into frozen area, route and obtain permit to render transport service to the traveling public. There are several cases, where, for instance, the inter-state passenger transport is exclusively reserved for the state road transport corporations. For example, the UP State Road Transport Corporation alone has the exclusive right to ply its stage carriages on Saharanpur-Shahdara-Delhi route and Bulandshahr-Delhi route.

Therefore, when a route is nationalized, the State Road Transport Corporation has right to ply on it to the exclusion of any private operators. Overlapping of 10 kms on such route by private operators of other routes is permitted only with a view to give facility to the public so that for short distance they need not have to change from a vehicle of private operator to that of State Transport Corporation during the travel.

This exclusivity has given a monopoly to SRTCs and has resulted in relatively excessive tariffs charged on several routes. For example, whereas the Volvo fare for Delhi-Vijaywada (intra-state) is about Rs.250 (a distance of 276 kms and route served by private operators as well), the fare for Delhi-Jaipur is Rs.435 (a distance of 252 kms and exclusively reserved for state transport corporation).

8. Rajcomp in Rajasthan: monopoly in providing IT services to government agencies

RajCOMP is a state Agency established by the Government of Rajasthan, as a consultancy organisation in the field of information technology. By virtue of its status, all state government departments, and state PSUs approach RajComp for their IT related work. RajComp has acquired a monopoly in providing IT services to the state government and its agencies, leaving out other players. Development of e-governance applications, MIS, procurement of computer hardware, etc related to government departments are all entrusted upon RajComp.

II. Access to Essential Facilities

9. Interconnection in Telecom, in particular to BSNL network: still unresolved[6]

In the last two years, there has been an exponential growth in cellular mobile services. However, the provision of interconnection has not kept pace with this growth leading to increase in inter-network congestion and poor quality of service to the customers. A recent study paper by TRAI highlights that the problem is escalating and unless immediate remedial measures are taken, the situation will only worsen.

Ideally, the regulator should have had full authority to get on with the task of getting all networks to hook up with one another in a timely (maximum 90 days) and transparent manner. However, with the TDSAT clipping TRAI's wings and leaving interconnection to mutual negotiation between operators, the regulator has been left with no teeth to enforce its

[6] *Interconnect exchange: Wires remain crossed*, Hindustan Times, 7 November 2005; *Study paper on state of Indian telecom network*, TRAI, 2005

directives. TRAI has appealed against this ruling at the Supreme Court, and the matter is subjudice.

In order to ensure efficient interconnection between service providers, TRAI issued Interconnection (Reference Interconnection Offer) Regulation,2002. BSNL challenged this Regulation before TDSAT which decided that the power of TRAI to fix the terms and conditions of interconnection are subject to licence conditions and the existing interconnection agreements between the operators. As this decision impinges on the effectiveness of TRAI to ensure effective interconnection regime, the regulator has filed appeal against it in the Supreme Court.

The problem of interconnectivity is extremely acute with BSNL, whether it is interconnection to their fixed network or the mobile network. The Interconnect Agreements between BSNL and other mobile service providers provides for provision of interconnect capacity within 12 months of making the payment for the required capacity. However, there are large number of cases pending where even after 12 months, the required junctions have not been provided by the BSNL.

Though TRAI has taken measures to reduce the lead-time for provision of interconnection, because of legal proceedings against these measures by BSNL in the TDSAT and the orders of the Tribunal thereon limiting the powers of TRAI to fix the terms and conditions of interconnectivity, these measures could not take off.

If interconnection issues are left for mutual negotiations, the incumbent operator and Operators with significant market power always try to delay interconnection to other players leading to inconvenience and high cost to subscribers and deterioration of network conditions. This is evident from the delay in providing interconnections by BSNL and recent dispute on interconnection between Reliance Infocom Ltd. and Tata Teleservices Ltd. where Reliance had delayed provision of interconnection to Tata Teleservices Ltd.

10. Decision not to unbundle has stifled competition in communications[7]

As per the progress reports, subscriber base of only 0.61 million for Broadband has been achieved by September 2005, out of which 0.26 million belongs to PSU and 0.35 million to the private service providers together. Hence the actual achievement by various operators together is much below the policy target of 3.0 million for December 2005, which is likely to be missed.

It is observed from the current trend that the incumbents (BSNL & MTNL) are not able to make full utilization of their infrastructure themselves and neither through franchisee option provided to them through Broadband policy. Because of this the existing local loops could not be utilized by incumbents as well as by the private operators. Many of the competitive service providers have mentioned about the difficulty to achieve the Broadband Policy targets unless Government mandates Local Loop Unbundling by incumbents. Concerned about slow uptake of Broadband in the country, TRAI has recently asked the Government to reconsider its recommendations pertaining to Local Loop Unbundling.

[7] TRAI documents

11. End of CONCOR monopoly, but need to ensure access to railway tracks and engines[8]

Despite the higher growth in container traffic, the share of total container traffic in traffic that can be containerised continues to be low in India as compared to international trends. One of the reasons for this is the problem of evacuation of containers from Indian ports, currently an activity that is the monopoly of the Container Corporation of India (CONCOR).

In November 2004, the government took the first step towards breaking Concor's monopoly by allowing the Pipavav Rail Corporation Ltd (PRCL) to transport containers by rail. This has been followed by an announcement in the Railway Budget of 2005-06 to allow private operators in movement of container trains, signalling an end to Concor's monopoly. However, an enabling policy framework to facilitate operation of other players is still absent.

Since railway tracks constitute a natural monopoly, with the entry of other operators, there is a need to regulate the prices and control the quality of railway tracks that are made available. Furthermore, entry of other operators in container movement by rail will require equal access to engines to pull these wagons. This requires a framework to ensure that railways do not squeeze out competition by not allowing them to move their wagons.

III. Separation of Policy-making, Regulation and Operation Functions

12. Government's role as licensor, policy-maker and service provider in telecom sector creates serious conflicts of interest[9]

Sector regulators have been set-up in the country to separate policy formulation function from regulation in order to ensure a predictable regulatory environment and participatory decision-making. However, temptation to command and control these autonomous institutions still prevails within line-ministries, often leading to turf wars.

To cite an ongoing case, the Department of Telecom (DoT) recently announced certain proposals (on ADC, one India call rate, interconnection usage charges) for restructuring the tariff regime in telecommunications, considering these as policy issues. However, the Telecom Regulatory Authority of India (TRAI), the sector regulator resisted these proposals. After TRAI's objection, the DoT contemplated exercising its powers under the Act to issue 'policy directives' to the regulator. Although the Ministry finally refrained from doing so this event highlights the need to clearly demarcate policy and regulatory issues.

In similar instances, DoT seems to be giving full favour to the state-owned operators. The terms on which BSNL provides services in the market are more favourable than those allowed to its competitors by the licensor, viz Ministry for Communications, which also happens to be the owner of BSNL. This conflict is exacerbated by the fact that the regulator, TRAI, also reports to the same ministry. For instance, the decision of not unbundling local loops, and payment of Access Deficit Charge to BSNL. Further, the fixed and mobile access providers, who, even after the unification of licences, hold the Unified Access Service Licence (UASL), are not allowed to interconnect across service areas. Even if they hold licences for contiguous areas, operators must reach their customers in the other area only by connecting to long distance service providers, amongst which BSNL is the most ubiquitous

[8] "Competition Issues in Transportation Sector", op cit; Mid-term Appraisal of the 10th Five-Year Plan (2002-07), Planning Commission, Government of India, 2005

[9] "Competition Issues in Telecom Sector", op cit

and the largest. BSNL has successfully resisted sharing its infrastructure, acquired since the days of it's being a public owned monopoly, with its competitors, even though regulations demand it.

13. Conflict of interest in port operations limits competition[10]
In the present dispensation, Port Trusts that are both owners as well as service providers are called upon to introduce competition or put out some of their facilities for private handling and face competition from them. This, in fact, gives ports, as owners as well as service providers, an opportunity to discriminate against competing service providers.

14. Organisational functioning of Railways introduces distortions in inter-modal transportation[11]
The Indian Railways formulates policy and provides services and also acts as a regulator. These three functions need to be separated. There is need to rationalise railway's fares and freight rates structure. Heavy cross subsidisation introduces distortions in the inter-modal mix of transport as a whole as well as in the operation of Railways.

IV. Free and fair market process

Trade policy related distortions

15. Inverted duty structure adversely affective domestic manufactures
One of the anomalies in the tariff regime is the higher import duty on raw materials vis-à-vis that on finished products (reverse tariff escalation), which leads to market distortions, adversely affecting domestic manufacturers. Certain examples of reverse tariff escalation are given below:

- The tyre industry, where import duty on natural rubber is 20 percent. However, the duty on imported finished tyres is only 10 percent. This has led to cheap unwarranted tyre imports, in particular from China. Profitability and market share of tyre companies has taken a hit[12]
- The Vegetable Oil sector where crude palm oil, a raw material for manufacture of vanaspati, attracts customs duty of 65 percent *ad valorem*; while import of vanaspati itself (the finished product) attracts much lower rate of duty at 30 percent. This is encouraging large vanaspati import and hurting the domestic vanaspati industry[13]
- In Petrochemical sector, suppliers of feed-stock like naphtha, natural gas (GAIL) and basic polymer (Reliance Industries) have a tariff protection advantage over producers of finished products like plastics and synthetic fibres[14]
- The Indo-Thailand Free Trade Area (FTA) Agreement envisages the elimination of duty on 82 selected products in a time frame of two years, while the duty on some of the inputs remains unchanged. For instance, the duty on colour television sets has been reduced to

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[10] "Competition Issues in Transportation Sector", op cit
[11] Mid-term appraisal to 10th Five-Year Plan, op cit
[12] Business Standard, 01.04.2005
[13] Business Line, 25.11.2004
[14] Financial Express, 28.05.2005

12.5 per cent on 1st September 2004, while the duty on some of the inputs has remained at 10-20 per cent. The inverted structure will be exacerbated if the duty on these inputs is not changed, because the duty on the finished product under the Indo-Thailand FTA is scheduled to go down to 6.25 per cent on 1st September 2005 and to zero on 1st September 2006. A similar problem has arisen for refrigerators/air conditioners where the duty on inputs has remained at 15-20 per cent while the duty on the finished product is being phased out[15]

- The indirect tax structure at the state level also adversely affects Indian manufacturers. Under Article 286(b) of the Constitution, states are not permitted to levy sales taxes on imports; such taxes are, thus, confined to domestically produced goods. Since the clause has not been amended, the bar will continue even after state-level VAT comes into force. Special additional duty (SAD) of 4 percent, levied since 1998 on imported goods to compensate in an *ad hoc* manner for state consumption taxes on domestic products, was also withdrawn in 2004. Adverse effects are likely to be particularly acute for goods where there has been progressive lowering of tariff rates such as IT products and capital goods[16]
- When excise duty on personal computers (PCs) was eliminated on 2nd July 2004, without lowering the 16 percent excise duty on some components, it became more advantageous to import PCs instead of buying them from domestic manufacturers. An attempt has been made to rectify this anomaly by imposing, on 26th July 2004, additional customs duty of 6 percent on the CPU box and 7 percent on the Full System. While this solved the problems of PC manufacturers, the manufacturers of some components, such as motherboard and monitors, which attract 16 per cent excise duty, have been adversely affected by the sale of parts from disassembled imported PCs[17]

16. Anti-dumping measures increasingly used to protect competitors[18]

The reduction of trade barriers has been accompanied by a proliferation of anti-dumping (AD) measures imposed by India. The WTO Agreement on Anti-dumping requires a member to establish that the imported goods are being dumped (exported at a price below "normal value"), injury to domestic producers, and a connection between dumping and injury. India seems to be interpreting these rules quite generously as is evident from the cases tabulated in Annual Report (2002-03) of the Directorate General of Anti-dumping and Allied Duties (DGAAD) of the Ministry of Commerce. In 83 percent of cases (135 out of 163 cases initiated), provisional or final AD was recommended or imposed.

It is easy to prove dumping based on comparing price with “normal value”, because the rules allow petitioners to construct normal value based on an estimate of costs, including administrative expenses as well as normal profits. The rules also allow various measures of injury, and the anti-dumping authority can accept any of them. In several cases, the DGAAD has accepted an increase in the foreign firms’ market share (which was only to be expected in a period of trade liberalisation) as evidence of injury, even though the Indian industry’s sales and profits were increasing at the same time. AD duties were imposed so as to ensure a ‘non-

[15] Mid-term Appraisal to 10th Five-Year Plan, op cit
[16] ibid
[17] ibid
[18] “Cross-border Competition Issues” in *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005

injurious' import price, which would guarantee a 'reasonable' rate of return to the domestic producers, based on their own cost data. This provided a cushion for inefficiency.

What the DGAAD considers reasonable is entirely subjective and usually not made public, but in a rare case in which the appellate authority set aside its findings, it emerged that it had fixed the AD duty so as to yield a 22 percent rate of return on capital to the Indian polyester industry! It also came to light that during the period of alleged dumping, the domestic industry was operating at full capacity and had in fact raised its prices. In almost all cases AD remedies have been used to protect Indian industries, and not to preserve competition. Moreover, AD measures have inflicted higher import costs on user industries, as it is mainly intermediate goods industries in the chemicals sector that have succeeded in obtaining protection.

17. Small-scale units producing reserved items compete against foreign manufactures[19]

The policy of reserving certain items for manufacture by small-scale industrial units has led to an anomalous situation. Following the elimination of import restrictions and falling levels of duty protection, the small-scale units in reserved sectors have to compete against foreign manufacturers (though they are still protected from competition from local medium and large enterprises) but they are not allowed to expand to meet growing competition. Over time, there has been a growing realisation that this policy is unsustainable and the government has been following a policy of reducing the number of items reserved for the small-scale sector. About 600 items are still on the list and there is a strong case for further and substantial de-reservation, especially in areas where import competition is significant.

18. Use of trade policy instruments in steel sector creates market distortion[20]

Direct state intervention, often protective in nature, has created externalities that have brought gains to steel producers' vis-à-vis the steel consuming industries. For example, the import duty rates remained at very high levels, as high as 25 percent till January 2004. The industry also gained from certain procedure related non-tariff barriers, like mandatory certification requirement for quality of imported products by the Bureau of Indian Standards (BIS). This involved a lengthy and cumbersome procedure entailing high transactions costs for the importers. The government also designated ports for imports of certain categories of steel with a clear intention to curb their imports. These measures although were, at times, against the interests of certain segments of the steel industry itself (for example, the merchant cold-rolled coils and Galvanised sheets and coils producers), they served the integrated steel producers when it came to competition with the downstream industry. The continuation of anti-dumping duty on non-alloy steel has been questioned widely by the consumer industry. Further, a prohibitive import duty on seconds and defectives also goes against genuine consumers, forcing them to buy these at high costs.

Procurement-related distortions

19. Procurement practice facilitated cartelisation in procurement of concrete sleepers

The Parliamentary Standing Committee on Railways (2004), while discussing the question of procurement of concrete sleepers, observed:

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[19] Mid-term Appraisal to the 10th Plan, op cit

[20] "Competition Scenario in Indian Steel Industry" in *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005

"*The procurement of concrete sleepers has become a very sensitive matter, because a lot of unscrupulous existing manufacturers have formed a cartel to secure orders by unfair means or tempering with procedure and simultaneously keeping the new competitors out of the race. The Committee is constrained to notice that there exists a regional imbalance in the setting up of concrete sleeper manufacturing units. They also express their unhappiness that new entrants are not encouraged, which ultimately strengthen the cartel of old/existing manufacturers*".

In procuring 160 lakhs broad gauge sleepers, the Railways awarded contracts to the existing 71 firms, and ignored the 24 new firms entirely.

20. Bid Rigging in Construction/Works undertaken by the Government[21]

An area of government procurement where there are cases of collusion is construction contracts undertaken by the Government. This is primarily facilitated by the rules that are laid down for procuring such services. Construction projects are generally taken up by government agencies through the medium of contractors. Generally, these works are awarded through a system of competitive bidding.

There is now a trend towards awarding works in much bigger packages, which effectively rules out small contractors from bidding. Other factors that restrict entry relates to the pre-qualification criteria, where for bigger packages, past experience in executing similar works is a must, leaving the contract open for only a few construction contractors.

In several cases, large contractors subcontract the work to smaller contractors, mainly because in large projects, it makes sense to subdivide work into smaller lots to make the project management task easier. This subcontracting is taken into account when the large bidders bid, and the profit, of both the sub-contractor and their own is factored in. This leads to an escalation in costs of bigger packages. It is estimated that there can be a 10-15 percent reduction in cost, if smaller contractors are not excluded from the bidding process.

Angered by the malicious process, the Rajasthan Minister for Public Works Department (PWD) announced in the assembly on July 20, 2004, that he would break all cartels, so that smaller contractors can bid for contracts. Subsequently, nothing happened, and it is now business as usual.

There are good practices as well, which can be adopted to ensure competition in the bidding process. For instance, by selling tender documents through multiple sources. This has been tried in certain contracts and has proved successful. The procedure creates uncertainty among the cartel members, as they are not sure how many bids have been submitted, and by whom. This makes it difficult for the cartel to monitor the number of bids outside the pool, and forces the members to submit reasonable bids. The Government of Andhra Pradesh's e-procurement scheme is another initiative to tackle the menace of bid rigging, and bring transparency in the entire procedure.

21. State Government's incapacity facilitated the formation of millers' cartel in Orissa[22]

The State Government of Orissa collects raw paddy from farmers and sells it to millers for further processing, who sell the processed products back to the State Government. The

[21] "State Government Policies and Competition" in *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005
[22] ibid

Government of Orissa does not have its own processing units. The millers capitalise on this and sell the processed products to the state government at a high rate. Ultimately, the Government sells the procured product to the people at a very high cost. The procurement policy has, in this way, become miller-friendly instead of being consumer friendly.

22. Maharashtra Cotton Monopoly Procurement Policy[23]

Distrustful of the market, restrictions have been imposed on trade and commerce in the country through regulations in various forms, invoking "public interest". A classic example is the Maharashtra Cotton Monopoly Procurement Scheme (MCMPS). Enacted by the state legislature in 1971, the scheme empowers the government of Maharashtra to acquire all raw cotton produced within the state (in reality, brought for sale in the state mandis). Originally due to expire in 1980 the law authorising the state's monopoly has been extended from time to time, and despite sharp criticism as a glaring impediment to the operation of a common market, continues to be in force even now. The scheme was devised to support cotton farmers through assured prices for their produce, however, its effect on their welfare is debatable.

The presence of the scheme has adversely affected the quality of cotton produced in the state. As there was monopoly procurement, no modernization took place in ginning and pressing industry. The prices received by farmers were based on the discretion of graders who decided the quality of the cotton. This power of the graders, who unlike private traders, had no interest in being judicious about quality aspect led to large scale corruption and worked as disincentive for farmers to produce quality cotton.

As the prices fixed by the government were higher than the open market prices, it became difficult for the government to pay the farmers the entire amount in one installment. Under the increasing burden of losses the state government decided to scrap the monopoly nature of the scheme in 2002. With this, positive changes are seen on the ground. New ginning and pressing units are being set up. The existing ginning and pressing units are being modernized. Farmers are becoming quality conscious as now they also deal with private traders who pay as per the quality of cotton.

23. Purchase preference given to units located within the state, may breed cartelisation[24]

Several states have some government order or regulation, which gives preferential treatment in purchase to units situated within the State. Most often, the policy is targeted to protect and support small-scale sector units. In the context of the overall development policy of the state, such policies may be desirable. However, concerns arise, when the policy creates conditions for formation of a cartel of local manufacturers, which is solely dependent on Government's patronage. In such cases, the state government ends up paying higher price for a product, which is often of poor quality. Moreover, with a captive market, where there is no quality control and no threat of competition, the enterprises may become uncompetitive.

This came to light in a case from Rajasthan. As per an earlier Rajasthan Government policy, a certain quota of barbed wire was to be procured from local manufacturers. This is supposed to have led to formation of a 'cartel' under the name of Rajasthan Barbed-wire Manufacturers Association in mid-80s. This association hiked the prices, and with an implicit arrangement allocated the total requirement of barbed wire amongst its members. Consequently, poor quality barbed wire was procured at a high price, with almost no quality checks at the

[23] "Policing the Common Market", Business Standard, 5 October 2004; "Not in the interest of poor", http://www.didaweb.net/mediatori/articolo.php?id_vol=1003

[24] "State Government Policies and Competition", op cit

Government end. Local manufacturers depended solely on Government's patronage rendering them uncompetitive. With the changed Government procurement policy, local units closed down and the association broke up.

The point is that whenever such policies are framed, which are designed to protect a class of enterprises, they should be implemented by acknowledging the market process, and any adverse effects on competition should be clearly laid down for exemptions.

Pricing-related distortions

24. Lack of Transparency in pricing of Petroleum Products[25]

The Administered Price Mechanism (APM) for petroleum products was formally dismantled with effect from 1 April 2002, after which the pricing of crude oil and petroleum products except for kerosene and domestic LPG sold through the public distribution system (PDS) was to be market determined. However, the factual position is that the public sector oil companies are collectively fixing prices of crude oil and petroleum products based on so called import parity pricing, and all price changes are approved by the Government of India prior to implementation. The sector is devoid of any real competition among the public sector oil companies. The entry of private oil companies in the marketing of petroleum products has not changed this ground reality since the bulk of output from private refineries is still marketed by the oil sector PSUs.

Further, the current pricing policy based on import parity is not transparent and includes several elements in the price build up that are debatable. The pricing mechanism uses import parity pricing even for products, in which India is the net exporter. This provides higher margins to the refiners. Moreover, custom duty on crude oil is 5 percent while average duty on petroleum products is 10 percent. This further increases the refinery margins. The normative transportation and storage costs charged to the products instead of the actual costs also increase the margins of refining and marketing companies.

Additionally, the government levies a cess on indigenously produced crude oil and natural gas. The Oil Industry Development Act, 1974 based on which the cess is being charged, states that "the cess collected under this provision would be made available to the development of petroleum sector". However, only a small fraction of this amount has been utilised for the purpose it is imposed. Over the past three decades, the government has collected about Rs.50,000 crore as cess, but only Rs.902 crore has been allocated to the Oil Industry Development Board (OIDB) that is supposed to disburse the money to the industry. The Parliamentary Standing Committee on Petroleum and Natural Gas thus observed, "there is no justification in levying the cess if the amount generated from it is not being utilized for the development of the oil sector".

25. Government pricing rules for SAIL limits its capacity to compete[26]

In steel sector, as a per a government order, Steel Authority of India Ltd. (SAIL) is required to compulsorily declare prices of major products in newspapers every month. Although this makes the PSU transactions more transparent, the publicly announced prices becomes a benchmark for other producers.

[25] Mid-term Appraisal to 10^{th} Plan, op cit

[26] "Competition Scenario in Indian Steel Industry", op cit

26. Pricing of coal weakens incentives for delivering better quality coal[27]

The current system of pricing coal based on "Useful Heat Value" (UHV) is irrational as it is based on an obsolete empirical formula. UHV classification also uses excessively wide bands for grading coal. This weakens incentives for delivering better quality coal and also for washing coal to improve its quality. There is a need to switch to pricing coal on the basis of Gross Calorific Value with narrow bands, in line with current international practice.

27. Implementation of MSP/PDS system distorts prices in the open market[28]

The declared minimum support price (MSP) has several negative fallouts. The first is the impact on foodgrain prices in the open market. Since the issue price and the purchase price are linked, higher purchase prices result in higher issue prices, which sets the benchmark for price in the open market. Further, with a large part of the marketed surplus in Food Corporation of India's warehouses, the lower supply exerts an upward pressure on prices in the open market.

Distortions created by rules and regulations

28. Government intervention in Petroleum Sector stifles competition[29]

From 1993 onwards, private sector enterprises have been allowed to import, as well as market, kerosene (SKO), LPG and LSHS products at the prices determined by the market forces. The new entrants are expected to develop infrastructure for imports of these products, tankers for storage, LPG Bottling plants, in addition to setting up their own distribution and marketing network including, transportation arrangements. However, only state-owned oil companies have been permitted to market subsidized domestic LPG and PDS kerosene. While there may be some genuine, social concerns that Government has to take care of, the non-targeted subsidies offered to PSU oil companies in terms of concessional pricing, distorts the market, and restricts the ability of private retailers to compete effectively.

Furthermore, the LPG Control Order has specified that the cylinders, regulators and valves used by the private operators have to be distinctively different from that used by the public sector oil companies. This requirement reduces the freedom of LPG end-users in switching from one supplier to the other, and restricts competition.

29. Sale of coal – monopoly enjoyed by state-owned incumbents[30]

Private sector has been allowed for captive mining of coal. Further, the Colliery Control Order 2000, has paved the way for full deregulation of coal pricing in India, leaving no power with the Central Government in this regard. Although pricing freedom has been given to the coal producing companies, the distribution of coal is still managed or mediated by government agencies, and only government-owned coal companies are allowed to sell coal directly to consumers.

Since the whole sector is owned by the Government, there is no competition among the suppliers of coal. Given the fact that coal constitutes about 50 percent of the primary energy

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[27] Mid-term Appraisal to 10th Plan, op cit

[28] "Central Government Subsidies in India", Department of Economic Affairs, Ministry of Finance, Dec 2004

[29] "Central Government Subsidies in India", op cit; "Competition and Regulation in Energy Sector of India", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005

[30] "Competition and Regulation in Energy Sector of India", op cit; Mid-term Appraisal to 10th Plan, op cit

consumption in India, competitiveness of the entire energy sector critically depends upon the competitiveness in the coal sector. The major prerequisite to promote competition, in the coal industry, is the removal of entry barriers, for the private sector, in mining and selling for non-captive purposes. Allowing private investors, only in mining, without allowing them to sell directly to consumers, is least likely to attract private miners, as they virtually face single buyer, i.e. Coal India, who would then, in turn, allocate to consumers. Such a market structure does not help to promote competition.

The Government also attempted to introduce the private sector in non-captive mining, which could have introduced competition in the sector. The Coal Mines (Nationalisation) Amendment Bill 2000 aimed at amending the provisions of Coal Mines (Nationalisation) Act 1973 and permit private sector in non-captive mining is still pending in Parliament.

30. Procedural formalities affecting the climate for doing business[31]

It is true that countries may help the firms compete more effectively by following a set of policies, which create an enabling environment. For example, the issue of clearances to set up a business and the time it takes. Recent investment climate assessment studies have noted relatively excessive regulation, with a large number of Central and state-level clearances needing to be taken, particularly in power and mining projects. This not only delays projects inordinately but also creates avenues for corruption.

A study conducted by the World Bank reveals that in India, entrepreneurs on average go through 11 steps to launch business, which takes 89 days, as against a regional average of 7 steps and 35 days! In a sample of 155 countries, India was placed at the 116th position in terms of ease of doing business, much below even Pakistan, Sri Lanka and Bangladesh.

31. Complicated procedures with duplication hold up investments in mineral sector[32]

There is tremendous scope for attracting investments, both domestic and FDI, and associated new technology in mineral exploration and mining. However investments and injection of new technology in this sector are held up by excessively complicated procedures with considerable duplication at the State and National level. Most mineral resources occur in forest areas and clearance from forest and environmental angle compound the problem. The current policies suffer from a bias against issue of large mining leases consistent with development of mines with application of new technology. The procedure regarding environmental and forest clearances is also non-transparent and highly dilatory.

32. Policy over grant of mining rights distorts competition in the steel sector[33]

Several states, where iron ore mines are located, (e.g. Orissa, Chhatisgarh, and Jharkhand) have decided to give iron ore mining rights only if the steel plant is established in their respective states. This raises a serious competition issue, as it has deprived steel makers in the country outside these states, the right to bid for mining leases and thereby makes the iron ore mining segment of the steel industry less competitive. This is an example of state governments adopting licensing/auctioning terms and conditions that are anti-competitive in nature. In a federal constitution, all citizens are equal irrespective of state of origin, and common mineral rights belong to all citizens, not merely those of one state. Hence tying a mine only to local state industries is discriminatory against citizens of other states, and unconstitutional.

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[31] Mid-term Appraisal to 10th Plan, op cit; "Doing Business in 2005", World Bank
[32] Mid-term Appraisal to 10th Plan, op cit
[33] "Competition Scenario in Indian Steel Industry", op cit

33. Inspector-raj for small and medium industry[34]

Small and medium industry is burdened by the phenomenon of repeated visits by multiple inspecting agencies, each of which has excessive powers without sufficient transparency or checks on how to use them. As per an estimate, small-scale units have to comply with 22 Central enactments. A survey conducted by the Federation of Indian Chambers of Commerce and Industry (FICCI) in October 2004 revealed that, on an average, a factory/establishment is subject to 37 inspections a year, with some factories facing 67 inspections in a single year, the maximum number of visits being those of the Environment Officer, State Pollution Board officials and the Labour Officer. Some of the inspectors have wide ranging powers: 20 of them have powers of imprisonment, 12 for sealing the unit and 21 for stopping operations. The wide powers vested in the inspectors and the frequency of their visits has led to the phenomenon of Inspector Raj and proved to be a fertile ground for breeding corruption. There is a need to rationalise these inspections.

34. 'Open Access to Electricity Infrastructure' - Poor Implementation of a Good Policy

The Electricity Act 2003 mandates the regulators to ensure non-discriminatory open-access to transmission and distribution infrastructure to consumers whose power requirement exceeds one megawatt, within five years from the commencement of the Act.

Open access was provided with the view to promoting competition and efficiency in electricity market. The Act also provides for imposition of a surcharge on open access transactions, to compensate the state electricity boards.

In practice, however, open access is not happening, though enabling regulations have been framed by many of the State Electricity Regulatory Commissions. The primary reason is that the additional surcharge imposed is out of proportion. Since the Act does not provide the extent of surcharge, it is being (mis)used such that opting for Open Access is not an attractive proposition. For instance, Rajasthan Electricity Regulatory Commission has determined a wheeling charge of Rs. 0.01/Unit for Extra High Tension (EHT) consumers. A further surcharge of Rs. 1.72/Unit was imposed which made it a not-so-attractive proposition.

35. State Excise Policy for liquor facilitates cartelisation[35]

In several states, excise policy for liquor facilitates cartels of liquor traders. As a result, bids are suppressed and, state governments lose revenue in the process.

In some states, liquor groups comprising of large geographical areas are auctioned for specific period. Over time, it has encouraged cartelisation amongst the few players that operate. As a result, bids are suppressed and state revenue declines. This is evident in the case of Rajasthan till 2004-05, which has witnessed a decline in revenue figures in real terms. Realising this, in its excise policy for 2005-06, the Government of Rajasthan has made significant changes, and aims at devolution of liquor selling rights to larger number of vendors in order to break the cartel of about a dozen liquor contractors.

Cartelisation has also been witnessed in states where the retail sale is granted by tender-cum-auction system. This system too encourages bidders to collude, resulting in underbidding in the auction, causing loss of revenue to the State Government. The state governments of Tamil

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[34] Mid-term Appraisal to 10th Plan, op cit

[35] "State Government Policies and Competition", op cit

Nadu, Uttar Pradesh, and Madhya Pradesh followed this system in the past, and faced problems. Later, they replaced the tender-cum-auction system by a system where liquor shops are allotted by a lottery system for a fixed licence fee. The Punjab government is grappling with the problem of monopolies in liquor contracts, and is contemplating to bring changes in the liquor policy.

36. Agriculture Produce Market Regulation Act: monopoly to state governments; loss to farmers[36]

The Agricultural Produce Market Regulation Act (APMRA) enacted by the states, brings all agricultural markets under the purview of the Act. The bringing of agricultural markets under the purview of APMRA, has considerably diluted mercantile power in agricultural markets. But, empirical evidence shows that the price formation process is open to manipulation through collusion.

Under the Act, state governments alone are empowered to initiate the process of setting up of regulated agricultural markets. This prohibits the private sector from taking any initiative in setting up a modern market infrastructure. Further, the Act renders illegal any sale and purchase of agricultural produce outside the regulated (notified) market or market yard except where exemptions are granted. The strongest criticism of APMRA is that it restricts the farmer from entering into direct contact with any processor/manufacture/bulk processor, as the produce is required to be canalised through regulated markets.

There is a need to develop direct marketing links for agriculture produce, and this requires changes in the agricultural marketing laws of the states. The changes needed are at the state level and there is enormous resistance to (as well as lethargy in) bringing about these changes because of entrenched vested interests who control existing *mandis* and the associated activities.

Some state governments have responded by providing alternative marketing avenues through cooperative marketing agencies and public agencies. Some experiences with direct marketing have been quite successful such as direct sale of fruits and vegetables to consumers in Hadapsar market in Pune (since 1976), Horticultural Producers Co-operative Marketing and Processing Society Ltd or HOPCOMS in Karnataka (since 1965). Some more recent experiments on the peripherals of cities are Uzhavar Santhail (since 1999) in Tamil Nadu, Ryathu Bazars (since 1999) in Andhra Pradesh and Apni Mandi in Punjab and Rajasthan.

Besides, a model Agricultural Produce Marketing Act has been drafted and circulated among the states. The Model Act provides for legal persons, growers and local authorities to establish new markets, growers to sell their produce in markets other than the regulated markets, establishment of direct purchase centres, consumers/farmers markets for direct sale, regulation and promotion of contract farming, etc. Although most states agreed to consider amending their respective APMC Acts, there has been little progress on this.
(Source: Chand, Ramesh, "Agriculture)

37. Essential Commodities Act: hampering normal market activity[37]

The Essential Commodities Act applies to any commodity declared as essential by the Central Government. The Act provides for instruments like licenses, permits, regulations and

[36] "Agriculture Markets in India: Implications for Competition", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005; Mid-term Appraisal to 10th Plan, op cit
[37] ibid

orders for price control, storage, stocking limits, the movement of produce, distribution, disposal, sales, compulsory purchase by government and sale (levy) to government. It is an instrument to regulate market conduct to safeguard the interest of producers and consumers and to raise the standard of agricultural markets.

Evidence suggests that Essential Commodities Act (ECA) has led to excessive control and intervention by the government, which is hampering the participation of private trade in agricultural marketing. The Act gives too much discretionary power to officials and discourages large investments by corporate traders.

With improved availability of various commodities and development of communication and transport network, markets are getting spatially and temporally integrated. This environment is conducive for expanding business enterprise and promoting competition. It has therefore been suggested that the ECA be so amended that rules framed under it apply in specified situations without hampering normal market activity.

In order to increase the participation of the private sector in agricultural marketing, some changes have been made in the ECA to remove the requirement of licensing of dealers and restrictions on storage and movement of food grains, sugar, oilseeds and edible oils. Similarly, the Sugar Control Order and the Milk and Milk Product Order have also been amended to allow more freedom and increased participation by the private sector in marketing of these commodities.

38. Restrictions on firms based in software processing zones limit their growth

Most IT hardware manufacturers in the country are based in software processing zones and some of them compete with the world's best technologies in the global market. However, there are restrictions on sales in domestic market for these firms, which in turn stifle their growth.

39. Promoting National Champions in Banking: Is it Required?[38]

The finance minister wants PSU banks to merge. The purpose is to create giant financial entities that can take on competition in the global market. But is becoming big better?

As an example, will Bank of Baroda (BoB) become a better bank if another PSU bank is merged into it? Is scale of essence in strengthening BoB? BoB is already bigger than HDFC Bank. Yet, BoB does only Rs 2.53 crore of business per employee, while HDFC Bank does business worth Rs 8.66 crore. BoB's assets are twice that of HDFC Bank's, but its market value is one-third. MoF should certainly worry about how BoB can be brought up to HDFC Bank's standards. But if size was of essence, BoB has that already. Similarly, SBI and IDBI would have then been exporters of financial services. The path to globally competitive finance does not lie in bigger PSU banks, but in asking questions about why Bank of Baroda and IDBI are so far behind the well-run banks of India.

Another aspect to consider is that when a PSU gets big, there are unique set of problems that come from it being so big that no government can accept bankruptcy. SBI has assets of Rs 409,771 crore, and it is the Ministry of Finance that has to worry about SBI going bankrupt. The threat of bankruptcy is a central device through which a firm is kept honest. A policy of

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[38] "Mergers and Acquisitions: Implications for Competition", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005; "PSU mergers: are bigger things better?" *Financial Express*, November 22, 2004

mergers will diminish this pressure on the PSUs and detract from efficiency. An important aspect to consider is that of competition in the sector. The interests of the citizen will be ill served by more concentrated banking.

Opportunities for introducing competition - - half-hearted or not availed of

40. Intra-port Competition: Opportunities lost[39]

To foster intra-port competition, the Government of India decided in 1996 that major ports would become landlord ports and cargo-handling services would be privatised. Still, not much has happened. Neither the Government of India nor the ports are conscious of the need to promote competition. In fact, more than once the government has lost the opportunity to create intra-port competition. For instance, in Chennai, the government put out all the (six) container berths in one bid instead of dividing them among two or more operators, which resulted in one party getting the facility for all six berths. In the process, the government lost the opportunity to introduce intra-port competition. Intra-port competition should be encouraged by multiple concessions at single port.

41. Private sector allowed to fly foreign destinations but competition restricted[40]

The government has allowed experienced (5 years' operation) private sector airlines to fly to foreign destinations. However, giving permission to only experienced airlines restricts entry of other less-experienced operators, mainly the no-frills airlines, for a certain period. This in turn, limits competition on international routes. It is not surprising that the two beneficiaries, Jet Airways and Air Sahara, had made this demand some time back. While, on one hand, the two airlines have been pleading with the government to allow them to fly to all overseas destinations (till now the exclusive preserve of state-owned airlines), on the other hand they have been demanding for such restrictive provisions.

42. Measures not taken to introduce competition in the construction of highways[41]

In the construction of highways, competition 'for' the market is possible as against competition 'in' the market. However, the National Highways Authority has not taken adequate steps to introduce competition, for example, by structuring the bid documents in an appropriate way. Generally, bids are structured in a way, which allows only a few large players to bid. For example, if certain flyovers and bridges are to be built, then all of them are put in the same tender. Though, two-three players bid, but more often, the one who is awarded the contract, sub-contracts the work to the other remaining players - - the so-called competitors. This was brought to light in the case of Chennai, where a flyover scam had rocked the state assembly in 2001. In this case, contractors had pooled up to share the contract for laying cables.

43. Monopoly for CNG Operators: opportunity to set the design right for competition

The draft bill to set up a Petroleum and Gas Regulatory Board has proposed that all distributors of compressed natural gas be given exclusive marketing rights in the cities they operate after being selected through a "competitive process". The idea behind the proposal was to make the business viable, given the large investments companies needed to make in setting up a city gas network. The regulatory board would be empowered to look into the

[39] "Competition Issues in Transportation Sector", op cit
[40] ibid
[41] ibid

"reasonableness" of prices fixed by oil companies, though it would not directly set retail prices.

Further details are not known. Anyhow, in this proposal it is important to set the design right by introducing elements of competition where it is possible. Thus, the distribution network at the retail level and supply network should be separated. There could be one pipeline owner (or distributor) in the city that is made to allow suppliers of gas, open and reasonable access to its pipeline network. In this design, competition can be introduced 'for' the market (by having one distributor of gas selected through a competitive bidding process, as already proposed), and 'in' the market (by allowing access to more than one suppliers of gas). This would ensure competition in the supply of gas.

Further, when granting exclusivity to distributor through "competitive bidding", the bid should be well designed. Following conditions should be in place to ensure efficient outcomes.
(i) the "monopoly" has a 'sun set' clause i.e. it is time-bound and at a specific date, it comes up for competitive re-bidding.
(ii) the competitive bidding process is accountable and transparent and post-winning bid, other bid information is available (with safeguards of certain commercial sensitive information about the bidder).
(iii) there are certain minimum performance standards that the winning bidder has to meet or the 'sun set' clause triggers in earlier.
(iv) there are minimum number of independent bidders or the tendering process is called off.

These safeguards would make "monopoly" of distributor less of an issue. Indeed, if monopolies come up for periodic bidding, there may not be the need to even regulate it. This ensures that the incumbent will perform or otherwise lose out in the subsequent round of bidding.

44. Delhi Govt's Power Distribution Licensing Condition: no reward for efficiency
The private distribution companies that have won contracts enjoy monopoly rights over their respective areas in Delhi, and there is a regulator in place. But power costs for consumers keep going up, and the inefficiencies of one company (when compared with the superior performance of another) are paid for by consumers and not by the company. This is because the government maintains a common retail tariff throughout Delhi for an interim period of five years.

<u>V. Competition and IPRs</u>

45. Patents (Amendment) Act: inadequate in dealing with abuse of IPRs
The Patents (Amendment) Act has over-riding powers over the Competition Act in matters relating to abuse of IPRs. The role of the Competition authority to examine such matters does not find any mention in the Act. Compulsory licensing and parallel importing are two key remedies of great importance and a competition authority cannot be kept out in this regard. The Patents Act should specify the remedies that are available, in case of abuse of IPRs and the Competition Act should override IPR laws.

VI. Transparent, Predictable, and Participatory Regulatory Environment

46. Government continuous interference in regulator's domain

Time and again actions have been taken that do not respect the autonomy of TRAI. Moves like the DoT plan to direct operators to withdraw rate plans that charge intra-network calls at concessional rates harms the credibility of TRAI. Now that the telecom industry is fairly mature, such rates must be decided by competition, or else by the regulator.

The Department of Telecommunications (DoT) recently announced certain proposals (relating to ADC, one-India call rate, interconnection usage charges) for restructuring the tariff regime in telecommunications, considering these as policy issues. However, TRAI resisted these proposals on the grounds that tariff related matters fall under its purview. After TRAI's objection, the DoT contemplated exercising its powers under the Act to issue 'policy directives' to the regulator. Although DoT finally refrained from doing so, this event highlights the need to clearly demarcate policy and regulatory issues. In a similar incident, the Ministry of Power attempted to clip the wings of electricity regulatory commissions through amending the legislation. This was however shot down by the Prime Minister's Office.

The ministry must work through regulatory agencies, rather than treating them as an appendage. TRAI, for instance, follows a healthy practice of formulating issues and proposals by involving the public. That practice needs to be encouraged, not throttled.

47. Government Plans to Recharge Power Regulators with a New Team

The government is reportedly mulling a plan to remove all electricity regulators at the Centre and in the UPA-ruled states as part of a plan to institute a new regime. A new team of power regulators is likely to be selected by instituting appropriate eligibility criteria and a transparent selection process based on expertise and essential skill sets to purge the 'existing inefficient regime'. The poor regulatory environment is stated to be of major concern to private investors in the power sector.

However, the poor regulatory environment in power sector is not due to the inefficient functioning of power regulators, but primarily because of government's continuous interference in their functioning. How can more investment come in power plants in a situation where the principal buyers, the state electricity boards, are bankrupt? The Electricity Act 2003 sought to introduce 'open access'. However, despite the legislation, the situation on the ground hasn't changed, as the state governments are delaying the process.

The plan to replace the regulators in the UPA ruled states would have an adverse impact on the regulatory process in India and set an unhealthy precedent, as it may be followed by other ruling parties in future. There is evidence to show that the removal of the Chairman and members of TRAI in 1999 resulted in a slowing down of private investment in the telecom sector till the new Authority became functional. What is the guarantee that another government would not find this procedure inappropriate and seek to change it all over again?

48. Role of TAMP ineffective and inadequate[42]

By amending the Major Port Trust Act of 1963 in 1997, the Government of India established the Tariff Authority for Major Ports (TAMP), an independent authority. However, it's

[42] ibid

authority is limited only to determination of tariffs at major ports. TAMP does not have any authority to take other measures to introduce competition. Till very recently, TAMP used to set floor prices below which the ports were not allowed to compete. Now, the government has asked TAMP to fix tariff ceilings instead. In any case, under the 1997 amendment, the government allowed the major ports as well as itself the right to establish their own rates irrespective of what the TAMP said!

Although terminal handling charges by private operators may constitute a significant proportion of the total cost of moving cargo through the ports, there is no explicit provision in law, empowering TAMP to regulate tariffs for terminal handling charged by private operators. TAMP is also not empowered to requisition records, summon and cross-examine witnesses, enforce orders and impose penalties for non-compliance.

The functioning/role of the Tariff Authority for Major Ports (TAMP) needs to be revised so that uniform and transparent norms prevail in matters relating to fixing tariffs as well as prescribing the quality of service for port authorities/terminal operators.

49. Tied selling in health service sector – A Case of Regulatory Failure at Local Level[43]
Tied-selling in health services, whereby service providers' influence/force the patients to buy medicines from prescribed shops or get diagnostic tests done from prescribed laboratories is a genuine concern. The issue is however not so simple. Service providers argue that this practice ensures maintaining uniformity or quality, especially where authenticity of medicines or reliability of diagnostic tests are a concern. Although there is regulatory framework to ensure genuine medicines in the market, the enforcement is weak. In the area of diagnostic testing, the regulatory framework is almost non-existent. Thus, regulatory failure in enforcing relevant regulations in health service delivery is a primary reason for the existence of tied selling. Therefore, it is important to put in place an appropriate regulatory framework to promote and maintain service standards, and thereby check tied selling.

VII. Movement of Goods, Services and Capital

50. Barriers to Inter-state movement of goods by road[44]
While there is a general declaration in the Indian Constitution that trade and commerce should be free, the Centre and the States (especially the former) have the power to regulate. While mandating free trade within the country, the Indian Constitution, nevertheless provides that restrictions can be imposed by Parliament on internal trade (and similarly by state legislatures on trade within their territory) as may be required in "the public interest".

Distrustful of the market, restrictions have been imposed on trade and commerce in the country through regulations in various forms, invoking "public interest". Complaints from Indian industry, especially the transport sector, relate to issues of taxation (both Centre and State), regulation by States on the movement of goods, frequent stoppages and delays under administrative rules and inspection agencies. As a result of excessive taxation and delays, transportation and transaction costs increase, which further increase the final cost of the

[43] "Competition Abuses at Consumer Level: Study of Select Sectors", *Towards a Functional Competition Policy for India*, CUTS and Academic Foundation, 2005
[44] "Barriers to inter-state trade and commerce – the case of road transport", background paper prepared for the National Commission to review the working of the Constitution

product, distorting competition in the domestic market. Most complaints concern the road sector, which is primarily in the private domain.

VIII. Deviations from Competition Principles

51. Free Power to Farmers – Is it desirable?

This policy seeks to provide support to farmers in irrigating their fields. However, it has produced several undesirable outcomes, including misuse of electricity, poor recovery of user charges, depletion of ground water, and distorted the cropping pattern towards water-guzzler crops. Moreover, farmers end up getting lesser supplies than what is required. More than helping the poor farmers, this policy serves the rich class.

Be that as it may, the farm sector in India requires government support, and the crucial issue is whether free electricity is among the most efficient carriers to extend government support to the targeted beneficiaries?

The Government of Andhra Pradesh had announced the policy of free power to farmers in 2004 after the new government took over, but had to review the policy. According to the State Finance Minister "*the government wanted to review its policy of free power to farmers not due to monetary constraints but because it has led to many unexpected developments such as the increase in unauthorised power connections leading to overloading of the distribution system. The unexpected load on the system has resulted in increased failure of distribution transformers".*

It appears that the government is following a piece-meal approach with regard to supporting the agriculture sector and offering electricity for free is just one component of this. What is actually required is policy reform in the agriculture sector. Government should decide about the comprehensive support package it wants to extend to the sector, and then do that in the most efficient manner possible. In this context, the ability of electricity networks to deliver government support to the identified people is debatable. Probably, offering electricity for free is not the most efficient way of supporting the identified people; leave aside the other undesirable consequences.

52. Food Subsidy – Distortions Galore

Food subsidy is the single largest component of government's explicit subsidy bill. It comprises of subsidies to farmers through minimum support prices (MSPs), support to the Food Corporation of India (FCI) to cover all its costs, and consumer subsidies through the public distribution system (PDS). The objectives of food subsidies in India are to maintain price stability; provide support to poor; and ensure adequate returns to small and marginal farmers.

Presently, the food subsidy policy uses the MSP-PDS operations to serve the 'conflicting' objectives of ensuring remunerative price to farmers and providing the foodgrains so procured, to the poor at affordable prices. By implication, this entails a huge gap between the purchase price and issue price, and consequently a larger subsidy bill. Therefore, the entire food subsidy regime begins on a distortionary note. Further, with large part of marketed surplus in FCI warehouses much of the consumer benefits is neutralized due to lower market supply. Worse, to run the excessive stocks down, foodgrains are often exported by providing food grains to exporters at near PDS prices.

As far as support to farmers is concerned, purchase operations are mainly confined to five areas (Punjab, Haryana, Western UP, Andhra Pradesh, and Chhattisgarh) resulting in concentration of support to farmers, majority of whom are quite well off!

In view of the several distortions, the first step required is to separate the procurement of foodgrains through MSP mechanism from the PDS operations. MSP operations should be confined to providing support to small and marginal farmers and using the foodgrains so procured to create a buffer stock for maintaining price stability. Secondly, procurement of foodgrains for distribution to poor through PDS should be done through competitive bidding. Since these foodgrains are to be distributed at lower price (to make them affordable to the poor), competitive bidding will minimise the cost of procurement. The same agency i.e. the Food Corporation of India should not be entrusted with meeting conflicting objectives.