"COMPETITION IN INFRASTRUCTURE"- by S L Rao

In one decade India has tried to do a U-turn on Competition. The Monopolies and Restrictive Trade Practices Act like many laws before liberalization constrained, not encouraged, competition. The MRTP was to restrict and control monopolies and monopolistic practices. Monopolies were defined in a very restrictive fashion. Companies with small turnovers by world standards, market shares that were of little consequence in markets that were themselves very small, very limited definitions of markets so that market shares appeared larger than they were if all alternative product forms were counted, made for small companies and small production capacities. The restrictive practices provisions in the Act were much more effective in placing at least larger companies on guard against practices that the Commission could rule as restrictive. Consumer disputes redressal machinery under the Consumer Protection Act will largely regulate these anti-competitive practices now.

The new Competition law aims to encourage competition and prevent anti-competitive practices not covered by the Consumer Protection Act. It tries to improve the environment for competition while enabling enterprises to grow and be efficient. The Competition Commission will have to devote much attention to questions such as market definitions, what to do about mergers and acquisitions in a globalised market where competitors are much larger than they are in India, and particularly how to encourage competition in infrastructure services in which natural monopolies and large sizes are considered necessary. Since many and increasing areas of infrastructure are coming under independent regulation, the boundaries of responsibility with them and the Competition Commission especially when the infrastructure regulators are required to encourage competition in their sectors require clarification. Further, since government owns most infrastructures, issues of competition become more difficult to determine, since government is regarded by many as always acting in the interests of the citizen and the consumer. State owned enterprises do not always act in the interest of the consumer and to promote competition or its effects.

The amendments to the Act separate out the competition aspects in infrastructure and leave it to the sectoral regulators. There has been some disagreement on this provision. However we have to recognize that competition in infrastructure today is an evolving area and the rules and regulations for bringing in a simulation of competition or introduce it in select areas can be best done only by the sectoral regulator. This is more so when there is a shortage situation and the regulator is trying to simulate the effects of competition. Mergers and acquisitions are a different matter and will pose issues that an expert Competition Commission must consider.

The Competition Act has been awaiting implementation for over a year because of dispute over whether someone from the bureaucracy or the judiciary should head it. Since neither has much experience of the rather technical issues of management and economics involved, it is surprising that the choice is not extended to include managers from industry and economists. Now it has apparently been decided to have a Competition Tribunal headed by a judge that will adjudicate on disputes and a Competition Commission to be headed by a bureaucrat who will deal with the advocacy and policy issues. The intention is to make the Tribunal also the common one for infrastructure competition appeals. We will have to see if this can work since competition in infrastructure itself has many complicated issues to be considered and might need specialists in each sector.

When it comes to infrastructure- roads, railways, posts, power, water, oil and gas, coal, airports, etc, government has been ambivalent on many aspects of competition. Government is not clear in many cases as to what are the pre-conditions for competition in infrastructure and whether India is ready for them in all cases. Legislation in some sectors like power has the objective of achieving competition. Others like coal do not even state such an intention. Sectors like Posts have introduced competition (through courier services) to the state owned postal services, apparently without even being aware of that they were doing so. Now there are pressures to place restrictions on courier service operators.

The Indian context in infrastructure is the reason given for not moving ahead. Markets and demand are highly segmented between the well off and the poor; the urban and the rural. Services have to reach the poor and the rural. Costs of delivering infrastructure services to them are higher than to the well to do and urban consumers or to consumers who buy in large quantity. Cross-subsidies or dual pricing are methods used to alleviate the inability of government finances to bear the costs of these subsidies. The better off are made to pay much more so as to subsidize these weaker sections. They are usually unable to pay full-cost tariffs. Cross-subsidies have resulted in enormous leakages through corruption, waste and actual delivery to only a fraction of those for who the subsidies were meant. They could also lead to such an imbalance in tariffs that the better off might be paying too much. This has happened to many industries in India, now paying much more than competing companies in other countries with whom they compete

The other set of constraints on competition in infrastructure has to do with the limited number of service producers, the relative shortage of the services and the constraints imposed by limited transportation mechanisms. This is made worse by single or limited ownership of the transport mechanisms. Nor is the effect of limited ownership contained by open access to the available transportation methods. Political interference in pricing keeps adding more numbers to the subsidized groups. More often, the ownership of the whole chain from production to supplying customers tends to be concentrated with governments. Governments have shown themselves to be inefficient at the state levels (for example, state water and electricity boards and their accumulated losses). At the central government level they have been lacking in vision and enterprise even if their management is good (for example, the inability of central government electricity generating companies to leverage their resources to substantially add to capacity or of ONGC to discover oil and gas when others do so in the same fields that ONGC earlier explored).

The resultant subsidies strain government finances, as do the inefficiencies and leakages. Cross-subsidies strain the finances of the service producers and providers because of limitations on their profits and uncontrolled thefts. Private providers manage the distribution system in a way that they minimize if not eliminate losses. Government owned service providers make huge losses that have to be reimbursed by the concerned governments. However, when laws are amended to enable greater private entry as with electricity through captive generation, regulators, governments and state-owned companies have procrastinated on implementation.

Despite all this there has been some progress in enabling private entry into providing infrastructure services. This has raised new issues for resolution. These have to do with the extent and nature of competition which will vary in different sectors.

In the case of electricity generation, oil and gas pipelines, airports, roads, water collection, treatment and pipelines, competition could be at the time of bidding. It is essential that a comprehensive blue print of the steps to be taken be agreed in advance and be freely available. For example, which part of the project is to be opened; what are the parameters for deciding whether a particular bidder is qualified enough to be considered; who will be the experts who will examine and recommend on the bidders to be considered as being qualified; how will such experts be chosen.

The bids themselves could be on different parameters:

1. On the basis of the lowest capital cost quoted for a project: this throws up a new set of issues since the capital costs might be padded to enable high returns, or the equipment might not be the most suitable;

- On tariffs that will be charged to customers: this is to be tried for electricity generation projects, though so far the announced policy has yet to be implemented; to be resolved will be issues such as the basis for comparing tariffs. For example, an electricity generation project may have a life of thirty years. Over that life there will be other costs including those like salaries and wages that are affected by inflation. What will be the basis for arriving at comparable tariffs from different bidders?

- On the quantum of subsidies that would need to be paid over a given period by government until the new operator has brought things under better control, for example, in electricity distribution, reducing transmission and distribution losses. This was innovatively the basis for the bidding for the Delhi electricity distribution, namely, the subsidy that government would have to give over a given period and the extent of reduction in transmission and collection losses;
- On the extent of revenue share that the bidder would give to government. This was the basis for the financial evaluation in the case of the privatisation of Delhi and Bombay airports. In practice, the experience with the privatisation of Bombay and Delhi airports resulted in bid rules being changed midway through the process, and the intervention of pressure groups and interests wanting to change the rules and parameters and so skew the decision in unfair ways. This makes it imperative to anticipate all eventualities so that when the process commences, there are no deviations.

Another problem is with infrastructure services that have huge lumpy 'natural monopoly' costs; as with airports, railway lines, roads, etc. For example, British Railways split the loose parts out of the 'lumps' by treating the rail tracks and signalling as one item for which all users paid user charges while the railway trains and carriages were the competing elements using the common tracks and signalling. Even these lumpy elements could be given to private operators and their charges made subject to independent evaluation. (Incidentally, British Railways after these innovative private entries have not been effective in offering convenience, cheaper rates or safety).

The limitations imposed by shortage of transportation and dominant government ownership creates other issues. Transmission and distribution of electricity and oil and gas through pipelines were considered natural monopolies in the days of the command and control economy. In electricity the law was amended in 1998 to allow private investment. The monopoly providers were a central government enterprise in interstate and state government enterprises in intrastate transmission. It is only in 2006 that individual private entry is likely to take place because of the obduracy of the incumbent monopolies.

In oil and gas the issue has been debated over years. As with electricity, the incumbent government enterprise, GAIL, has resisted private entry into pipelines. There is yet no decision by government on whether private entry can take place. We had mentioned government ambivalence to competition. This is well illustrated by the inability or unwillingness of government to press its own enterprises to enable faster private entry.

The same concept of competition even in 'natural monopolies' could apply to pipelines and storage for water, airport terminals and runways, railway tracks, stations and signalling, and roads. It might be possible to 'unbundle' them to separate out parts into which competition can be introduced. The experiment by British Rail has been mentioned. In electricity, unbundling of transmission and distribution wires, which are treated as natural monopolies while distribution and supply are open to competition and generation plants are bid for on a competitive basis, is a model that the U.K. has successfully used.

Trading in electricity introduces greater opportunities for competition but demands open access to the wires. The Regulator can ensure that this is done. Even transmission capacities that have been bought up might be regarded as tradable and be sold when they are available, to the highest bidders. The CERC in India has forbid this for now. The same principle of selling bought up pipeline capacities could apply to pipeline capacities for oil and gas.

On 'natural monopoly', India has recognized in the Electricity Act 2003 that parallel transmission lines could be laid, thus accepting that more than one transporter could cover the same route. In fact India has implemented this in telecommunications. Multiple and separate fibre optics wires have been laid all over India by different telecom service providers. But neither electricity nor gas has seen parallel networks to date. However, in the case of roads, this seems to be happening (probably without forethought). The instance is the Bangalore-Mysore highway where both government and a private provider are creating their own expressways. In

the case of electricity the justification for parallel wires was that the existing transmission and distribution lines had no redundant capacities and were unable to carry much more than they already were doing. Also, most distribution wires were installed a long time ago and since then there has been much technical progress, new lines laid in parallel are more cost effective.

The multiple wires laid in telecom are leading to a huge fall in call tariffs, an explosion of demand and to the wires being used for new uses combined under the label 'convergence', like broad band, cable television, digital television, internet, voice over internet, etc. Thus when there are huge investments made in such multiple wires, new uses might well be invented to use the capacities.

Another issue in competition in infrastructure awaiting resolution is that of monopoly being encouraged by permitting vertical integration. Vertical integration has been objected to because it is said to make possible the exploitation of the consumer. A truly independent regulator can ensure that there is no exploitation. By closely monitoring capital and revenue expenditures the regulator can see to it that costs are not padded so as to get higher tariffs. Another way is by separating ownership and operation of different segments. For example, in electricity the law does not allow a generating company to own transmission lines. There is a move to do similarly in the case of oil and gas. Similarly, airlines cannot own airports.

An argument for vertically integrated enterprises is that ownership of its source of fuel (coal or gas), generation plant, transmission and distribution, can guarantee for its consumers, steady supplies and tariffs. Independent regulators could then insist on separate strategic business units for each activity, with separation of costs and determination of tariffs at each point, and so minimize if not avoid exploitation of consumers. On the other hand, we have had integrated electricity monopolies with state owned electricity boards. They have for years shown very poor results: erratic supplies, poor quality, high and rising tariffs, waste, thefts and gross inefficiencies. It is possible that private ownership might be more responsive and accountable especially if there is strong independent regulation.

Government ownership does not stop exploitation. Thus, the state electricity boards have had their biggest increases in costs because of electricity bought from central government enterprises like NTPC. Central government enterprises have long-term contracts (up to 30 years) for committed quantities of power from each of the state utilities. Tariffs are determined for 3 to 5 years (now by the Regulator). However, there is no spot transaction and spot markets are an important element in a competitive market. It is not correct to attribute the lack of spot transactions to supply shortages. In a vast market like India with considerable variations in demand over seasons, time of day, etc, there are always surpluses and deficits for short periods that can be traded on spot transactions.

Airport Authority of India is a government monopoly that owns and operates airports. It makes a profit but that is because of its monopoly position. It is established that Indian airports handle a fraction of the traffic handled by others of similar capacity overseas. They have very high landing rates. Their facilities are poor both for airplanes and for passengers.

The European Commissions' Competition Commissioner has identified issues in regulating infrastructure for ensuring competition. They are relevant for us:

1. Access: India is yet to resolve this question in areas like oil and gas pipelines and electricity.
2. Price formation: e.g., when price of gas is linked to that of oil; or where surplus transmission or pipeline capacity is hoarded for price gouging when opportunity arises. Electricity prices in India are capped while the principal inputs, coal and gas, are not and are unrelated to the electricity prices
3. Market Concentration: Domination by a few large groups, restricting competitive pressures and raising barriers to entry. This is a future danger in India. Central government owned generation companies today account for almost all the trading in electricity and face virtually no competition. Vertically integrated monopolies (from well

or pithead to wall socket) are a distinct possibility in India and regulators have to find ways to tackle them.

4. Vertical foreclosure: For example, importers of gas who control LNG terminals might also own pipeline network and storage infrastructure as with central government companies. This is the case in India where GAIL, a central government utility, owns all the pipelines while Power Grid is the interstate electricity transmission monopoly and the state utilities are so in the intra state transmission.
5. Market integration: Electricity and gas markets must be well interconnected nationally for competitive pressure on dominant groups. This is not the case as yet in India. In the case of gas, neither privately owned gas fields nor LNG, which is with the private sector, are subject to the same tough regulation as the state owned gas suppliers.
6. Transparency: Information on transit and storage capacity in the gas market or availability of transmission capacity must be easily available. In India this is not the case.

Many issues need to be resolved in introducing competition into infrastructure services. They centre around the need for a set of standard procedures and processes especially on the bid arrangements. There could be different types of competition in bidding: whether competition is going to be on capital cost bids, tariffs to users, loss reductions or revenue shares to government. The bid process must be faultless and transparent, including the selection of the independent assessors of the technical and financial bids. No participant must have an unfair advantage over others. Hence production of the service and its transportation to users must be clearly separated. When the service has consumer segments that need price support, the eligible users and methods for giving that support as well as reimbursing the supplier must be clearly spelt out. There must be no changes made to rules and procedures after the process has started or during implementation. The price relationships between different services must be clear.

We have yet to develop a way in which the competitive process is transparently followed in India despite many years of large government purchases, sales and project investments.

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