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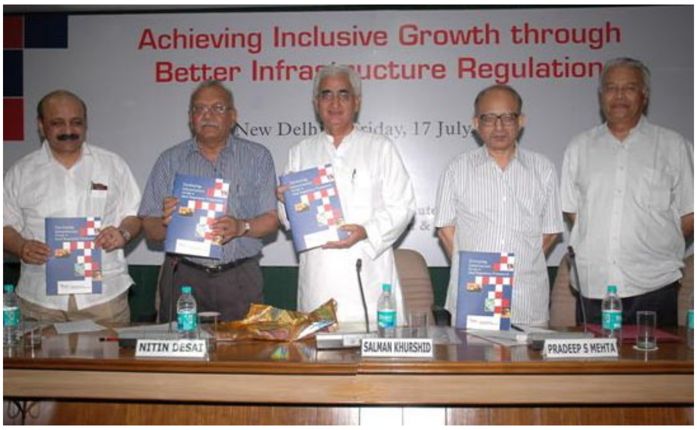
Covering developments in the area of research, training and education on public policy issues

Infrastructure: An Essential Ingredient for Inclusive Growth

CUTS Institute for Regulation & Competition (CIRC) organised a Policy Seminar on "Achieving Inclusive Growth through Better Infrastructure Regulation" in New Delhi, on July 17, 2009, in the wake of ongoing debate on reforming regulatory framework to deliver better infrastructure services in India.

Hon'b'le Minister of State for Corporate Affairs (Independent Charge), Salman Khurshid was the Chief Guest, while three speakers were Pradeep S Mehta, Secretary General, CUTS International; Saumitra Chaudhuri, Member, Planning Commission of India; and Swaminathan S A Aiyar, Consulting Editor, *The Economic Times*. Nitin Desai, Chairman, CIRC Managing Committee moderated and chaired the programme.



On this occasion, the Minister released a policy document entitled *Developing Infrastructure through an Ideal Regulatory Framework* (see Back Cover). Nitin Desai explained that the book is a compilation of a number of articles advocating for regulatory reforms in the infrastructure sector. He added that this publication would help policymakers to take appropriate measures for better infrastructure regulation and growth in India.

Initiating the discussion, Pradeep S Mehta emphasised on the need for integrated approach in regulation of cognate sectors. Setting up sectoral regulators covering multiple sectors will also help achieve independence of regulators and set them free from the administrative control of a line ministry.

Swaminathan Aiyar said that "connectivity is the essence of inclusive growth". He cited the widening gap between *Bharat* and India wherein *Bharat* continues to lag on account of connectivity. Growth implies that villages should be well connected and that only quality infrastructure can bridge the gap between *Bharat* and India.

Saumitra Chaudhuri stated that it is easy to impose regulation for everything but too much regulation should be avoided. He discussed various examples to state that India has the ability to create world-class regulators.

Nitin Desai said that inclusive growth is not just about infrastructure only but about when infrastructure actually reaches people. He suggested focussing on the last mile connecting the most backward areas with the more advanced ones to achieve the desired welfare goals.

Salman Khurshid emphasised that while growth is necessary, the problem is to achieve inclusive growth. The idea of inclusive growth means growing with inclusion. He queried whether regulation ensures inclusive growth? According to him, the main issue is the purpose of regulation. He exemplified that regulations were brought in when some sectors grew fast such as telecommunications. He advised that regulatory bodies must perform impact studies to know whether regulation is inclusive or not. He suggested devising an inclusivity index to make the debate lot more informed.

Cover Story

What's Inside

Telecommunications

How many Telecom Companies should India have?

*– Thomas K Thomas & T C A Srinivasa-Raghavan**

What's the similarity between Indian agriculture and Indian telecoms? First, both have raised output to levels that no one would have thought possible when output boosting began. Second, relatively speaking, firms (farmers) have low start-up costs but high operating costs. Third, both have an extraordinarily high degree of competition. Fourth, both have a fairly high degree of flexibility in output mix; and, crucially, fifth, both compete for one scarce resource – land in the case of agriculture and spectrum in the case of telecoms.

Competition, Key Driver

Yet, no one talks of limiting entry into farming but when it comes to telecoms, serious thought is being given to capping the number of firms. This is despite the fact that the key driver of growth of telecom has been competition. Post-2000, a substantial drop in tariffs and subsequent increase in the number of subscribers has happened each time new players entered the market.

For instance, the entry of Code Division Multiple Access (CDMA) players in 2003 doubled the mobile subscriber base in 2004. Similar trends have been recorded with the entry of fourth cellular operator, BSNL/MTNL and, most recently, launch of Global System for Mobile Communication (GSM) services by Tata DoCoMo, which introduced per second tariffs into the market.

Output Factor

However, just as small pieces of land held by many farmers reduce agricultural output compared to the output from a large tract of land owned by a single farmer, dividing spectrum among 13-14 players has resulted in operators having an average of about 7 Mhz. In contrast the global norm is to give above 20 MHz per operator. Lower availability of spectrum also means higher capex because more cell sites have to be put up, leading to inter-site interference and resultant constraints on quality of service.

From this, it is easy to conclude that allowing more operators will only worsen the situation given that there is only limited bandwidth available in the frequency bands currently under use. Unlimited competition could also make it financially difficult for everyone in the market as newer operators will keep bringing down the tariff levels, which may not always be backed by a viable business case, leading to bankruptcy.

More players, lower prices

	Effective Charge (Rs/Min)	Subscriber base (in million)	Average No. of operators per circle
1988	16.00	0.88	2
1999	15.70	1.20	2
2000	6.50	1.88	2
2001	4.10	3.58	3
2002	3.75	6.50	4
2003	3.00	13.00	6
2004	2.00	33.60	6
2005	1.20	52.20	6
2006	1.00	90.14	6
2007	0.90	165.11	6
2008	0.80	261.07	8
2009	0.50	450.00	10 (3 more to launch)

Source: TRAI, COAI and AUSPI

Spectrum Allocation

However, easy but counter-productive solution is what the government excels in. It must, therefore, be resisted. Another solution is to undertake spectrum reforms to identify newer bands.

To bring in more transparency in spectrum allocation, it should be auctioned so that everyone, new or old player, gets an equal chance to buy radio waves at market price. Deploying newer technologies will also enable existing players to use spectrum more efficiently. If global operators got 20 MHz spectrum in the 1980s it was because the technology available in those days was bandwidth guzzlers. But the networks today are becoming smarter.

The question of whether the market has the appetite for more players should be answered by the market itself. If any player believes that there is room for more, then regulation should not stop it.

Wireless Operators*

Wireless Group	Subscriber Base as on Dec 08 (in millions)	Market Share (in percent)
Bharti	85.65	24.69
Reliance	61.34	17.68
Vodafone	60.93	17.56
BSNL	46.23	13.33
Idea	34.21	9.86
Tata	31.76	9.16
Aircel	16.08	4.64
MTNL	4.19	1.21
Spice	3.8	1.10
BPL	1.95	0.56
HFCL	0.38	0.11
Shyam	0.37	0.11
	346.89	

**on basis of market share (Dec 2008)*

Source: TRAI

Contestability

The current thinking which is veering towards creating an oligopolistic market structure must be discouraged. Number of studies has shown that in such market structures, it is not the number of incumbent players that is important but what William Baumol called the 'contestability' of a market.

Otherwise, collusive pricing and restrictive trade practices will always creep in. In a contestable market, entry is free and this is what keeps the incumbents from colluding. Is that what the Government wants?

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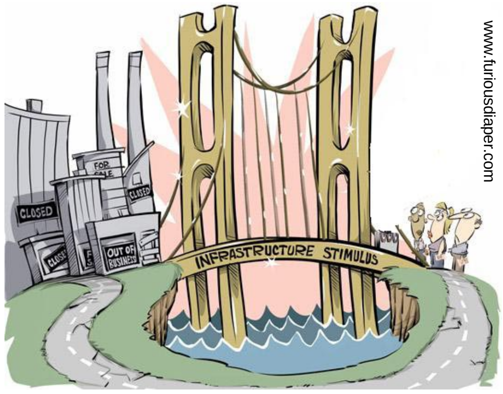
* *The writers are with The Hindu Business Line. Abridged from an article that appeared in The Hindu Business Line, on September 29, 2009.*

PPPs in Infrastructure

Build on this Latin Lesson for Projects

– Michael Walton*

Can public private partnerships (PPPs) solve India's huge infrastructure deficit? Don't expect miracles. Consider the experience of Latin America, which has faced comparable problems. At the beginning of the 1990s, all countries suffered big infrastructure deficits, dismal service standards, tight fiscal constraints and deep problems with the traditional mode of public delivery. There were weak incentives for efficiency and infrastructure delivery was often embedded within patronage-driven political systems. While many governments had a reasonable capacity to get things done, there was excessive influence from private interest groups and extensive corruption, not unlike in India.



A Pragmatic Solution

The idea of private involvement in infrastructure as the solution to both the financing and efficiency problems swept through the region, affecting almost all countries. It seemed a pragmatic solution. In sectors with natural monopolies, such as ports, roads and water and sanitation, the favoured contractual form was not full privatisation but a concession: such as build operate transfer. Regulation is built into the concession, sometimes backed by independent regulators.

So did it work? Results were mixed. Infrastructure got built, in electric power, roads, ports, water and sanitation. Levels of service often improved dramatically, if from awful levels. Prices were typically raised, if from highly subsidised rates for the few with access.

Increasing access actually often helped lower income and poor groups. A careful study of municipal water privatisation in Argentina found big gains in child mortality of the poor, relative to municipalities that had not privatised.

Moreover, by the early 2000s, privatisation had become highly unpopular, according to opinion surveys, as populations became discontented with the combination of higher prices, access issues, and tales of fat profits of private companies.

Contracting Nexus

A big part of the issue lies in the contracting nexus. There were some cases of spectacular corruption and private enrichment. According to a World Bank database some 74 percent of water and sanitation and 55 percent of roads contracts were renegotiated by the early 2000s. Over 60 percent of renegotiations were initiated by the operator, and a majority were resolved in favour of the private company.

So what was going on? Initial bids may have been low in the expectation of holding up the government later, with bribes or other means. Even in the absence of corruption, operators and Ministries of Public Works have a common interest in getting the works done. Ministries of Finance have more of an interest in high operator profits than in protecting the interests of all consumers.

The Chilean Experience

There is an exception, which is Chile. Chile also faced problems of renegotiation, and concerns over the MPW favouring concessionaires. But private involvement effectively eliminated Chile's infrastructure deficit over 15 years, and roads, ports, airports have underpinned a highly competitive economy.

Chile also innovated in the design of explicit subsidies to ensure access to poorer groups. Where did success come from? There is a mixture of two things: first, Chile has a markedly stronger tradition of rule of law and respect for property rights than most of the rest of the region; and second, there were specific issues of design, around a well-crafted 1991 concession law and, more recently, effective independent regulation.

So what does this imply? The broad Latin American experience illustrates the problems of PPPs. Chile may illustrate the possibility. The parallels in India's institutional conditions unfortunately look stronger with the rest of the Latin America than with Chile.

PPPs in India

Does this mean PPPs are a bad idea for India? No. In fact, in most countries, PPPs, for all their problems, performed significantly better than public sector delivery. But it does imply that the institutional challenge cannot be underestimated.

Moreover, there are not design tricks, such as "have an independent regulator". The issue is understanding just how difficult regulation is, that regulatory capture or incoherence is the norm if there is not already a strong established tradition. And this has to be backed by effective courts, transparency, independent technical analysis.

Last, it is crucial to build into the process public incentives for provisioning for equity, for both substantive and political reasons. Regulating this often fails, if the operator lacks incentives. Otherwise there will be a justified backlash. India's infrastructure sector needs private involvement, but it is important to start with recognition of the depth of the institutional challenge.

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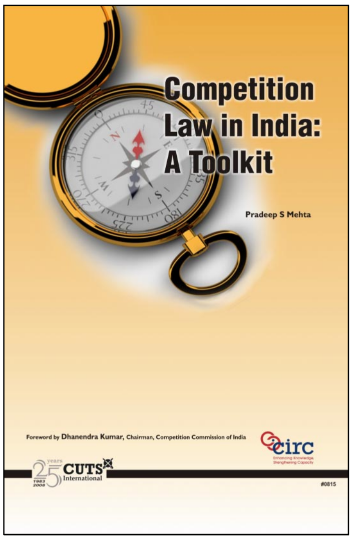
* *Harvard Kennedy School, the Institute of Social and Economic Research and the Centre for Policy Research. The article appeared in the Financial Express, on August 05, 2009*

A Foundation for an Important Nursery for Regulators

This Policy Document is a compilation of essays which look at how infrastructure and its growth enhancing effects can be promoted through regulation. They are to generate greater awareness on the importance of infrastructure as an engine of economic growth. They are both comprehensive and enriching, capturing cross-cutting and sector-specific issues, and within each set, conceptual, empirical and practical solutions.

In the Foreword to this document, C Rangarajan, Chairman of the Economic Advisory Council to the Prime Minister of India and President, CIRC, wrote: "The ability to detect the need for regulation, use regulatory tools discerningly and take appropriate action against anti-competitive practices requires specialised knowledge and skills. These skills have to be developed through targeted instruction and training which simulates reality. It is only then that such skills can be honed by learning by doing and finally used for the benefit of the economy. CIRC has been conceived with the objective of not only developing capacity in regulation but also that of various stakeholders who support and provide strength to regulators – government and business executives, business specialists, civil society organisations, etc."

Competition Advocacy in Practice



The purpose of this Toolkit is to suggest ways to deal with all types of competition abuses. It looked at various types of anti-competitive practices in light of the new competition law of India and juxtapose it with examples from the country and of similar cases from other jurisdictions, in particular from other developing countries.

This document is to help citizens of India to appreciate the market problems and their solutions in order to promote an orderly market and economic democracy.By analysing experiences from India and other countries, it has advocated that a new competition law has to be implemented gradually rather than with a bang. It explains why creating a healthy competition culture depends on effective implementation of competition law and supportive policy environment.

In its Foreword, Dhanendra Kumar, Chairman, Competition Commission of India, wrote: "It is gratifying that CUTS has brought out this timely publication, which will be found useful by all concerned. It deserves commendation for supplementing the efforts of the Commission in creating awareness about the benefits of competition law as well as the provisions of Competition Act, 2002".

Participation

- **Pallavi Kishore** attended a Training of Trainers Workshop under the International Finance Corporation Bangladesh Investment Climate Fund (IFC-BICF) Project of CUTS on Competition Policy and Law in Bangladesh in Dhaka, on July 09-11, 2009. She introduced the subject of Competition Advocacy giving a broad overview of all the aspects. Practitioners like Manas Chaudhuri from J Sagar Associates conducted various sessions.

- **Arpan De Sarkar** attended a National Conference on 'Regulation and Electricity Services to the Poor' organised by *Prayas* Energy Group, Pune, in New Delhi, on August 07-08, 2009. It was aimed to bring out the potential and limitations of the regulatory process to address issues facing the poor. Various pro-consumer initiatives for better access to electricity and the draft Regulatory Reforms Bill 2009 were also discussed.

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