**TOWARDS A COMPETITIVE ECONOMY**

by

Arvind Virmani

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**TABLE OF CONTENTS**

1. INTRODUCTION

The two fundamental principles underlying economic reform are,

a) To increase competition.
   This involves both increasing the competitive pressure on economic agents to perform better and making it possible for them to compete. This in turn will improve the efficiency and productivity of the economy.
b) To redirect the energies of the State towards functions, which only it can perform, by getting out of the plethora of functions it is performing and which the private & co-operative sector can do equally well or even better. This directly improves social welfare.

Both these have consumer/public welfare at their core. They also improve growth prospects.

Between the mid-sixties and the mid-eighties, a vast plethora of government mandated controls and restrictions were built up in the form of economic laws, rules & regulations and government policy & procedural controls. These have had the effect of gradually choking off competition in many sectors and sub-sectors of the economy. Our ability to identify and remove these government created distortions will determine how fast the economy and employment grow in the next decade. These distortions are present in both external and domestic policy areas and in both product and factor markets. Government also nationalised, reserved and monopolised several sectors, including the public utilities and infrastructure sectors.

In certain areas ('natural monopoly' segments) regulatory systems and agencies will also have to be improved to ensure competition. The new competition law should take care of residual areas of anti-competitive practices once the policy created impediments to competition are removed.

2. EXTERNAL COMPETITION

### *2.1. Import & Export*

A free import-export regime is a potent force for competition for tradable goods and services. Many goods and services, which were earlier thought to be non-tradable, are becoming tradable with the decline in transport and communication costs.

The threat of imports (even when actual imports are minimal) is one of the most powerful forces for competition. India has already committed to eliminate all import controls that have been justified for decades on BOP, grounds by March 31, 2003. These will likely now be eliminated by April 1st, 2001.

- This requires complete de-canalisation and a shift of restricted and SIL items to OGL.
- This will have little impact on the import bill of the country.

Export restrictions and quotas need to be simultaneously lifted. Such controls favour users of the concerned item at the cost of producers of the item thus reducing competitive pressure on the former and incentives for the latter. For instance, export controls on cotton reduce the competitive pressure on yarn producers and the incentive for farmers to improve the productivity and quality of cotton.

Reduction of the exorbitant customs tariff rates has also been an essential element in promoting competition. Our customs tariff rates remain among the highest in the world and will have to be brought down to those of other fast growing economies in Asia and elsewhere if the economy is to become fully competitive.

- *Observation*: Some people however wrongly club CVD, which is our (MODVAT) counterpart of the European VAT, with protective customs duty!

The force of international competition is increasingly being felt in new services such as back-office operation and data processing and management. Several of these new service areas are ones in which we have a comparative advantage and great opportunity, while some developed countries are fearful of competition.

### 2.2. Foreign Investment

Foreign investment simultaneously increases competition and the ability to compete. Technology in the broadest sense of the word (i.e. including management, organisation, logistics, and marketing) is transferred and it gradually defuses into the rest of the economy. With the possible exception of traditional agriculture and a few other specified sub-sectors/areas, all foreign investment should be put on the automatic route from March 2000. In general, 100% per cent foreign investment should be allowed in all manufacturing & modern services and specified types of modern agriculture (& allied sectors). Foreign investment in 'Natural monopoly' networks (fixed line distribution networks for telephone & electricity) can start at 100% if it is in the form of a separate company in which it is diluted to

49% per cent within ten years. Foreign investment in other services could be automatic up to 74%, 50.1% and 49%. There could be a short negative list of (sensitive) services to which the automatic route will not apply.

### *2.3. Technology Import*

Restrictions on technology import reduce the ability of domestic industry to compete with foreign companies. These should be completely eliminated. Under a competitive system no industrialist will pay royalty in excess of the value of the new technology.

## 3. DOMESTIC COMPETITION

### *3.1. Product Markets*

#### 3.1.1. Price & Distribution Controls

Price and distribution controls restrict competition and generally tend to favour the inefficient at the expense of the dynamic and competitive. We have to eliminate the remaining price & distribution controls imposed in an earlier era. Among the industries that are still subject to control and need to be reformed are;

- The ***sugar*** industry should be de-controlled to increase competition. Removal of sugar from the PDS will facilitate this de-control.
- The distribution and sale of ***fertiliser*** can be de-controlled (along with imports), while producer subsidies are phased out, by lowering producer prices to international level, over the next few years.
- The dismantling of the APM will lead to complete de-control of the ***petroleum*** sector, phased elimination of LPG subsidy and incorporation of (remaining) Kerosene subsidy into the budget.
- A dual pricing system could be considered for those ***drugs*** which are still under controls and figure on the list of drugs for the Primary health centres /programs when prices of all other drugs are de-controlled.

#### 3.1.2. Investment Licensing & Reservation

Investment licensing and reservation even though instituted with the motivation of planned development, act as barriers to entry and are consequently anti-competitive. The elimination of most industrial licensing has therefore increased competition. The task will be completed when remaining public sector and small industry reservation and investment licensing have been phased out. Environmental, health, public & national security concerns can be addressed directly through the laws on these matters. SSI reservation and labour inflexibility are together responsible for India's abysmal performance in labour-intensive manufactured exports (and consequently in generation of organised employment) relative to Indonesia, Thailand, Malaysia and China. Reforms need to be undertaken in the direction indicated by the Presidents address so as to promote employment generation and labour intensive export growth.

#### 3.1.3. Agriculture & Allied

There are many controls and restrictions on agricultural land, on agricultural inputs and on agricultural produce; its storage, transport and processing which hinder the emergence of a competitive, efficient and productive agriculture. The elimination of import and export controls on agricultural or related items and de-licensing of sugar industry will also make agricultural more competitive. SSI reservations on agricultural machinery and tools and on agro-processing of bread, mustard & groundnut oil hinder agricultural development. The MPPO and the Essential Commodities act also hinder competition. An integrated Food Act and a single Food Regulatory Authority must replace the current multiple laws and agencies related to food products. The primary purpose of this agency should be to act as a watchdog against dangerous and spurious food products. The land market could be freed from the rigour mortis of land ceiling law in areas where feudalism has been eliminated and modern markets exist. Private and foreign investment is to be encouraged in the entire food chain starting from development, propagation & dissemination of new seeds & agricultural technology, through storage, transport and processing, so as to unleash competitive forces.

#### 3.1.4. Coal

The government's monopoly over the coal sector can be eliminated by de-nationalisation, de-reservation & de-licensing. We should move to a situation in which the private sector is free to lease coal mines, invest in them and freely produce and sell coal, subject only to an independent modern regulatory authority. In principle this could be a single mining regulatory authority or a separate Coal mining regulatory authority. Thorough competition in this sector may require separating-out of the different public coal companies and their ownership by the general public.

### *3.2. Public Monopolies*

Monopolies are the obverse of competition and 'created-monopolies' are the enemies of competition and undermine the credibility & bonafides of the creators. During the seventies central and state governments created a number of public sector monopolies &

oligopolies which must now be dismantled and replaced by competition. One of the most difficult jobs facing the central and state sectors is to introduce competition in public utilities and infrastructure services and to dismantle state monopolies.

### 3.2.1. Regulatory System

Regulatory laws and systems must be designed to promote competition to the maximum possible extent. Where competition is not possible the regulatory system must try and mimic competition through various means such as separation of natural monopoly segments and "benchmark competition." This often requires unbundling or break-up of the state monopoly. Once this is done public and private organisations can compete to supply quality service at the cheapest price to the public.

### 3.2.2. Infrastructure

Some of the most intractable problems have arisen in the state owned infrastructure sectors. Initial results of private entry sectors like civil aviation and telecommunication were quite promising. Subsequent setbacks have to be tackled by widening and deepening policy reforms.

Among the reforms that can be taken to further competition are:

3.2.2.1. Telecom

The new Telecom Policy takes a great leap forward in setting the stage for competition. The conversion of the Department of Telecom into a one or more companies (Athreya committee suggested 5), de-licensing of investment and entry into all areas of Telecom and a strong TRAI could play a critical role in making competition a reality.

3.2.2.2. Airports

If Air traffic control is retained with the Airports authority of India, all airports could in principle be leased to private parties. Building of new airports could be simultaneously thrown open to private parties. This would introduce 'benchmark competition' into the airport sector and increase accountability and efficiency.

3.3.1.3. Ports

Minor ports have already been thrown open to private entry. Conversion of Major port trusts into companies could be followed by dis-investment of shares in these new companies. These public companies should be freed to compete against each other in running different ports.

#### 3.2.2.3. Power

The power sector consists of state wide monopolies in the form of State Electricity Boards. Competition can be introduced in the generation sector by allowing any existing State electricity board or existing or new electricity generator to produce and sell electricity to any other board, company or set of users. Urgent action must also be taken to privatise distribution and to set up independent regulatory authorities to over see the power sector, so that 'benchmark competition' is introduced on the distribution side.

### 3.2.3. Urban Services

Supply of Urban Services like drinking water, sewage and sanitation have traditionally been the monopoly of the urban municipalities. Garbage collection and disposal services can easily be privatised and provided on a competitive basis. The construction, maintenance and running of urban services can be done by the private sector on the basis of competitive bids. The degree of competition will increase as a number of different private parties enter and service different parts of each metro.

### 3.2.4. Real Estate & Housing

Though the central government has abolished the Urban Land Ceiling Act this needs to be carried through and implemented by each and every state government if a competitive urban land market is to be created in every state. Many states also monopolise urban land under "Urban Development Authorities" (such as DDA). This monopoly must be abolished and replaced by clear, simple and transparent rules and procedures for private acquisition and development of land for urban real estate. This must include the right to convert 'agricultural land' inside or on the periphery of the city to urban use, on payment of market prices to the farmer-owners. To increase competition in real estate development & multiply the benefits for low income and middle class of cities the *rent control act may need to be abolished*. This will unleash a boom in construction of rental housing, stopping the growth of slums and gradually eliminating them. To expedite this process, municipal laws, rules and procedures must be modernised and attention of municipal authorities focussed on urban planning, roads, water supply network, and sewage & drainage system.

### 3.2.5. Education

The state (and central) governments have a virtual monopoly over tertiary education and arbitrary powers over all other education & training. This along with politically determined controls on fees have resulted in a dramatic deterioration in the quality and relevance of the education provided by colleges and universities.  There is an urgent need for drawing up clear and transparent rules for the setting up of private universities, colleges, institutes and schools so as to introduce quality-enhancing competition.  Controls on fees could be replaced by market based fees combined with a comprehensive system of scholarships for poor students and student loans for low to middle income students.  An independent regulatory system would insure that ranking & certification information is generated and made available to the parents/students and that fee increases during the tenure of the course are fair and reasonable. The regulatory system should also oversee the public universities and their fee setting so as to free it from political interference.

### 3.2.6. Broadcasting

If competition is allowed in this sector, India could become a media power within ten years on the lines of what has happened in software & IT.  This requires an opening up of the radio and television broadcasting stations to private investment.  There must also be clear and reasonable rules on the equity proportion allowed under FDI.  Unbundling of physical facilities (radio & TV stations) from content (broadcast companies) would allow us to limit foreign equity in the latter while allowing a more liberal regime in the former.

## *3.3. Factor Markets*

### 3.3.1. Insurance

The passing of the IRA bill will usher in a new era of competition in the insurance sector. The separation of the four government-owned general insurance companies could help in strengthening competition and accelerate efficiency gains.

### 3.3.2. Financial Sector

#### 3.3.2.1. Banks

Even though private entry is allowed in the banking sector, the ownership and management control of the government on an overwhelming majority of banks and financial institutions means that it is an oligopoly (near monopoly).  Truly "public sector banks" must be owned by the "public" and must have sufficient equity to be strong and safe.  The require us to remove artificial limits on government holding in the nationalised banks, while continuously strengthening the regulatory system (prudential regulations).  The controls on public sector banks contained in the RBI act, the Banking Regulations act, the Bank nationalisation act and the SBI act must also be removed. This will introduce competitive pressure and help bring the financial sector to world standards.

3.3.2.2. Interest Controls

Interest rates cannot be brought down by government or RBI fiat. There are a number of controls and restrictions that reduce competition and keep the interest rate from falling. Interest rates must be market based (i.e. equal to the risk adjusted, net of tax, return on competitive market instruments). Remaining controls on interest rates and the remaining controls & guidelines on public sector/ nationalised banks need to be identified and removed. Simultaneously "Prudential regulations" will have to be strengthened.

A reduction of the fiscal deficit coupled with a phased opening of the capital account would be needed to bring interest rates to developed country levels.

3.3.2.3. Pension & Provident Funds

Provident funds are so heavily controlled that they are virtually a monopoly of the government. A system of well-regulated private, portable pension and provident funds is an essential ingredient of a competitive structure. Modernisation of regulations requires replacement of controls by prudential conditions and greater transparency & accountability.

3.3.2.4. Government Securities

Greater competition in the government securities market is essential for developing money markets and reducing interest rates. Among the reforms needed are:

- Eliminate stamp duty on trading in debt instruments in de-materialized form,
- issue government debt through electronic exchanges and trading through terminals connected to such exchanges,
- standardise & de-control repo and reverse-repo transactions and
- Permit 'when issued' trading and short sale of government T-bills & securities (backed by security borrowing).

### 3.3.3. Labour Market

A reform of the labour laws, rules and procedures is necessary for breaking down the barriers between the organised and unorganised sectors, making Indian industry and labour more competitive and generating high productivity job at a much faster pace. Reform of the Contract Labour act will produce the greatest benefits at the least cost. This act has been completely distorted from its original intent by a spate of court rulings. All ambiguities in this act must be removed so that industry can freely contract out all services peripheral to the central manufacturing process, without being held responsible for such workers for their entire lifetime. Other labour laws and procedures must also be modified to impart greater flexibility to the labour market. An organised labour system that makes it *most* difficult to fire the *worst* employee cannot generate productive employment for the honest and hard working masses.

## 4. COMPETITION LAW

Pursuant to FM's Budget announcement the Department of Company Affairs has set up a committee on Competition policy. The committee should adopt a modern regulatory approach in contrast to the traditional control approach.

Among the issues that need to be kept in mind in framing competition or Anti-trust Law are,

- Experimentation and Innovation must be encouraged not hindered, while coming down hard on collusion among producers to thwart free competition.
- Technological change is driving changes in industrial structure in many industries, so we should avoid rigid structures based on past control approach.
- The boundaries between different industries should not be defined too narrowly. Because of rapid change, two industries that may have once been considered distinct may soon be considered one. One example is the convergence taking place between Telecom, computers and media.
- Focus on ways and means of distinguishing aggressive and innovative competitive practices from anti-competitive predatory practices.
- For instance vertical restraints such as Resale Price Maintenance and exclusive dealing have efficiency benefits, which have to be weighed against the costs.
- How to distinguish "natural" barriers to entry from barriers, which are "created" to monopolise an industry and to prevent natural competition.
- Feasibility of unifying scattered elements of competition policy and bringing it under one independent competition authority. The feasibility of members of this authority being chosen jointly by the departments that currently oversee scattered elements of competition policy.
- Role of Information and private quality certification agencies such as "Consumer Reports" magazine/organisation in the US, which ranks quality of products and services.