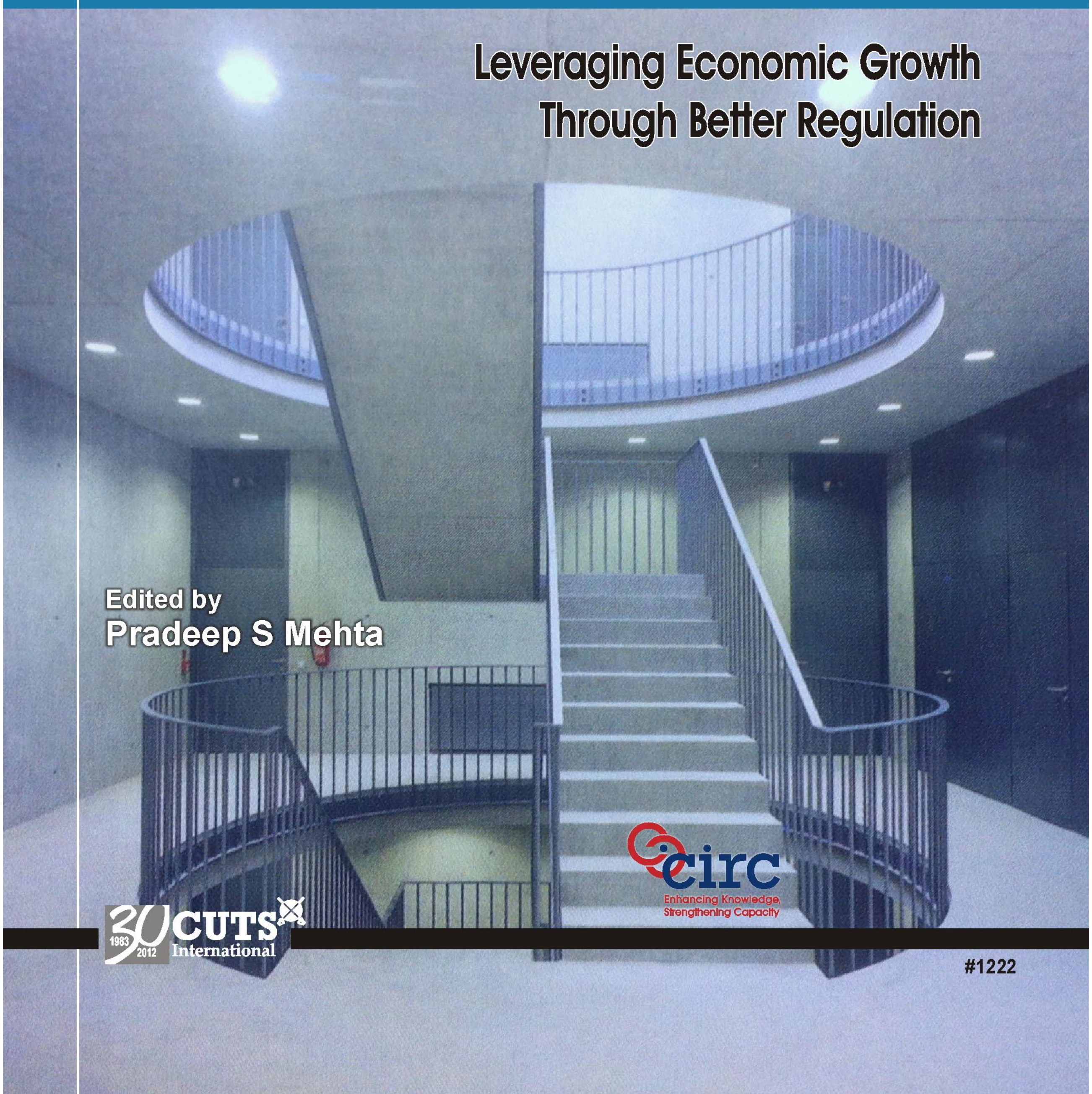
Competition and Regulation in India 2011

Leveraging Economic Growth Through Better Regulation



Edited by
Pradeep S Mehta

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Reflections

Given the recent reforms implemented by the government, the report produced by CUTS, 'Competition and Regulation in India, 2011' is very timely. The report backed by previous work undertaken by CUTS, lays out key issues such as adoption of National Competition Policy, ensure establishment of independent regulators, creation of an Indian Regulatory Service, etc., which does deserve wide attention of the Policymakers. The report shows the way forward to the government to implement regulatory reforms effectively, which can help in sharing the gains from liberalisation equally among stakeholders in India.

Kamal Nath
Minister of Urban Development
Government of India

The third report by CUTS, Competition and Regulation in India, 2011 goes further in exploring what has happened, what is happening and what should be done in promoting effective competition and regulatory reforms in India. The ICRR reports are remarkable as they provide us with a thorough, comprehensive and frank analysis of the reality of economic regulation in the country. As this report reflects, action is needed on various fronts to overcome policy paralysis and to create a predictable environment to ensure investments and increase in competition to benefit the consumers.

Vijay Kelkar
Chairman
India Development Foundation

It was on August 24, 2004, soon after UPA I government was sworn in that the Prime Minister talked spoke about "...revamping the regulatory framework... one that is transparent independent, autonomous, world class, independent of government and provides an impartial balance between public sector and private sector". Eight years on the nation is still grappling with the seven pillars of infrastructure regulation: (i) Autonomy (ii) Empowerment (iii) Accountability (iv) Transparency (v) Jurisdictional Clarity (vi) Fair and efficient dispute resolution, and (vii) Regulatory capacity. This third and latest CUTS report (Competition and Regulation in India, 2011) takes a hard look at all these evolving issues, and suggests decisive ways going forward – taking all the stakeholders along, viz. Policymakers, Civil Society, Academia, Judiciary, Competition Commission, Media, Sector Experts and Business.

Vinayak Chatterjee
Chairman, Feedback Infra and
Chairman, CII's National Task Force on Infrastructure Projects

After decades of obsession with market imperfections and the case for more regulation, at last a wide-ranging and fact-based documentation of regulatory imperfections and the case for regulatory reform, set in the context of "poor governance, policy paralysis and populist grandstanding by the polity". The ICRR Report also brings considered recommendations for improved policy: private rather than state ownership, more effective competition instead of monopoly franchises, and appropriate rather than disproportionate regulation. This is a valuable input to policy making nationally and internationally.

Professor Stephen Littlechild
Fellow, Judge Business School, University of Cambridge, UK

India is witnessing a spate of scams that have their roots in either regulatory failure or public policy capture – both fallouts of failure of government and other regulatory institutions. These have, in turn, caused serious setbacks to investor and consumer confidence in many areas that are still crying for investments and growth and are holding back the growth of various sectors such as telecom, transportation, energy, finance etc. – all critical to establishing India on a path of sustainable growth. These recent spectacular examples of crony capitalism and political entrepreneurship underline the urgent need for significant reforms in governance and building/rebuilding credible and performing regulatory institutions that are capable of handling challenges of economic regulation in today's India. Some of the newer regulators like competition regulator, CCI, have demonstrated their ability and intention to make a difference by championing competition, and therefore, consumer interest. We need more. CUTS and its research are playing a valuable role in helping the development of these institutions – which, in turn, is critical to the future sustainable growth of our economy. In Weber's memorable words, "Building public institutions is like slow boring of hard boards."

Rajeev Chandrasekhar
Member of Parliament, Rajya Sabha, India

State controlled 'dirigisme' was not a robust economic model. Market fundamentalism has proved comparably fraught. The pendulum has swung towards 'regulatory capitalism'. Against this backdrop, report is a timely, incisive and valuable contribution to the literature on regulatory processes and regimes and provides clear guideposts for creating a regulatory apparatus that whilst encouraging competition and economic growth provides a forum for addressing the concerns of consumers, producers and the government. It should be carefully studied by all regulators.

Vikram S. Mehta
Chairman, Shell Group of Companies in India

CUTS third report on Competition and Regulation scenario in India has established itself as a benchmark in assessing the need for and the status of regulation and competition in India, the importance of effectiveness of regulatory process and the spread of awareness among stakeholder groups. This is the third in the series of reports and focuses on the six selected sectors of Microfinance, Natural Gas, Real Estate, Retail, Road Transport and Telecommunications. It also covers few general but important chapters such as Political Economy of Regulation and Essential Facilities Doctrine.

The partnership with the Oslo-based Norwegian School of Management provides a great deal of value addition for all those connected with policy making, regulations and economic and social development in India and Norway. The third report, in the series, is a most valuable and a welcome timely contribution in the discourse on competition and regulation in India, given the current spate of reforms adopted by the government. The report lays down key policy recommendations, which must be adopted by the government.

Bhaskar Chatterjee

Director General & CEO, Indian Institute of Corporate Affairs

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Foreword

The India Competition and Regulation Report, 2011 (ICRR, 2011) is a compendium of policy relevant research on the status of competition and regulation in India spanning across sectoral and institutional dimensions. This volume is the third in a series of biennial reports which endeavour to monitor people's perception of the state of competition and regulation in India, with an emphasis on certain selected sectors.

The theory of economic regulation has advanced significantly employing the tools of mechanism design with incentives and asymmetric information providing the necessary foundation. Using this framework the economists have classified and categorised all sorts of market failures and developed a sophisticated "optimal" regulation theory to address the same. However, the theory has all along assumed a benevolent state ready and willing to correct these failures.

Classical welfare economics has treated the state as one large "black box" and scant attention has been paid to the likelihood of the informational and incentive challenges of the state itself. The theory of regulation, as it has developed, has ignored the peculiar characteristics of developing countries. It is important that the institutional milieu is well understood such that regulatory framework and practice is aligned to the same. It is in this space that this report positions itself by providing unique insights of each of the sectors' institutional context, its' implications thereof and the dilemmas posed for arriving at a feasible regulatory policy. An attempt to unravel the "black box" is thus timely and important.

A central theme of the report is that as a fiduciary of the State, it is important to delineate the appropriate means and degree of control exercised by the state over the regulator. In this regard it is vital that the political system provides a clear objective and mandate to a regulator. The regulator should have the legal basis and the incentives to pursue her mandate. Creation and sustenance of independent regulatory institutions requires a substantial degree of political and judicial maturity. We are slowly but surely moving towards that institutional maturity. But all this will not happen in a day. It takes years of development and other complementary reforms for economic regulators to execute their fiduciary responsibility and pursue the mandate given to them to the satisfaction of the society.

While the report points to lacunae in the regulatory framework, it attempts to put ideas on the agenda and stimulate public debate, which is an important contribution in the area of regulatory and competition policy dialogue of India.

Another important strand of discussion in this report is about the legislative ambiguities and overlapping jurisdiction between sectoral regulators and the competition regulators. The interface need not necessarily be adversarial as regulation and competition law enforcement aim at similar goals: economically efficient prices, innovation, and productive efficiency. While regulation seeks to achieve them directly, competition law pursues these goals indirectly by promoting and preserving a competition environment that facilitate these goals, through its enforcement and advocacy mandate.

Traditionally, regulation and competition law enforcement served distinct functions. However, with robust liberalisations in the erstwhile closed or monopolised sectors, and the regulators performing the role of facilitating competition, the traditional policy of separation cannot be strictly followed. There are bound to be overlaps and hence the interface may be a source of tension. However, with effective coordination the two regulators have to find a way to harness their respective expertise such that each can play a distinct and non-conflicting role, resulting in better overall economic regulation outcomes.

Last, the report puts an onus on the Competition Authority to enforce open access to critical infrastructures by invoking the Essential Facility Doctrine (EFD). While, there are significant positive externalities that open access produces, a case for an absolute essential facilities doctrine, may be hard to make. The application of EFD depends on the industry in question, the associated technology, the level of competition (hence the market structure) and requires a dynamic and not necessarily a static analysis to categorise what is an essential facility.

In addition to the above general themes this volume has analysed very specific competition and regulatory aspects of sectors such as Retail, Natural Gas, Real Estate, Road (passenger transport) and Telecommunications.

I am sure this report will generate sufficient interest among practitioners, policymakers, lawyers, consultants and anyone interested in knowing about regulation and development linkages.

Ashok Chawla
Chairman
Competition Commision of India

Preface

The third ICRR report is well-timed as it coincides with efforts at clarifying the relationship between the Competition Commission of India and sector regulators. The success of this effort will determine whether the two can have a constructive and harmonious co-existence and work together for championing the cause of competition in the economy or will they be at loggerheads on policy issues and act at cross purposes only to protect their own turf and thus, defeating the larger objective of promoting competition in a particular sector and the economy as a whole. The challenge is to have a clear distinction between matters that are violative of basic principles of competition and those that constitute violations of regulations that are sector specific.

This report covers Micro Finance Institutions, Natural Gas, the Real Estate Sector, Retail Distribution, Passenger Road Transport and Telecommunications apart from cross-sectoral issues such as the Political Economy of Regulation and the importance of independent regulation.

Given that the regulatory apparatus is a necessary component of economic governance in any country, it is important to evaluate its adequacy, effectiveness, awareness about its availability and usefulness. This series of Reports on Competition and Regulation in India brought out by CUTS International in association with CIRC with support from Royal Norwegian Embassy, serves the purposes of reviewing the state of regulation and competition in select sectors; garner perceptions of stakeholders regarding regulatory issues; develop recommendations for improvement of regulatory framework.

The contributors to this report are researchers, eminent academics and policy makers. I had the privilege of chairing the National Reference Group (NRG) that guided and advised the authors for the duration of the project, i.e., 2011-2012. The NRG members met twice for meetings and discussions in Delhi and displayed great commitment to the project. As a result, all the meetings were highly productive and it was a pleasure chairing them. I would like to thank all the participating NRG members for giving their time to this endeavor and enriching it through high quality discussion.

The credit for preparation of the report goes entirely to Pradeep S Mehta and his team of young, bright and energetic professionals at CUTS and CIRC led by Suparna Karmakar, working closely with Udai S Mehta, Kamal Sharma, Neeru Batra and Hari Prasad C G.

Our hope is that this report like the previous ones will stimulate public debate on the operation of the competition and sectoral regulation mechanisms that are now so large a part of our policy apparatus.

Nitin Desai
Former Under Secretary, UN &
Chairman, Institute of Economic Growth
New Delhi

Editor's Note

We have to continue running a course of hurdles ...

This note is being written in the background of recent policy reforms in India. More about it in the Epilogue. However, what is important is for the policymakers to ensure that rules of the game favour the poor, while boosting growth. Promoting equity is as essential as promoting growth, and people should believe so.

Competition policy promotes economic equity and democracy, which is a building block for political democracy. While macro reforms have to be followed, micro reforms with effective meso-level institutions are as important to ensure that markets function well. In fact, the poor suffer more when markets do not function well. Businesses too benefit from competition reform, as they are also consumers and so do the poor, as it leads to more equitable growth.

The current buzzword for economic planning and management is 'inclusive growth'. The root cause of political economy differences related with 'policies and the need for change' lies in the way 'reform' is perceived. For the common man, reform in general stands for changing the status quo to facilitate corporate interest, on which I have written frequently in the media. The common man is unable to appreciate that such reforms can lead not only to creation of wealth, but also jobs, the equity agenda. The polity, government, business and civil society have a big agenda to speak to the people and also ensure that public interest is not sacrificed to private interest. People should be confident that equity remains at the core of governance, so that we can grow harmoniously

A few words about this Report and how and why it will help the reader. The report series has resulted from the experiences gained in a raft of competition and regulation projects that CUTS has been engaged in since 1990s. Given this background, CUTS formulated a proposal to do a Status of Competition & Regulation in India report on a biennial basis, i.e. the first one in 2007, second one in 2009 and the third one in 2011.

While the first two reports were supported by the British High Commission in Delhi, the Royal Norwegian Embassy, New Delhi decided to support the 3rd cycle of the project with funding in 2010. The Norwegians have a mandate to support efforts which can aid economic reforms in India and also facilitate partnerships between Indian and Norwegian Institutions through such research and advocacy projects. The project is being implemented in partnership with the Norwegian School of Management (BI). We are grateful to RNE and BI and we do hope to publish this as a flagship publication of CUTS Institute for Regulation & Competition (www.circ.in) in partnership with CUTS, its parent body.

The last report of 2009 had its primary focus on sector regulators, and it captured the state of the world in the select sectors and made an effort to highlight the institutional and other aspects of the situation. The 2007 report had focused on competition reforms, as the Competition Commission of India was coming into operations.

As a part of the current report's structure, it covers Micro Finance Institutions, Natural Gas, Real Estate Sector, Retail Distribution, Passenger Road Transport and Telecommunications apart from cross-sectoral issues such as Political Economy of Regulation and Essential Facilities Doctrine.

Apart from the above mentioned sector studies is an ongoing perception survey which has shown positive results in the regulatory space in terms of improved awareness index on the competition and regulatory scenario due to informed policy responses by our country's economic managers. The good news is that public confidence in the system has shown a steady increase over the last five years.

The work in progress of the project was guided by a National Reference Group (NRG), chaired by Nitin Desai, who has been guiding the project since inception. The group comprised lawyers, competition law experts, academicians, regulators and former civil servants. We are very grateful to Nitin for the time that he devoted to the project and steered the meetings so well. It was a delight to have him as our adroit helmsman.

The NRG met twice in New Delhi and deliberated over the draft papers. This process was very pertinent for the project as well as raised awareness of the issues. We are very grateful to all the NRG members for their time, contribution and enthusiasm. This certainly helped the project hugely. A list of NRG Members is annexed to this Note.

The writers who contributed to this report are Suparna Karmakar, Udai S. Mehta, Simi TB, Sunil Jain, Espen R Moen, Christian Riis, Tom Hegeddal, Santadarshan Sadhu, Kenny Kline, Justin Oliver, Shyamal K. Sarkar, Payal Malik, Ashutosh Limaye, Rohan Sharma, Abhishek K. Gupta, Nagendra Goel and S. Sriraman. The editorial assistance was provided by

Madhuri Vasani, while the layout was done by Mukesh Tyagi and Rajkumar. We are grateful to them also.

Suparna Karmakar, as the Project Manager, worked closely with Udai S. Mehta, Kamal Sharma, Neeru Batra and Hariprasad C G under my overall guidance. All of them have worked hard to produce an excellent report. The 2007 version was lead by Manish Agarwal and the 2009 version was lead by Siddhartha Mitra working with colleagues.

I am also very thankful to all who have commented on the report, whose names and endorsements are carried at the back and inside pages of this document. Finally, we owe gratitude to Ashok Chawla, Chairman, Competition Commission of India for writing the encouraging Foreword.

In conclusion, readers are requested to peruse the Epilogue which lays out the relevant parts of the future reforms agenda for the country. Indeed, we have to continue running the course of hurdles...

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Secretary General, CUTS International
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Annexure to Editor's Note

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Abbreviations

AAI	:	Airports Authority of India
ABARE	:	Australian Bureau of Agricultural and Resource Economics
ABT	:	Availability-based Tariff
ADC	:	Access Deficit Charge
AERA	:	Airport Economic Regulatory Authority
AERB	:	Atomic Energy Regulatory Board
AERC	:	Atomic Energy Research Commission
AGR	:	Adjusted Gross Revenue
APERC	:	Andhra Pradesh Electricity Reforms Commission
APM	:	Administered Price Mechanism
ARPU	:	Average Revenue Per User
ATMs	:	Automated Teller Machines
BOMA	:	Building Owners and Managers Association
BOT	:	Build-Operate-Transfer
BRICS	:	Brazil, Russia, India, China and South Africa
BSES	:	Bombay Suburban Electric Supply Ltd
CAG	:	Comptroller and Auditor General
CAGR	:	Compound Annual Growth Rate
CAT	:	Competition Appellate Tribunal
CBM	:	Coal Bed Methane
CCI	:	Competition Commission of India
CERC	:	Central Electricity Regulatory Commission
CGAP	:	Consultative Group to Address the Poor
CGD	:	City Gas Distribution
CII	:	Confederation of Indian Industries
CMTS	:	Cellular Mobile Telephone Services
CNSC	:	Canadian Nuclear Safety Commission
COPRA	:	Consumer Protection Act
DGH	:	Directorate General of Hydrocarbons
DoP	:	Department of Posts
DoT	:	Department of Telecommunications
E&P	:	Exploration and Production
ECJ	:	European Court of Justice

EFD	:	Essential Facilities Doctrine
EWS	:	Economically Weaker Sector
FDI	:	Foreign Direct Investment
FIPB	:	Foreign Investment Promotion Board
FMC	:	Forward Markets Commission
FMCG	:	Fast Moving Consumer Goods
FRAND	:	Fair, Reasonable and Non-Discriminatory
FSI	:	Floor Space Index
FTS	:	Fixed Telephony Services
GAIL	:	Gas Authority of India Limited
GGCL	:	Gujarat Gas Company Limited
GSPC	:	Gujarat State Petronet Limited
GSRTC	:	Gujarat RTC
GST	:	Goods and Service Tax
HUD	:	Housing and Urban Development
HVDS	:	High Voltage Distribution System
ICTS	:	Indore City Transport Services Limited
IDA	:	Indore Development Authority
IGL	:	Indraprastha Gas Limited
IMC	:	Indore Municipal Corporation
IP	:	Intellectual Property
IPPs	:	Independent Power Producers
IRDA	:	Insurance Regulatory and Development Authority
IUC	:	Interconnection Usage Charges
JNNURM	:	Jawaharlal Nehru National Urban Renewal Mission
KERC	:	Karnataka Electricity Regulatory Commission
LARR	:	Land Acquisition, Rehabilitation and Resettlement
LIG	:	Lower Income Group
M&A	:	Mergers And Acquisitions
MACS	:	Mutually Agreed Cooperative Societies
MC&IT	:	Ministry of Communications & Information Technology
MFIs	:	Micro Finance Institutions
MGL	:	Mahanagar Gas Limited
MNO	:	Mobile Network Operator
MNP	:	Mobile Number Portability
MoAs	:	Memorandum of Agreements
MRTP	:	Monopolies and Restrictive Trade Practices

MSC	:	Mobile Switching Centre
MSEB	:	Maharashtra State Electricity Board
MTNL	:	Mahanagar Telephone Nigam Limited
MTNL	:	Mahanagar Telephone Nigam Limited
MVNO	:	Mobile Virtual Network Operator
NABARD	:	National Bank for Agricultural and Rural Development
NAC	:	Non-Agricultural use Clearance
NBFCs	:	Non-Banking Financial Companies
NCR	:	National Capital Region
NDPL	:	North Delhi Power Limited
NE	:	North East
NELP	:	New Exploration Licensing Policy
NGO	:	Non-governmental Organisation
NOC	:	No Objection Certificate
NSICT	:	Nhava Sheva International Container Terminal
NTP	:	National Telecom Policy
NTPC	:	National Thermal Power Corporation
NUHHP	:	National Urban Housing & Habitat Policy
O&M	:	Operation and Maintenance
OALP	:	Open Acreage Licensing Policy
OGL	:	Open General Licence
PCs	:	Personal Computers
PEL	:	Petroleum Exploration Licence
PLL	:	Petronet LNG Ltd
PML	:	Petroleum Mining Leases
PMT	:	Panna Mukti Tapti
PNG	:	Piped Natural Gas
PNGRB	:	Petroleum and Natural Gas Regulatory Board
PPP	:	Public and Private Partnership
PPPs	:	Public-Private Partnerships
PSC	:	Production Sharing Contract
PSU	:	Public Sector Undertaking
PTCS	:	Property Title Certification System
QoR	:	Quality of Regulation
RBI	:	Reserve Bank of India
RE	:	Real Estate
REITs	:	Real Estate Investment Trusts
REMFs	:	Real Estate Mutual Funds
RGTIL	:	Reliance Gas Transmission Infrastructure Limited

RIA	:	Regulatory Impact Assessment
RICS	:	Royal Institute of Chartered Surveyors
R-LNG	:	Regassified-Liquefied Natural Gas
RTA	:	Regional Transport Authority
RTC	:	Road Transport Corporations Act
RAY	:	Rajiv Awas Yojana
SEBI	:	Securities and Exchange Board of India
SERP	:	Society for Elimination of Rural Poverty
SHGs	:	Self Help Groups
SLC	:	Subscriber Linked Criterion
SPV	:	Special Purpose Vehicle
SRTCs	:	State Road Transport Corporations
SRTUs	:	State Road Transport Undertakings
STA	:	State Transport Authority
TAMP	:	Tariff Authority for Major Ports
TDSAT	:	Telecom Dispute Settlement and Appellate Tribunal
TRAI	:	Telecom Regulatory Authority of India
TRIPs	:	Trade-Related Aspects of Intellectual Property Rights
UAS	:	Universal Access Service
UASL	:	Universal Access Service Licences
ULBs	:	Urban Local Bodies
ULCRA	:	Urban Land Ceiling Regulations Act
ULIP	:	Unit Linked Insurance Products
USOF	:	Universal Service Obligation Fund
VAS	:	Value Added Services
VAT	:	Value-Added Tax
VMSS	:	Vadodara Municipal Corporation
VSNL	:	Videsh Sanchar Nigam Limited
WCP	:	Wireless Planning & Coordination
WHO	:	World Health Organisation
WiLL	:	Wireless in Local Loop
WTO	:	World Trade Organisation

CHAPTER 1

An Overview

With economic liberalisation and reforms in the 1990s, India embarked on a path of market-driven economic governance. The earlier decades saw the country's economy being governed in a socialistic manner, where the government held or coordinated the commanding heights of the economy. However, over time, signs of government's failure to deliver on its targets started to become apparent, leading to situations where intervention produced new and more serious problems that did not exist before.[1] The outcome was high inefficiency in the economy together with the country being stuck at poor rates of GDP growth, popularly known as 'hindu rate of growth'. Cumulative external developments and politically expedient government actions forced the country to a balance of payments crisis in late 1980s, and partly as a result of the conditionalities imposed by the multilateral lender of last resort, a.k.a the IMF, India was forced to move onto a market based economy.

The thrust of economic reforms since 1991 has been to allow for more competition from private players (privatisation and liberalisation), and the state started to vacate some of the commanding heights of the economy. Now, state's responsibility for the provisioning of services is no longer synonymous with state ownership, and the private sector is encouraged to take up the vacated economic space. The command and control mode of governance that relied on state ownership and provisioning of goods (esp. infrastructure) and services has moved towards a new mode of regulatory governance where public private partnerships and private sector participation require governmental priorities to be achieved through independent regulation and the law of contract. A majority of Indian policymakers today seem to believe in the adage: "(c)ompetition is the way most productive firms win out... Sometimes the less productive firms go out of business. Other times they react to the competitive pressure and increase their own productivity".[2]

To that end, the primary means of promoting competition has been through elimination of unnecessary restraints on the market processes (some emanating from practices that enterprises indulge in through the abuse of their dominant power in the market place) which often distorts competition.[3]

It should also be recognised that inefficiencies in market functioning also often arise of political economies that cannot be neatly classified as either market or government failures.[4]

With liberalisation and privatisation however, it was recognised that under certain circumstances regulation[5] of markets is also needed to ensure that their working is not impeded through barriers created by the market players, i.e. markets continue to offer wide choice, with enough supplies available. Following this theology, changes were made in the economic governance system of the country. This included changing government policies/measures; amending existing legislations and/or enacting new ones such as the new competition law, Indian Competition Act 2002, as amended in 2007; establishment of sector regulatory bodies in telecom, electricity, etc. All such measures were designed to ensure that markets function well in the new economic policy regime and yield desired results.

In particular, the Competition Act was designed to regularly check and rectify anti-competitive behaviour of enterprises statutorily through the implementation of its legislative provisions that are designed to attack behaviour such as cartelisation, abuse of dominance, mergers and takeovers that may cause Appreciable Adverse Effect on Competition (AAEC) in Indian market. However, since many sector regulators were in place before the competition regime became operative, they tend to view the work of the competition agency as an encroachment on their turf.[6] The ongoing debate on powers of the Competition Commission of India (CCI) versus RBI on M&As (in the proposed Banking Regulations Amendment Bill) is an example of such conflict.[7]

Over the last two decades, India has witnessed drastic changes in the method of administration by the government in various sectors of the economy. Numerous regulatory laws have been enacted and consequently regulatory authorities have been set up both at the Centre and states. India's experience with these regulatory agencies in public services was however initiated as an institutional transplant from the industrialised world. Introduced at the behest of international donor agencies, with the World Bank serving as the dominant vector for transmission of the restructuring of ideas to India, regulators in India were intended, somewhat naively, to provide an apolitical space for decision making to assuage investor concerns over arbitrary administrative actions.[8] In practice, however, regulators have had to negotiate a terrain over which the state and its administrative arms (ministries) continued to exercise considerable control. Regulators have also been shaped in their functioning by national and sub-national political traditions and by administrative and political practices.

The result is the emergence of a hybrid institutional form of regulation that combines politics-as-usual with intriguing new, and unanticipated, opportunities for political intervention. And the latter is the reason why many feel that India's extant regulatory system may be bust and in need of urgent repairs.

Designing an Appropriate Regulatory Regime and Applicability of New Theories

The need for a regulator in any economic sector depends on whether there is a need to infuse dynamic efficiency in different systems influencing a market. The objective of attaining dynamic efficiency[9] depends on three factors: (1) existence of near perfect competition (large number of consumers as well as producers); (2) full information or minimal information asymmetry (stakeholders are fully aware of all options that a market offers them); and (3) low switching costs (costs to a consumer in switching from one to another option). In most developing countries, in most product markets (also depends on how one defines a market of a product – geographically in particular) at least one of these conditions are missing, and hence the need for a regulator to correct for the market's failure to naturally support competition and maximise efficiency through creation of competition enabling conditions. A regulator, therefore, is that institution who uses its powers to simulate the existence of these three pro-competitive conditions so that the interests of both consumers and producers are protected.[10]

And for the sake of impartiality and fairness, creation and operation of regulators/regulatory agencies ideally are required to be independent of excessive influence from any stakeholder group. In India however, other than helping the country to keep up with the global consensus (since 1960s) in favour of regulatory governance,[11] creation of a regulatory agency is often seen to be undertaken at the behest of one powerful trade union, the Indian Administrative Service, which has progressively engineered a monopoly on virtually every regulator's job, including the governorship of the Reserve Bank of India, mostly as a *sinecure.*[12]

This has the additional fallout of subverting the *de jure* independence of the regulatory agencies as these regulators have conflicts of interest problems, especially since there is no concept of a cooling off period for the appointees.

Regulatory reform is thus imperative. The concept, as defined by the OECD, refers to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Given the rising conflicts in the regulatory space in the country, in addition to infusing clarity on the jurisdiction of regulators, government and the CCI, the time perhaps has also come to take a hard look at how the experiment with 'independent' market regulators has worked, and design appropriate changes that can be introduced in the system (introducing a cooling off period for the regulator-candidates from the IAS is one such idea for consideration). The sectoral regulators were supposed to provide a superior alternative to government decision-making, free of political considerations and armed with sufficient expertise to make informed judgements on complex issues.

The reality has turned out to be very different, and most regulatory agencies (save a few rogue pronouncements of TRAI) today seem to vocalise/legitimise the established government position. Where there is no ministerial capture, we have seen capture by business houses — with the usual cast of suspects. But if market-oriented policy options are to work in key economic sectors, especially in infrastructure, India needs to look for a new paradigm for regulators and regulatory governance.

Redesigning the modalities/principles of determining regulatory policies in India is also important. Competition and sector regulation are dynamic, intertwined concepts. For them to work in tandem, one needs well-defined laws and policies in both cases. Also, when jurisdiction over certain areas is not clear-cut, confusion arises. For example, all regulatory laws are required to promote competition in the sector that they regulate. This cannot be interpreted to mean that the sector regulators are also empowered to check anticompetitive practices, the primary remit of competition agencies, unless specifically empowered to do so.[13]

Legislative ambiguities and overlapping jurisdiction (lack of clarity about powers vested in the competition authorities as well as the sector regulatory bodies) create confusion, as is happening in India currently, and leads to conflicts.[14] In the interest of promoting growth-inducing dynamic efficiency, the government can boost the competition culture in the country and reduce conflict by: (1) amending the Competition Act to ensure coherence and efficiency *vis-à-vis* sector regulations, and (2) addressing the huge number of policy-induced competition distortions through a National Competition Policy, with the latter purposely enabling coherence among sector regulators and the competition authority to address overlaps.

So what would be an appropriate regulatory governance regime for India at this point in its economic history? Traditionally, India has crafted regulatory policies and governance regimes on a *sui generis* basis, using the discretion and understanding of the regulators/their advisors. In principle however, as the liberalised sectors mature, regulatory governance modalities and the theories underlying them are required to adapt, and transform into a more systemic, market-based and institutionalised regime. Policymakers and regulators in any case should be open to learning and incorporate new theories in their governance design. For example, the mechanism design theory is a major breakthrough in the modern economic analysis of institutions and markets, and being deeply embedded in policy is a very relevant development in the regulatory design space.

A mechanism specifies the set of messages that participants can use to transmit information and the decision that will be taken conditional on the messages that are sent. Once a mechanism is in place, participants effectively "play a game" where they send messages (e.g., a bid in an auction) as a function of their information. The goal is to find a mechanism with an equilibrium decision outcome (sometimes required to be unique) that is best according to the given measure of quality. The strength of mechanism design lies in its generality: any procedure, market-based or not, can be evaluated within a unified framework. Mechanism design theory, applied in the right manner, has the ability to revolutionise outcomes of sectoral regulations, and as such has affected virtually all areas of policy. Its policy implications lie at two levels.

First, mechanism design theory informs when markets or market-based institutions are likely to yield desirable outcomes and when other institutions will be better at achieving the desired goals. Second, mechanism design theory gives guidance to design such alternative institutions when markets fail.[15]

Auctions are one of the early applications of mechanism design theory. The problem here is to decide how to allocate some object(s) among potential bidders when the value of the object(s) to a bidder is only known to that bidder. The objective can be to maximise the revenue raised from the sale, or to ensure that the objects go to those who value them the most (achieving the goal of efficiency). Today, governments use auctions to allocate scarce economic resources like spectrum, airport slots, oil drilling rights, timber or land. They also use reverse auctions to procure goods and services from the private sector. In each case, mechanism design theory has successfully been applied to give recommendations on how to best set the rules of the auction as a function of the government's objective and the nature of private information.

As auction plays a significant role in allocation of scarce resources, auction theory occupies a significant place in economics and regulatory governance. Auction models are also very dynamic and versatile, and can be designed to accommodate a range of objectives and sectoral peculiarities. The most crucial component for achieving economic objectives and enhancing total welfare through the auction process therefore is the formulation of its *design*. There are obviously exceptions to everything, but with variations in auction design, it is possible to accommodate most situations one can think of. Economist Paul Klemperer's auction theory highlights the success of the design of an auction in so far as its ability to address the two major market imperfections of: (1) barrier to entry by potential competitors, and (2) discouraging collusive behaviour among incumbent firms.

There are essentially two designs of auctions that are used most commonly: (1) the ascending auction, in which the price is raised successively until only one bidder remains and that bidder wins the object, and (2) sealed bid auction, in which the bidder independently submits a single bid without seeing others' bids, the object is sold to the bidder making the highest bid. It has been studied that due to their inherent designs, ascending auctions are likely to encourage collusive behaviour as well as deter entry. Such auctions allow bidders to use the early rounds to signal to each other how they may collusively divide the spoils and if necessary use later rounds to punish rivals that fail to cooperate. Furthermore, potential entrants may also apprehend that a strong incumbent bidder can rebid to top any bid that he makes which discourages entry therefore.

On the other hand, a sealed bid provides no such signalling or punishing opportunities and also since the stronger incumbents are unlikely to know the amount to outbid and are driven to bid lower in the interest of profit seeking, a potential entrant knows he may have better chances to enter the market and this acts as an incentive for him to compete. Having said this, it is important to note that there is no one size fits all approach when it comes to designing a successful auction and a lot depends on the specific details of the situation and economic circumstances. The issues that determine an auction's success, as mentioned above, are with respect to how well it addresses the market's specific imperfections. But once the policy objectives are clear (cheapest telecom services, for instance), auctions can be modified to accommodate them, making them an important part of the standard toolkit of every policymaker and economic regulator worldwide.

In the recent redesigning of telecom spectrum allocation policy, Indian regulators and policy literati have increasingly been seen to be open to learning from new regulatory design theories and have recommended their application. It is the Indian polity that needs to evolve, growing out of its mindblock and looking beyond the short-term political imperatives of policy choice.

Motivation for the Report

Economic reform is an evolving process, which seeks to facilitate the market process to achieve desirable outcomes. India is following a policy of market oriented economic reforms for the past one and a half decades. Given the important role played by market processes, there is a need to periodically review the competition and regulation scenario in the country. Further, the recent financial meltdown and the global recession have highlighted the inability of markets to function on their own. The important lessons that can be gleaned from the recent meltdown are: it is important to have fair competition, not totally free competition; and, it is equally important to have appropriate market correcting regulation, not over or under regulation.

Given that an appropriate regulatory apparatus is a necessary and important component of the system of economic governance in any country including India, it is important to evaluate its features, its adequacy as provided by law, effectiveness after being set up, awareness among consumers and other stakeholder groups about its availability and usefulness and their perceptions about regulatory effectiveness.

It is this context that makes the CUTS reports on the competition and regulation scenario in India, undertaken at regular intervals (2007, 2009 and 2011), a valuable resource for future. The first report in the series of biennial reports on Competition and Regulation in India was released in 2007 (Competition and Regulation in India, 2007),[16] while the second report (Competition and Regulation in India, 2009),[17] was released on March 28, 2009.[18]

CUTS started work on the third edition of its India Competition and Regulation Report in late 2010, and the project has undertaken research to evaluate, among other things, the state and quality of regulation in six selected sectors, viz. Microfinance Institutions, Natural Gas, Real Estate (residential), Retail, (Passenger) Road Transport and Telecommunications. The aim of these papers was to assess the need for and status of regulation and competition, the importance and effectiveness of regulatory institutions/ processes, awareness among consumers and other stakeholder groups, which forms the core of this report.

In addition the report looks at some thematic issues, namely Political Economy of Regulation in India and Essential Facilities Doctrine with the objective of creating awareness about functioning of the extant regulatory systems in the country and identifying possible methods of improving the current system. Another key objective of the project is to garner perceptions of a cross section of stakeholders regarding the state and also the general competition and regulatory climate in the economy and to develop recommendations for improvement in the regulatory framework in India, the findings of which has been reported in a separate chapter on perception survey.

CUTS is implementing this project in partnership with Oslo-based Norwegian School of Management (BI) and New Delhi-based CUTS Institute for Regulation & Competition (CIRC). The project's goal is to improve the quality of regulation and enhance the level of competition in select sectors of the economy through research, networking and advocacy based on research findings. The project is supported by the Royal Norwegian Embassy in New Delhi, India.

Overview of Report Chapters

The rest of this chapter outlines in brief the findings in the report. Going through the individual chapters, the one thing that comes out clearly is a call for reducing the political interference in regulators' work, improvement of the quality of regulation and it governance, transparency, continuity and reduction of regulatory complexities. In all the individual economic sectors that this report focuses on, we also note that business demands are for modernising existing regulations and its harmonisation rather than reinventing the regulatory wheel, for introducing sensible regulations rather than deregulation unlike in the US, need for inter-ministerial and inter-departmental coordination in designing sectoral regulations (to prevent them from working in cross-purposes) and a single focal point regulator as a single window for approvals and licensing requirements.

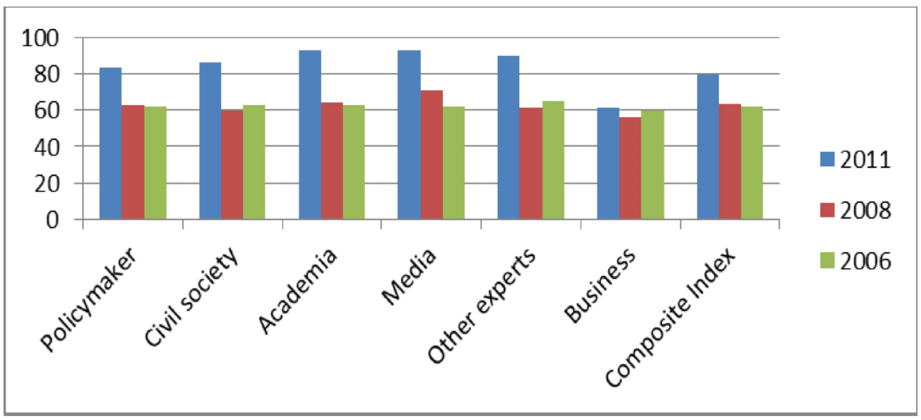
The *Chapter 2* that follows this introduction reports findings from a random sample *perception survey* of informed stakeholders conducted in the first half of 2011; it reports views on the prevailing regulatory regime and status of competition enforcement in India particularly in selected economic sectors, namely, microfinance institutions (MFIs), natural gas, real estate (residential), retail distribution, road transport (passenger) and telecommunications. As the questionnaires were also designed to assess popular perceptions about the level of competition and efficacy of regulatory practices in the country, particularly on key issues like the drug pricing, finance and manufacturing competitiveness etc, the chapter presents information on awareness of economic and regulatory policy proposals in the country, and analyses the findings from an inter-temporal as well as their inter-sectoral perspectives.

The main finding of the survey analysis is an encouraging all-round rise in the Competition Perception in India, with the Composite Index (CI)[19] at 79.3 in 2011 as compared to 63.7 in 2008 (see Chart for details), though there exists a divergence in the competition perceptions of different stakeholder groups. It appears that the growing Indian economy and consumer market can profitably accommodate more players, at multiple levels of product and service sophistication, which the business community can exploit without harming consumer interests.

On the other hand, the survey indicated that the Indian consumers are still unhappy with the quality of regulation in the country, rating an average of 2.5 on a 5 point scale where the choice satisfactory returned a value of 3. Even on the awareness and effectiveness of the regulations and competition, the survey indicates that there is a lot of room for the government and advocacy groups to intervene and bridge; more than one-fourth of the stakeholders in the survey set are uncertain about the efficacy of current government policies on competition and regulation, whereas 35 percent of the stakeholders were of the view that the government is not fully equipped to investigate the anticompetitive actions or monopoly actions of the supplier/marketer.

Figure 1.1: Competition Perception Indices (CPI) & Composite Index (CI)

(Inter-temporal comparison of perceptions on level of competition in the country)



Source: Computed from the data collected from the CIRC-CUTS Perception Surveys

The respondents appear to be adequately aware of the business practices prevailing in the market and their impact on welfare, though the motivation of the established business practices are almost always viewed with scepticism. However, on the effect of ministerial/political interference and administered/directed pricing/fee structures on effective regulatory functioning, the stakeholders seem undecided and unsure whether such interference is detrimental to the functioning of the independent regulator, given the lack of counterfactuals as in most cases citizens are unable to discern benefits accruing from a really independent regulator in any sector.

On the role and efficacy of sectoral regulations, the overall feeling seems to be that in those sectors with higher consumer welfare concerns (microfinance, retail and real estate) existing regulations are not very effective when compared with some other infrastructure sectors like telecom and natural gas. The view was strong that proper implementation and enforcement of laws and regulations are necessary to improve the quality of governance and eliminate malpractices/corruption in the key sectors of the Indian economy.

Chapter 3 outlines the *Political Economy of Economic Regulation in India* and outlines the gaps in implementation of the regulatory principles adopted by the Government of India, discussing concerns about India's regulatory structure and its practices with particular reference to lack of independence of regulators, their autonomy and accountability, and the general unpredictability of the regulatory regime in the country. But more importantly, the chapter shows that the Indian regulatory story is work-in-progress, varying in different sectors/situations, and having successes and failures in equal measure. Using examples of regulatory failures/best practices to guide the discussion, the chapter discusses a wide range of issues starting from the need for regulation and independence of regulators, to assessment of the current state of regulation and competition in India. To that end it is a logical and analytical continuation of the perception survey findings and analysis.

The key messages of this chapter can be summarised as below. With privatisation and liberalisation of the Indian economy in 1991, economic regulations began to be used to ensure economic efficiency as well as distributive justice, in particular in the sectors where competition was missing in the earlier governance regime. Soon, having 'independent' regulatory agencies to monitor public services and other delicensed economic sectors with erstwhile public sector monopolies became an important part of the new regulatory governance system the country was migrating to.

However, given the way these agencies were designed, the effective power their functionaries wielded was negligible and more regulators than is explicable have tended to give recommendations that the government of the day has wanted. This despite specific legislations have been enacted for creation of these bodies which lay out the functions and powers of the authority and explicit provisions covering grant of licence, determination of tariff, promotion of competition, efficiency and economy, regulating investments, quality of service, aid and advice to the government, and power of appeal etc.

Clearly, the challenge lies in India being a democracy where the executive is responsible to the electorate through the minister, who in turn is responsible to the Parliament; thus regulators cannot be fully independent either. Also under the current law, regulators have limited powers of enforcement. That said, a clearer demarcation of areas of jurisdiction and making the regulators directly accountable to Parliament will help in limiting interference.

As per the survey findings, around 30 percent of the sample surveyed felt that reducing political interference is the most important requirement for improving the quality of regulation in the country. There is room to learn from developed country jurisdictions which have tried different models, in some their powers are legislated while in other they are implied, and even have differential powers in scope and by design; however, most regimes have regulators who can create and enforce rules, fine and even jail people for violating their regulations.

Making regulators in India truly independent therefore requires reform in selection processes of regulators, fully empowering them according to the letter and spirit of the laws that have created these agencies, have detailed procedures for ensuring 360 degree accountability, and finally, develop regulatory capacity in the country which is a necessary first step for fighting *sinecure*.

We follow in *Chapter 4* looking at the case for an *Essential Facilities Doctrine (EFD) in India*, considered important because EFD mandates open access, and the latter is important in a country like India where a large number of economic sectors continue to operate as *de facto* monopolies/oligopolies, and introduction of competitive efficiency necessitates more players are allowed to competitively offer the good/service under consideration. Cases implicating the EFD arise when a vertically integrated firm that is a natural monopolist in one market refuses to provide access to the monopolised input to a rival/competitor in the same/adjacent market. Although such activities can be dealt under 'refusal to deal' case, but traditional 'refusal to deal' cases differ from 'essential facilities' cases.

The chapter discusses the instances where EFD is best applied, and based on the Frischmann and Waller thesis, explains the motivations for the use of the doctrine through an exposition of the economics of network goods and their associated externalities. In particular for India, the case for pharmaceutical industry is elaborated in detail and concern for access to medicines is deemed as a key motivation for invoking EFD. The chapter argues that from a theoretical standpoint, compulsory licensing has interesting parallels in EFD, insofar as essential drugs can be compulsorily licensed to other manufacturers (other than the original patent holder) in the interest of public health. Detailed analysis of the EFD case laws in different jurisdiction has been undertaken in this chapter to evaluate the potential and justification for a formal statutory provisioning of EFD in India.

In India, EFD is intimately linked with infrastructure sectors where interconnectivity across nodes of a network is critical (in addition to Indian Patents Act's compulsory licencing regime, discussed above), albeit not as a doctrine upheld by Indian courts but rather in the regulatory statutes associated with certain infrastructure goods, in particular in the telecom, electricity and oil and gas sector regulations. The case for the doctrine in India is also compounded by the relative lack of experience of the competition authority in adjudicating such infractions, and the fact that Indian regulators are not independent from the government in the spirit of the term, the latter compromising their ability to be a neutral judge/adviser when a state-owned/operated (monopoly) utility is an offender in an open access case.

That said, the restoration of TRAI's powers to regulate tariffs and arbitrate interconnect issues has given some comfort that *ex ante* intervention by the regulators may still work in the country, albeit in select cases. Analysis of different examples show that while such mandated presence of the EFD can be introduced into the regulations of select industries, it is not an easily replicable exercise. The *ex post* regulation under the competition law is important not only as markets are maturing but also to develop potential new markets. The chapter argues that the CCI should formulate a regulation to provide free access to common facilities under the EFD in order to balance the economic and competitive interests of all the stakeholders, in view of public interest in opening up the market to greater competition.

The *Chapter 5* discusses the regulations for *Microfinance Institutions.* With the Rural Development Ministry raising concerns about the current draft Microfinance Bill adversely affecting the self-help groups' prospects, the much-awaited regulation for the microfinance sector may have hit yet another roadblock. However with the recent clearance from the Cabinet, the already delayed Bill has taken a baby step towards enactment. Going forward, once the Bill is tabled in Parliament, it will have to go to a standing committee for further discussion. The proposed Microfinance Institutions (Development and Regulation) Bill is expected to supersede all state-level regulations, including the controversial Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act, 2010. RBI is proposed to be the regulator for the sector, and a Microfinance Development Council is proposed to be set up to advice the government on formulation of policies, schemes and other measures required in the interest of orderly growth and development of the sector with a view to promote financial inclusion.

As chapter 5 points out, microfinance institutions or MFIs give small loans to low-income borrowers at 24-36 percent interest rates, sourcing money primarily from banks to do business. India has around 800 MFIs, which include firms incorporated as non-banking financial companies, NGOs and trusts, which control 80 percent of the market by volume. As the events unfolding since 2010 proved, the crisis-gripped sector is in urgent need of regulation, in the interest of both protecting the vulnerable small borrower as well as improving the MFIs' efficiency. But, a comprehensive national regulation that promotes both has eluded the country since 2007 due to lack of consensus on critical aspects, including the status of the regulator and the mode of regulating and financing small microlenders.

The analysis of the existing sector regulations in the chapter brings out the lack in present regulatory regimes of product transparency requirements necessary for ensuring fair competition, stringent regulatory requirements for availing priority sector that raises finance costs for MFIs which get passed onto the borrowers, a lack of clarity on central and state regulatory jurisdiction as some of the major limitations of the present MFI regulatory regime needing redressal. The chapter recommends some prudential and non-prudential regulations that the sector would benefit from, identified from the cross-country analysis of best practices, while noting that there is no need for a complete regulatory overhaul in the sector, and a new MFI law should only make changes where the current regulations are lacking.

To that end, the analysis here seems to suggest that the draft MFI Bill seems to meet most of the sector's requirements, despite the concerns raised by different stakeholders, including government departments. However, for MFIs registered under other legal structures, a small minimum capital requirement and easier documentation is required to ensure that these institutions can also meet the proposed regulatory reporting requirements and following uniform disclosure norms provide some minimal basic information to RBI.

Chapter 6 then follows with a discussion on the need for regulatory reforms in India's *Natural Gas* sector. Clearly bringing out the fact that oligopolistic production and monopolistic transmission and distribution systems in the country, created by the Constitution and the sectoral laws, making the sector unattractive to private players, the chapter suggests that the time is ripe for a change in the regulatory governance regime in this key energy sector. It is bold to state that 'the ministry has consistently undermined the PNGRB, and such emasculation needs to be reversed at the earliest' and that 'DGH is a technical wing of the government in the upstream sector'.

Since there are very few players, early framing of 'competition regulation' as well as finalisation of the draft regulation requiring open access in LNG is deemed critical'; also, regulators in the natural gas sector need to follow market determined principles of economic regulation rather than ad hoc principles satisfying the populist motives of the government of the day.

Much of the chapter details the policies that govern the sector in India, and explains the process of gas price determination in the country, looking at the causes of lack of competition. The competition assessment incriminates the high entry barriers in the sector (the large number, about 70, of clearances that are required to establish exploration and production (E&P) business, which is time consuming and delays establishment of assets), lack of adequate pipeline infrastructure and timely information backed with quality data, ending with 'competition in the gas sector is (also) limited by the lack of interconnection in city gas distribution (CGD) networks.

The conclusion is, therefore, rather straightforward: the development of a competitive gas market, would require augmentation of the pipeline network and its interconnection to be taken up on urgent basis, as the creation of a gas market would critically depend on the appropriate infrastructure being available. Tariffs would also need to be market determined to evince private sector interest.

Second, mandatory open access is a precondition to developing a competitive gas market, or even for generating interest in the sector among business houses. Open access implies that economic regulator should ensure that any spare capacity available in the pipeline is offered on a non-discriminatory basis to anyone wishing to use such capacity for transport of gas.

Finally, a case has also been made for an independent upstream regulator, and for expedited resolution of the institutional issues such as overlapping jurisdiction with the CCI and effective coordination with other energy sector regulators. The economic regulator in the gas industry is also empowered to protect the interest of consumers by encouraging fair trade and competition, and regulate access to common carrier or contract carrier facilities. This issue could potentially lead to conflicts between the sectoral regulator and the CCI. The gas sector legislation therefore needs to be amended to make the guidelines and principles laid down in the Competition Act, 2002 binding on the regulator.

Regulations of the Indian *(Residential) Real Estate* sector is the theme of *Chapter 7*, with special focus on the affordable housing issues. It is an important issue, especially given the rapid growth of urbanisation in the country in a scenario where scarcity of land for construction has resulted in a very rapid and unsustainable rise in land valuation. It has been estimated that once easier conversion from agricultural to urban use is permitted (reform of the Non-Agricultural use Clearance or NAC), arguably a difficult regulatory process notwithstanding the provisions of the proposed Land Acquisition, Rehabilitation and Settlement Bill, 2011, land prices can jump twenty-fold. Provision for affordable housing has already become unviable even for the government sector, which is the main reason for many scams that has engulfed the sector.

The chapter gives an overview of the existing regulations and government policies that govern the sector, highlighting the fact that despite the need for multiple regulatory approvals from diverse departments and local regulatory bodies, the sector is not governed by any defined regulatory mechanism that oversees and controls the licensing, registration requirements and conduct of developers or brokers/architects; also, no alternate dispute resolution mechanism or sectoral consumer redressal forums exist for the benefit of the consumers, other than the consumer courts and the country's formal judicial-legal system. Such unregulated growth backed by high demand has bred corruption and builder malpractices are more of a norm than exception.

Thus, there is an urgent need not only for regulatory reform, but an emphasis on institutional & procedural reforms, improving infrastructure services, market transparency and making land accessible for real estate development is necessary to unlock the land value for the community/ country. Also, given that land and urban planning in India is a state subject, the fragmented nature of polity and the strong control of local governments and development bodies call for localised rather than centralised governance.

The chapter analyses the draft Real Estate Bill, 2011 considering it a huge positive step towards creating and bringing about the much needed transparency (through creation of a focal point of governance) and proposing regulations of the housing sector in India. However, it does note that the Bill while aiming to be balanced has ended up being a partial legislation which fails to address the key concerns of a key section of stakeholders, namely the builders/promoters, and in doing so also ill serves the consumers it seeks to protect.

A single window clearance system to cut through the red tape and enable fast tracking of real estate projects has been a long standing demand of the developer community in India has not been found worthy of consideration; this is a significant omission given that project delays are more often than not a result of the inordinate time lag between the application and approval for a particular project, and that delays are often compounded by the multiplicity of uncoordinated government agencies from which such approvals must be taken. In the absence of some manner of consolidation/ harmonisation of the process for approvals, the builders/promoters are right to complain that the Bill will add to the regulatory cost and compliance delay.

The Ministry of Housing and Urban Poverty Alleviation has in the interim formed an internal committee to evolve a workable strategy for reducing the time taken in approval of real estate projects; it is estimated that if the time of granting approval is reduced to six to eight weeks, it could ultimately reduce the cost of houses by 25 to 40 percent. Finally, it is suggested that existing inconsistencies in the provisions of the Bill *vis-à-vis* the other regulations applicable in the sector need to be eliminated.

Chapter 8 on *Retail regulations* also tries to outline the regulatory reforms necessary for the sector to improve its efficiency while ensuring that the small and medium retailers, supplier-manufacturers and farmers don't lose out in the search for productivity. The specificity of this sector is in its encompassing a large number of sectors and economic agents, with divergent capabilities and motives, which make it difficult to carve out a single policy/regulatory regime that benefit all. It is notable that while the unorganised segment of the Indian retail business suffer from low entry barriers, they still face innumerable regulatory impediments emanating from the individual states' requirements of meeting statutory rules on labour, land use and establishment norms, legal metrology and its inspection/ compliance formalities, agricultural sourcing and marketing norms, health related regulations etc.

Given that sometimes more than 30 licences have to be obtained (and renewed at regular intervals) before retail operations can commence, many contend that the sector is overregulated. If entry barriers are further raised for the organised segment of the business, as different states are allowed to have different norms, the malaise of unregulated-unorganised sector and its attendant malpractices will continue. But the predominance of unorganised sector stores makes anticompetitive behaviour like predatory pricing a non-issue in India, a feature that will continue for a long time. However, a rationalisation and harmonisation of the operational barriers and licencing/inspection/certification requirements will benefit both the traditional and organised segments. Also, there exist important areas like health standards and product specifications/labelling requirements where regulations are either lax or missing, which need to be urgently redressed.

The paper finds that given the present regulatory circumstances (esp. physical infrastructure and taxation regimes), current practice of using multiple intermediaries in different jurisdictions is an efficient model of distribution, as despite higher prices the retailers are able to reach out to most consumers in the country. However, if the organised retailers are allowed operational freedom with improved supply chain; reduced policy and regulation induced inter-state barriers; provisions for geographical integration; improved storage and credit infrastructures; the number of intermediaries will automatically reduce by the natural process of consolidation.

It may be noted that protecting the employment and income for the intermediaries have been the prime reason for opposing entry of foreign investment in the sector, albeit at the cost of consumer welfare. Finally, the sector urgently needs a focal body to deal with the various barriers retailers in the country face, which can be either in the form of a single window clearance mechanism or a state level regulator, so long as its primary objective is business facilitation and reduction of bureaucratic red-tapism.

The next *chapter (9)* in the report deals with the *Public Road (Passenger) Transport regulations i*n India. While the railways historically played a dominant role in the overall transport system in India, road transport has now come to occupy a pivotal role. Passenger movement by road is expected to rapidly expand in the years to come, and congestion and environmental consciousness will likely push popular demand of public passenger transport modes which includes mass transit/metros, contract carriages (buses, taxi-cabs, and auto-rickshaws), stage carriages (high capacity buses, mini-buses). Since the bus mode in India is beset with problems arising out of faulty policy and regulatory regimes, instituting an enabling policy environment and a complementary regulatory regime is necessary. The chapter first outlines in brief the post-independence changes in, but transport philosophy, pointing out that it is only in the nineties that the sector was liberalised.

The contemporary bus transport regulations are mainly governed by the Motor Vehicles Act, 1988 and various state specific regulations. Entry is controlled through permits, which in turn affects competitiveness. Fare regulations are a norm, with the State Transport Authorities making changes at the behest of the state governments, and inevitably follow political compulsions of the ruling parties. It must also be noted by many of the SRTUs (under the guise of special provisions) have become insensitive to the needs of users' – their primary clients – as result of which any private sector provision despite all its weaknesses has been accepted as a reasonable alternative to the SRTU. The reversal in the policy direction since the nineties encouraged greater reliance on private sector provision by liberalising market entry in all market segments, and while the market has managed to circumvent the restrictive regulatory policies resulting in a more flexible transport system responsive to the specific needs of the passengers, this has been achieved at the expense of 'so- called' public regulation, and also to some extent at the cost of meeting minimum international service quality (safety and environment) standards.

The chapter points out that in the bus transport segment, there is complete arbitrariness in issue of permits, especially in regard to the need for additional capacity. Even when it comes to competitive bid franchising, the concerned authorities have hardly any idea as to what the service needs are. Accordingly, the need arises for a planning and specialist regulatory agency that has the expertise and skills to examine these issues with the implementation being left to the administrative authorities. In the Indian context, there is an urgent need for a National Transport Commission which besides reviewing India's transport priorities and policies within an integrated framework on a continual basis, could also monitor economic regulation and thereby promote competition.

With a view to creating a market in which passenger services of various types and size, compete with each other, unassisted, policymakers in India should be concerned with putting in place a proper regulatory environment. In particular: (i) regulations that internalise social costs, such as those related to the environment, safety and congestion, so that the market can allocate resources in a socially desirable way; and (ii) regulations that establish basic rules for fair competition should be developed and implemented. The main focus of regulatory policies in the case of bus services should be qualitative standards related to ensuring the safety of the services and the minimisation of negative environmental impacts. Unfortunately, in India these beneficial regulatory dimensions are also not generally enforced for the same reasons that economic regulations are not generally enforced, i.e. transport operators generally find it more advantageous to make 'facilitation payments' to the transport authorities.

The final chapter, *Chapter 10* deals with *Telecom sector regulations*. The sector has been in news for much of the past 30 months, in the aftermath of the 2G spectrum allocation missteps. The chapter points out that Indian telecom sector was liberalised in the 1990s, and the need for independent regulation arose with the entry of private players. On an average, there are around 10 operators in a license region (or circle) competing for the same customers, though the majority of the market is split among the five/six largest among them. Consequently, Indian mobile telephony market is characterised by fierce retail price competition. Also, to fulfil the commitments made when India joined the World Trade Organisation (WTO) in 1995, the Telecom Regulatory Authority of India (TRAI) was established in 1997 to regulate telecom services including fixation/revision of tariffs.

The focus of Indian telecom regulation is on ensuring efficient and adequate competition in the retail end of the market. However, the government's priority on competition may lead to inefficient allocation of resources, as efficient spectrum usage is subject to increasing returns to scale. This chapter discusses some important market and regulatory inefficiencies in India, focusing on three sources of inefficiency related to: (1) the allocation of licenses, spectrum rights and scale economies; (2) distortions associated with the fee and taxation system; and (3) lack of transparency and credibility in telecommunication policy, and suggests reforms and policies to remedy these inefficiencies.

The chapter argues that the most efficient way to allocate new licences is to have open auctions, as long as the number of licenses offered is not so large that it hinders trunking efficiency. Auctioning licences will lead to more efficient spectrum allocation across firms. In addition, the economic rent associated with the spectrum will be allocated to the government. Furthermore, today's system with administrative discretion gives rise to opportunistic behaviour like rent seeking and corruption, with the risk that huge values are extracted by those who manage to get access to this valuable resource. In fact, the industry appears to be too fragmented and suffers from regulation-induced inefficiencies to survive in its current form.

Alternatively, one may use a system of license allocation that is enforceable and not prone to manipulation. For this to work smoothly, licence fees should be uniform. If firms only pay for spectrum through the licence fee, the fee should approximate the economic value of spectrum, to avoid market fragmentation. In particular, license fees should be sufficiently high and the number of firms sufficiently low so that trunking efficiency is obtained.

Finally, it has been argued that transparency and credibility are key for efficient allocation of resources in the telecommunications sector. It is proposed that: (1) the Ministry of Finance or the Parliament should be in charge of the fee/taxation system, (2) telecom specific taxation should be abolished in favour of a more general corporate tax system (the economic value of the spectrum should instead be obtained by auctioning spectrum licences), and (3) the sector should be governed by rules and regulations rather than discretionary actions of government officials.

In conclusion, the common themes on India's regulatory situation that have been highlighted in the various chapters of this report are as:

1. Open access is an important requirement for many of the infrastructure sector regulatory systems to improve operational efficiency and for promoting competition
2. There is a clear call for reducing the administrative and political interference in regulators' work – interference by government functionaries/ministries and their political masters continue to emasculate many a regulator, and has made their role irrelevant
3. Institutional issues such as overlapping jurisdiction with the CCI, and effective coordination with other regulators should be addressed for the regulators to function as per their mandates
4. Transparent and simple regulations (and/or reduction of regulatory complexities) that establish basic rules for fair competition should be developed and implemented

Based on the survey findings and the research in the report, one can conclude that while the perception of competition and regulation in the country is rising and favourable, stakeholders and analysts are clear in their requirement of regulatory reforms, insofar as the reforms improve regulatory quality, that is, enhance the performance and effectiveness of regulations and related government formalities, as well as the regulatory governance system.

The latter, in particular, is required to be less arbitrary and have more transparency in decision making, if India is to benefit from the philosophy of regulatory governance and sustain its growth prospects. The significance of proper governance and appropriate regulatory interventions in boosting growth cannot be more underlined at a time when India's growth prospects are fading spectacularly in the light of poor governance, policy paralysis and populist grandstanding by the polity. The vote appears to be clearly in favour of designing appropriate regulations, depending on the state of development of the sector concerned, and their proper implementation rather than favouring either heavy-handed regulation or deregulation.

Endnotes

1 Some types of government policy interventions, such as taxes, subsidies, bailouts, wage and price controls, and regulations, including attempts to correct market failure, may lead to an inefficient allocation of resources, sometimes referred to as government failure. Following Weimer and Vining we'd like to highlight the distinction between "passive government failure," where government *inaction* results in Pareto inferior outcomes, and "active government failure," where government *action* results in outcomes worse than if government had done nothing. Source: Weimer, David L. and Aidan R. Vining, 2004, *Policy Analysis: Concepts and Practice*. Fourth edition. Upper Saddle River, NJ : Pearson Prentice Hall.

2 Lewis, William W., 2005, "Power of Productivity: Wealth, Poverty and the Threat to Global Stability," University of Chicago Press.

3 www.oecd.org/competition/toolkit

4 Market failure is the standard justification for government intervention in neoclassical welfare economics. Market failure is said to occur when free markets do not bring about economic efficiency, that is to say when a Pareto sub-optimal allocation of resources exists in a particular economy or sector; it is often associated with information asymmetries, non-competitive markets, principal–agent problems, externalities, or public goods. However, when the assumptions for efficiency in market processes (i.e. perfect competition, appropriate incentives and accurate information) are missing, we often

find markets producing sub-optimal solutions, or markets fail. In India since 1990s, government interventions in most cases have been aimed at boosting efficiency and optimal allocation of resources by use of regulations intended to introduce competition to either eliminate the earlier market distortions in the public-sector monopolies (excess market power or correcting for earlier government failures) or creating conditions of proper market functioning in the new economic sectors (lack of market). In that sense, while government interventions in India today are aimed at preempting market failures, the latter is not always of the kind commonly understood in standard neo-classical literature.

5 Regulation may be broadly understood as an effort by the state 'to address social risk, market failure or equity concerns through rule-based direction of social and individual action.' Economists regard economic regulation by the state as necessary only when a natural monopoly exists, or where a dominant player abuses monopoly power or to overcome some other form of market failure. States also generally use economic regulation in a broader context to achieve a range of non-market public policy objectives which include ensuring universal and equitable access, consumer protection and maintaining safety and health standards.

6 The competition agency in India, the Competition Commission of India (CCI), started functioning in 2009 under the Competition Act of 2002 (CA, 02). As of 2011, it has 117 cases pending before it. It is facing jurisdictional challenges from key sector regulators.

7 The problem of conflicts resulting from regulatory overlap is however not specific to India. A majority of countries have adopted an institutional approach to this problem. There are three main approaches: (i) primacy to the competition agency, (ii) primacy to the sector regulator, (iii) concurrent jurisdiction to be shared by both. Of these, the Planning Commission in 2006 has recommended that the best approach for India is a type of a concurrent framework, which involves continuous mutual mandatory cooperation/consultations between sector regulators and competition authorities.

8 Dubash, Navroz, 2008,"Institutional Transplant as Political Opportunity: The Practice and Politics of Indian Electricity Regulation", CLPE Research Paper No. 31/2008, 04(06).

9 The stress on long-term efficiency mirrors a common assumption among economists that "dynamic" efficiency, or efficiency over time in innovation as well as in resource allocation, is critical for an economy's growth. Economists agree that dynamic efficiency is best achieved through increased competition, which can in turn be boosted by designing appropriate regulations. The long-term benefits of competition are an article of faith among most supporters of deregulation. Establishing a regulatory regime that has minimum government intervention (light hand of government) but encourages and promotes free and fair competition is thus deemed as key for sustaining dynamic efficiency in an economic sector; guessing which companies will use resources most efficiently in the long-run is no simple task.

10 For a general discussion on theoretical and practical aspects of operating principles of sector regulation, see Sappington, David, 1994, "Principles of Regulatory Policy Design", World Bank Policy Research Working Paper No. 1239, January.

11 One study found that while around 5 new regulators were created worldwide each year in the 1960s through the 1980s, this rose around four times in the next two decades, reaching a peak of 40 new agencies each year between 1994 and 1996.

12 Ninan, T. N., 2012, "Made to IAS order", Business Standard Opinion, May 05, New Delhi.

13 The Electricity Act is the only statute that mentions the competence of the sector regulator to check anticompetitive practices. This reflects an inherent discrepancy in the drafting of the legislation and incoherence in law-making. In view of the fact that when the legislators had acknowledged the need for a specialised competition agency to deal with anticompetitive practices in the TRAI Act, which is older than the Electricity Act, one wonders if political economy concerns was the reason why the electricity regulator was empowered to deal with anti-competitive practices subsequently. Especially since, the recent Airport Economic Regulatory Authority (AERA) Act has kept matters pertaining competition with the Competition Act and outside the purview of the AERA Act.

14 Mehta, Pradeep S, 2012, "**Untangling Regulatory Overlaps", Financial Express,** June 19.

15 Cantillon, Estelle and Patrick Legros, 2007, "The Nobel Prize: What is mechanism design and why does it matter for policy-making?", VoxEU, 18 October.

16 www.cuts-ccier.org/icrr/icrr.htm

17 www.cuts-ccier.org/icrr09/pdf/Competition-Regulation-India-CurtainRaiser09.pdf

18 www.cuts-ccier.org/icrr09/pdf/Report-Competition_and_Regulation_in_India_2009.pdf

19 The CI is an aggregated index, the weighted average of stakeholder-wise CPI or the Competition Perception Indices for the of the six identified stakeholder sub-categories, namely, policymakers, government officials, civil society, academia, media, sector/subject experts and business professionals for the survey queries on the state of regulation and competition in India. A value 1 implies that the stakeholders' perception of competition and regulation in India is near zero, and there is a very low level of awareness. A value 100 indicates perfect awareness, as well as perceptions of high level of competition and an excellent regulatory system in the country.

Chapter 2

Perception and Awareness Reporting

Introduction

This chapter reports on findings from a random sample perception survey of informed stakeholders conducted between February-August 2011, soliciting their views on the prevailing regulatory regime and status of competition enforcement in India, particularly in selected economic sectors, namely, micro-finance institutions (MFIs), natural gas, real estate (residential), retail distribution, road (passenger) transport and telecommunications. The questions were also designed to assess popular perceptions about the level of competition and efficacy of regulatory practices in the country, particularly in key sectors like the pharmaceuticals, finance, manufacturing competitiveness, etc.

This chapter presents information on awareness of economic and regulatory policy proposals in the country, analysing the findings from an inter-temporal as well as their inter-sectoral perspectives, wherever feasible. It may be recalled that the present report on India's Competition and Regulation systems is the third in the cycle of biennial reports by the same name, the earlier two reports having been published in 2007 and 2009.

The survey findings were also used to compute the India Competition Perception Index devised by CUTS to measure the state of play in competition and regulation in India. The index tries to gauge the understanding of the informed stakeholders on the prevalent competition and regulation scenario in the country, returning an overall index as well as indices for the Competition Perception of the six identified stakeholder sub-categories, namely, policymakers, government officials, civil society, academia, media, sector/subject experts and business professionals.

In a similar exercise, the Legatum Institute Survey of Entrepreneurs in India, entitled 'INDIA 2011',[1] reported findings on the governance practices in India that are insightful as well as comparable. Their 2011 survey of around 2000 business people highlights popular concerns about increasing corruption and poor governance (it still takes on an average a month to start a business in India, according to the World Bank, Doing Business 2011 report), despite the general optimism about the economic opportunities in this country. Most worryingly for Indian business, 80 percent of entrepreneurs in the Legatum Institute survey stated that overall corruption is getting worse.

When asked to describe in their own words the types of problems that entrepreneurs think are caused by corruption, there was a wide range of responses. The frequently cited problems are "having to pay bribes to obtain licences" and "delayed and uncertain (business) progress/ policies/regulatory regime". While the survey also tried to gauge the popular perception about the (rent-seeking) motivations and the uncertainty and irregular implementation of government policies and regulations, the focus of the survey was firmly on assessing the stakeholders' perceptions on select aspects of the competition and regulatory regime in the country.

Research Methodology

The statistical analysis is based on the data/inputs gathered from administering structured questionnaires to a random stratified sample of the Indian populace. This primary stakeholder/consumer survey was conducted (with the help of regional survey partner institutes and their dedicated teams) covering 11 states in the country, representing the varied geographical regions of India.[2] Southern India is represented by Andhra Pradesh, Karnataka and Tamil Nadu, the east by Bihar, Orissa and West Bengal, the north by NCR and Uttar Pradesh, the west by Maharashtra and Gujarat and the centre by Madhya Pradesh. The wider geographical coverage ensures representation from a diverse group of respondents and also identifies (if there exist) the divergences in the awareness and opinion of different (socio-cultural) respondent groups in states/regions far removed from New Delhi, the seat of central regulation and policy-making.

The method of sampling used is random stratified sampling. This method was chosen specifically since it often improves the representation of the sample by reducing sampling errors. The total sample size considered in the survey is 984. Representation of samples (size) does not much depend on the population size, which is counter-intuitive to many. Most polling companies use 400 or 1000 people in their samples. The reason for this is that a sample size of 400 gives a confidence interval of +/-5 percent 19 times out of 20 (95 percent), whereas a sample size of 1000 leads to a confidence interval of +/-3 percent 19 times out of 20 (95 percent). The target of sample size was 1000 and could achieve 984.

The survey administered two different types of questionnaires: one for the business persons and sectoral experts and the other for the general consumers. The questionnaires, in turn, each consist of two parts: the first part seeks general information and the second part is aimed at eliciting sector-specific information. The survey was conducted through personal interviews with the stakeholders in different categories.

Out of the total 984 respondents, 443 are in the business/experts category and 541 belong to the general category. The data/information was pooled and answers to questions under each head were converted into normalised numerical scores to facilitate application of statistical tools. Similar queries in the two sets of questionnaires (business and general) were analysed in an aggregated manner. The perceptions for specific sectoral issues were only collected through the business questionnaire by interviewing the business stakeholders, sectoral experts and policymakers and has been analysed separately.

Composition of Survey Respondents

The composition of stakeholders participating in the survey is presented in Table 2.1. The Table also provides a comparative picture of the stakeholder composition in the earlier surveys. It should be noted that, in 2011, the share of experts and business persons in the sample is higher than the earlier years, which, however, is somewhat compensated by the lower share of academia, compared to the share reported in earlier years.

Table 2.1: Comparative Status of the Stakeholders' Participation
(figures in brackets indicate percentage shares)

Stakeholder's by Group	2011	2008	2006
Policymakers/ Government Officials	108 (11)	99 (20)	94 (14)
Civil Society	148 (15)	78 (16)	137 (21)
Academia	115 (12)	118 (24)	126 (19)
Media	55 (6)	54 (11)	59 (9)
Other Experts/Practitioners	221 (22)	150 (30)	83 (13)
Business	337 (34)	-	160 (24)
Total	984 (100)	499 (100)	659 (100)

Source: Computed from the data collected from the CIRC CUTS Perception Surveys of 2006, 2008 and 2011

State-wise data on stakeholder participation is given in the Table 2.2. This detailed data breakup is, however, available only for 2011.

Table 2.2: State-wise Stakeholder Participation (2011)
(figures in brackets indicate percentage shares)

	Government Officials	Civil Society Organisations	Academia	Media	Other Experts/ Practitioners	Business	Total
A.P.	2 (2)	7 (8)	18 (22)	15 (18)	24 (29)	17 (20)	83
Bihar	7 (7)	14 (14)	12 (12)	0 (0)	23 (23)	44 (44)	100
Gujarat	2 (5)	4 (11)	22 (58)	3 (8)	0 (0)	7 (18)	38
Karnataka	26 (24)	6 (5)	8 (7)	2 (2)	11 (10)	57 (52)	110
Maharashtra	6 (5)	6 (5)	29 (26)	16 (14)	20 (18)	36 (32)	113
M.P.	12 (12)	28 (28)	9 (9)	0 (0)	11 (11)	40 (40)	100
NCR	16 (21)	14 (18)	16 (21)	2 (3)	7 (9)	21 (28)	76
Orissa	21 (23)	8 (9)	28 (30)	8 (9)	8 (9)	20 (22)	93
T.N.	4 (3)	18 (15)	19 (16)	5 (4)	50 (42)	23 (19)	119
U.P.	11 (11)	29 (28)	11 (11)	3 (3)	1 (1)	48 (47)	103
West Bengal	1 (2)	14 (29)	6 (12)	1 (2)	3 (6)	24 (49)	49
Total	108 (11)	148 (15)	178 (18)	55 (6)	158 (16)	337 (34)	984 (100)

Source: Computed from the data collected from the CIRC-CUTS Perception Survey, 2011.

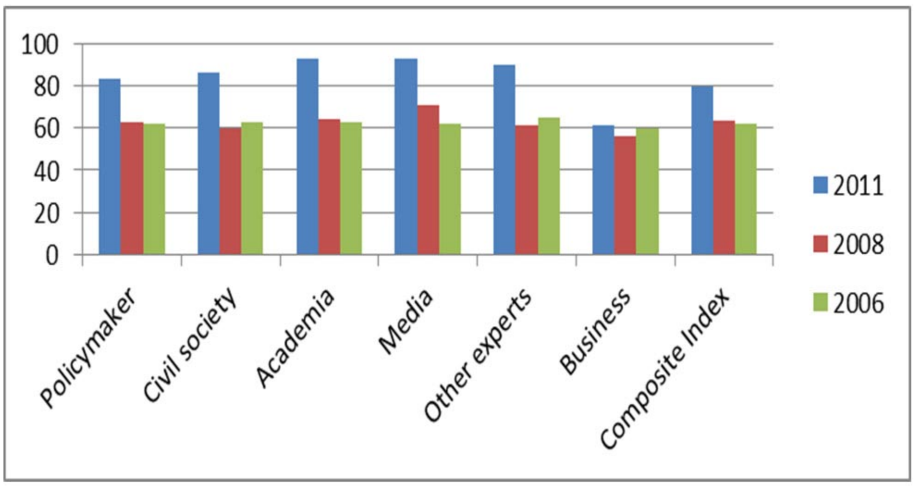
Analysis of Survey Findings/Results

A striking difference noticed in the current survey results, as compared to those in 2006 and 2008, is that the perception and awareness on the competition issues/market structures and the regulatory regime in the country seem to have increased significantly. The awareness index of the perception on the level of competition in the country in different product categories (see Figure 2.1 and Table 2.3 for details) has recorded ‘substantially all’ levels in 2011, scoring an average 85 percent plus for almost all stakeholder groups, except for the business group, the latter surprisingly indicating that the level of competition in selected products in the country leaves a lot of room for improvement.

Over one-third of the business stakeholders interviewed feel that there are not enough choices in the market in key consumer products like watches, fans, refrigerators, motor cycles and computers, which is in stark contrast with the hugely positive perception recorded by the other respondents. This divergence in perception between the producer and consumer needs to be reconciled.

However, as can be seen from Figure 2.1, the inter-temporal results are heartening, insofar as we can observe a clear improvement over the years in the competition perception index of both the individual stakeholder groups as well as the composite index, which is a weighted average of stakeholder-wise CPI (returning 79.3 in 2011 as compared to 63.7 in 2008), possibly indicating that the Indian market over the years has seen increased competition (and is profitably supporting higher competition) in most consumer product groups (and not merely the much-in-news mobile telephony services); one could further surmise that the stakeholders have been benefitting from the change and that has generated a virtuous cycle in the system and regional communities, which is now gathering pace.[3]

Figure 2.1: Competition Perception Index (CPI)
(inter-temporal comparison of perceptions on level of competition in the country)



Source: Computed from the data collected from the CIRC CUTS Perception Surveys of 2006, 2008 and 2011

Furthermore, the questionnaires were structured to get feedback from the respondents on their awareness and knowledge of: (a) the regulatory and competition issues in general, like impact of monopoly, role of a regulator, regulatory independence, quality of regulation, etc; (b) nature of business practices prevailing in the market and their impact; and (c) nature and impact of government policies and regulatory measures.

On the first set of questions, namely, awareness and general knowledge of the regulatory and competition issues, stakeholders were found to be uncertain about the effectiveness of current government policies on competition and regulation issues. Around 27 percent of the stakeholders overall were unclear about the effectiveness of the existing policies, whereas 35 percent of the stakeholders were of the view that the government is not fully equipped to investigate the anticompetitive or monopoly actions of the supplier/marketer. However, nearly 4/5th of the respondents agreed that the existing mechanisms in the country were effective in addressing the bad effects of cartelisation.

Table 2.3: Product and Stakeholder-wise Competition Perception, 2011

(percentage of positive responses to 'some or enough competition' in selected product categories)

	Policymaker/ Government	Civil Society	Academia	Media	Other Experts	Business
FMCG	84	85	94	93	94	59
Car	91	92	88	96	91	62
Coffee/Tea	77	85	94	93	94	59
Watches	79	86	94	91	87	41
Fan	80	88	95	89	88	45
Refrigerator	89	90	95	91	92	54
Washing Machine	86	88	94	96	93	72
TV	85	86	92	96	91	64
AC/Cooler	87	87	91	96	92	64
Computer	81	84	91	91	86	54
Mobile	83	82	94	95	95	78
Bicycle	87	84	95	98	96	82
Motor Cycle	74	80	86	89	78	54
Composite Share	83	86	93	93	90	61

Source: Computed from the data collected from the CIRC CUTS Perception Survey, 2011

Awareness of stakeholders and respondents on existence of regulators increased reasonably to around 70 percent in 2011, as opposed to 58 percent in 2008 and 55 percent in 2006. Furthermore, around 3/4th of the respondents were confident that national independent regulators are able to effectively enforce their orders even at the local levels. While around 78 percent of the respondents had some views on the role of a regulator, only a third of the total group of respondents reported ever attending any of the stakeholder meetings organised by the regulators. This is clearly an indication of the failure of the government and civil society outreach while formulating regulatory policies/ principles and needs redressing.

An illustrative finding was in the views of respondents on the role of a regulator, the details of which can be seen in Table 2.4. As can be observed, 39 percent of the total respondents and the majority of the non-business respondents feel that the role of the regulator is to facilitate business arrangements, while only 29 percent agreed that the regulator's role is to develop and implement rules that create a competitive environment in the market. In a country where the regulators often are appointed from among the retired government officials in line ministries and in certain sectors, the ministry directly controls regulatory organisations. This can easily be interpreted as an allegation of corruption and rent-seeking on the part of the regulators and an emerging unholy nexus between the regulators and the regulated in the new regulatory regime.

Table 2.4: Stakeholder Perceptions on the Role of a Regulator
(figures in brackets indicate percentage shares)

	Policymaker/ Government officials	Business	Sectoral Experts/ Practitioners	Academia	Media	Total
Can't say/ don't know	28	20	61	38	11	158 (19)
To facilitate business arrangements	39	62	105	77	44	327 (39)
To implement the Competition Law	11	78	18	0	0	107 (13)
To develop and implement rules that create a competitive environment in the market	27	175	35	0	0	237 (29)

Source: Computed from the data collected from the CIRC CUTS Perception Survey, 2011

Answering queries on the attributes of the quality of regulation (QoR), namely, independence, accountability transparency and integrity, around 36-40 percent of the respondents said that they do not perceive 'independence' of the regulator or the 'quality of regulatory personnel' as important elements in improving the QoR in the country; respondents agreeing to very important on these two measures are 44 and 46 percent, respectively. While it is not possible to draw any conclusive inference from the survey on the subject, it is interesting to note that an equal share of the respondents in all stakeholder categories, around 30 percent overall, felt that reducing political interference is the most important requirement for improving the QoR in the country. Overall, the respondents seem to think that the QoR in the country is poor to satisfactory (respondents were required to rank the QoR on a scale of 5, very poor, poor, satisfactory, good and excellent, with the last getting the highest score).

On the issues of *sinecure*, or the appointment of retired/retiring bureaucrats and judges as regulators, around 55 percent of the respondents were of the view that such a practice precludes the appointment of professionals and also undermines the regulatory effectiveness. Not surprisingly, only 41.5 percent of the policymakers/ government officials interviewed felt thus, whereas 55-62 percent of the academia, other experts and sector professionals and experts from media responded that way.

However, on the effect of ministerial/political interference and administered/directed pricing/fee structures on effective regulatory functioning, the stakeholders seem undecided and unsure whether such interference is detrimental to the functioning of the independent regulator and seem to suggest that sometimes this practice actually does help the regulator in discharging its duties and in developing the sector.

Awareness of the respondents on the nature of business practices prevailing in the market and their impact appear to be in the range of moderate to high, though the motivation of the established business practices is almost always viewed with scepticism. The concern (negative fallouts) of market dominance in key sectors is high on the awareness levels of the Indian consumers, though the business sub-group highlighted the presence of anticompetitive practices that they face in the up-stream sectors while purchasing raw-materials and intermediate inputs. Thus, this matter needs to be looked into from the perspective of both the groups and remedial policy/regulations devised carefully as it affects the final price paid by both consumers and producers.

Awareness of stakeholders on the motivation, nature and impact of government policies and regulatory measures seems high too and around 49 percent of the respondents agree that government laws/regulations designed to address public safety and environmental concerns are justified and help to ensures compliance. Around 63 percent of the stakeholders said government intervention is needed for controlling the prices of all essential drugs, 42 percent of the stakeholders believed that government's intervention in price-fixing with regard to selected patented products is necessary to protect consumers' interest and government intervention in price-fixing for essential commodities was considered imperative by 40 percent of the stakeholders.

On Public Sector Undertaking (PSU) preferences in government procurement, around 33 percent of the stakeholders in each category agreed 'PSUs should not get any special protection' and 'such preferences lead to creating an uneven playing field in the market'.

State of Awareness and Perception on Sector-specific Competition and Regulatory Issues

In addition, awareness and perceptions on specific sectoral issues were collected through the business questionnaire by interviewing business stakeholders, sectoral experts and policymakers. This section discusses the findings of that exercise. More than 73 percent of the stakeholders were of the view that prohibiting cheap imports is important to prevent undermining of the product standards in the country and that competitor countries adopt unfair production practices at home, which create distortions in the Indian market.

To regulate these unfair practices, 50 percent stakeholders approve of strict monitoring of imports quality through spot tests of products being sold/at the customs terminal. Moreover, around 48 percent (22 percent said important and 26 percent said this is very important) of the stakeholders were of the view that there should be a national regulatory body to monitor the quality of the foreign products sold in the domestic market, though around 42 percent of the stakeholders (mainly from the business subgroup) disagreed with this suggestion of more stringent checks and regulatory oversight.

Notably, a similar 42 percent (30 percent said very important and 12 percent said important) respondents said that it's the innovativeness in product design and unique competitiveness in price through better marketing strategy that can effectively mitigate the imported competition distortion as discussed above. However, around 61 percent of the stakeholders agreed that using safeguard measures to protect the domestic producers as well as managing the imported competition distortion is an effective and sustainable practice.

On **Micro Finance Institutions (MFI),** the majority of the stakeholders (68 percent) were of the opinion that the sector in India needs to be regulated. More than 57 percent of the stakeholders agreed that the sector/consumers suffer because of the coercive practices and high interest rates charged by the creditors. But, to control the on-going problem of over-borrowing and unsustainable debt of MFIs (as MFIs in

India give multiple loans to borrowers), majority of the respondents (63.7 percent) suggested that the creditor should conduct an ability to pay test (a.k.a the know your customer or KYC exercise) before extending multiple loans. This seems to suggest that the industry stakeholders as well as the policymakers need to understand the nature of functioning of the MFIs and appreciate the continued need for such a financial intermediation in the country.

On the **Natural Gas** regulations however, it appears that the respondents' perceptions and awareness of the existing regulations relating to gas supply infrastructure and pricing is not adequate, including on major issues related to the natural gas supplies, namely, open access to pipeline infrastructure, distribution and supply and supply agreements. A possible reason for this could be that since gas prices are still regulated in the country and the supply is deemed to be a largely government policy exercise (all the natural gas companies being PSUs), there is little interest in understanding its ramifications even among the otherwise aware business community.

The lack of private sector participation in the sector was deemed to be a function of tariff regulations (especially LPG/residential city gas subsidies) and lack of a level playing field *vis-à-vis* the PSUs (including the extant market dominance of the PSU players). However, around 46 percent of the respondents suggested that partnership with supplying nations could be a better strategy for infrastructure development, whereas around 67 percent of the respondents opined that long-term supply agreements may be help in a better way in this regards.

In the **Real Estate sector,** a majority of the respondents (around 52 percent) agreed that the existing regulations in the real estate sector are not very effective in addressing the competition concerns and regulation needs of the sector. In fact, 63.2 percent of the respondents are of the view that the regulatory requirements, especially multiplicity of regulation and lack of consistency among regulations in different states, are the main obstacles for growth of this sector. According to 54.9 percent of the respondents, a strong regulation policy (as proposed under the Model Real Estate Management Bill) and its proper implementation and enforcement will help improve the quality of the governance and reduce corruption in the sector.

The **Retail Distribution** sector also is deemed to be suffering from onerous licencing requirements. Nearly 55 percent of the respondents were of the view that the licencing requirements for the domestic market operations have restricted competition, thus reducing consumer choice and inflating final prices. The respondents were also asked if they feel that reduction in the number of intermediaries would be best facilitated by:

(1) better infrastructure for improved physical connectivity;
(2) integration of supply-chain by encouraging organised retail; and
(3) remove the cross-border barriers for more efficient pan-national sourcing.

In each option, the respondents were asked to rank the efficacy of the choice. The results indicate that physical infrastructure is seen to be the most limiting factor and is also the prime cause for fragmentation of the market/distribution chain. Thus, it is not surprising that reform therein was considered to be a highly effective method of addressing the problems that emanate from the multiplicity of intermediaries in the distribution/supply chain.

Finally, the respondents were asked to rate how the problems of the small retailers and consumers can be addressed most efficiently. The majority of the respondents seem to think that a structured two-stage regulatory system will be of most use, though a large number (differing by 14 percentage points) feel that elimination of malpractices and timely planning will sufficiently help in resolving the small retailer/consumer woes.

Also, an overwhelming majority of respondents (more than 56 percent) agreed that the relaxation of foreign direct investment (FDI) cap in retail so far (51 percent FDI in single-brand retailing and 100 percent FDI in cash-and-carry) has been beneficial for the consumers, insofar as the choices available have increased significantly, thus forcing product and service quality upgradation from domestic mom and pop retailers.

In the **Road/Highway Transport (passenger)** regulations, an important finding from the survey is that the myth that the exclusive rights given in concession agreements to concessionaire in this sector is damaging, i.e. creating the possibility of abuse of dominance has been disproved. Around 38 percent of respondents said that the exclusive rights given in concession agreements are not relevant from any abuse of dominance perspective, while around 26 percent of the respondents explicitly state that it is not damaging. Similarly, around 63 percent of the respondents disagree that road tolls may cause potential abuse of authority by the concessionaire.

Most significantly, 56 percent of the respondents agree that the present regulations do not adequately promote competition in this sector while addressing the demand for road infrastructure and the absence of an independent regulator for the sector is a serious limitation.

Last, responses on the queries on **Telecommunication Services** regulations and regulatory practice also break some preconceived notions. Despite the multiple problems with the spectrum sharing and distribution in the country, 70 percent of the respondents seem to either not have any concerns or do not agree that the prequalification processes and requirements for bidding for licences are in any way restrictive. Furthermore, contrary to popular perception, approximately 37 percent of the stakeholders were of the view that the functional and financial performance of the Telecom Regulatory Authority of India (TRAI) has not deteriorated over time.

Surprisingly, the analysis revealed that 38 percent of the stakeholders did not consider the efficiency of regulatory bodies as a factor contributing to the growth of the sector. The survey also tried to capture the views of the stakeholders on the slow pace of growth of the broadband services. There was no significant trend found, though around 39 percent of the respondents opined that both technology and regulations are equally important for growth of the sector. And finally, a majority of the stakeholders (47.4 percent) agreed that mandatory infrastructure sharing with private entities will facilitate competition as well as reduce costs for the telcos.

Conclusion and Key Messages

The survey of 2011 definitively establishes that the public awareness of competition and regulatory policies in the country has been on the rise and is picking up pace since the last couple of years. Not only did the CPI improve significantly over the previous years, as the analysis above shows, the improvement was observed across the stakeholder groups surveyed. Like in the previous years, however, the business group seem less enthusiastic about the level of competition in the country in key products and services when compared with the rest of the populace.

Over one-third of the business stakeholders interviewed feel that there are not enough choices in the market in key consumer products and this divergence in perception between the producers and consumers needs to be reconciled. While definitive and reasoned explanations can come only from a dedicated and more detailed survey of the business community in the country, the analysis focusing on why they feel more competition is needed, especially when the consumers feel they have enough choice. Pending such an exercise, an intuitive explanation is offered by the fact that the growing Indian economy and consumer market seem to be offering opportunities for more and more players, at multiple levels of product and service sophistication, which the business community wishes to exploit.

Concerns of over-competition in the market (as may arise as in the case of Indian telecom market) however affect businesses more than the consumers/policymakers and as such the policymakers should simply let the market forces play its role and the individual product/service markets find their equilibrium.

It is also heartening to note that perceptions and awareness of the sectoral policies and regulations in the country are on the rise. The questionnaire was designed to assess whether the respondents also understand the ramifications of an issue and can work out solutions to the problem. It is a pleasure to report that the community of informed stakeholders that the Indian government may wish to engage in is not only becoming more aware but is also actively considering the possible solutions to important concerns facing the emerging competition and regulatory ecosystem in the country.

Endnotes

1 www.li.com/attachments/EntrepreneursIndia2011.pdf, accessed on November 01, 2011.

2 Due to logistical and institutional limitations, the north-eastern part of the country could not be covered in the survey

3 An important disclaimer here is that the targeted respondents of the 2011 survey do not completely match the respondents in the earlier surveys. This implies that the awareness on competition and regulations in the country is genuinely increasing, precluding the possible criticism of any 'inbuilt selection bias' in that the PS was interviewing a minority 'already aware' group and hence the survey results/CPI are contrived

Chapter 3

Is India's Regulatory System Bust?*

Introduction

The recently debated scam on the allocation of 122 2G spectrum licences has fuelled a discussion on whether it reflects collective failure of India's regulatory processes and whether the level of governance in India is inadequate. It has raised concerns about India's regulatory structure and its practices, with particular reference to lack of independence of regulators, their autonomy and accountability, which is not confined to the telecommunications sector. The head of the Atomic Energy Regulatory Board (AERB), the independent regulator for the nuclear power sector in India, reports to the Secretary of the Atomic Energy Research Commission (AERC). This is an example of regulatory failure.

A similar arrangement has been criticised in Canada when Linda Keen, Former President and CEO of the Canadian Nuclear Safety Commission (CNSC), was fired in January 2008 after closing down a nuclear reactor for safety reasons. It has been widely condemned by civil societies as a case of direct political interference of an arm's length, independent regulator of a potentially hazardous industry. Yet, not much attention has been given in India to similar political encroachment on the independence of sector regulators.

There is anecdotal evidence that corruption is rife in most industries that interact with the government, especially those that require licences, access to natural resources or changes in the law. For example, not so long ago, the Oil Ministry asserted itself into a private arrangement and insisted on rewriting a contract that delayed last year's US$9.6bn deal between London-listed Vedanta and UK-based Cairn for Indian Oil fields. The quality of regulation suffers, as a result.

* This chapter is based on a paper contributed by Sunil Jain, Opinion Editor, *The Financial Express*, CUTS International (CCIER) Research Project on *Quality of Regulation*, 2010; and media reports

Unfortunately, the still-rapid growth in most of the regulated sectors, telecom being the oft-cited example these days of high performance in spite of bad regulation, makes it difficult to make a definitive case either for India's regulation working well or of regulation being completely subject to regulatory capture. It is argued that the high revenue collection in the auctions for 3G and BWA licences and the continued investor interest and faith of both foreign and domestic companies in the Indian markets (proved by the high profile M&As and takeovers in selected sectors) can not be indicative of poor regulatory practices or even existing regulations being detrimental to the growth prospects of the sector/economy.

The findings of a perception survey of informed stakeholders (policymakers, business persons, practitioners, academics and media persons) conducted between February-August 2011 across 11 states by CUTS under this project reveals that, contrary to the popular perception, approximately 37 percent of the stakeholders felt that the functional and financial performance of the telecom regulatory authority has not deteriorated over time. Despite multiple problems with the spectrum-sharing and distribution in the country, 70 percent of -the respondents seem to either not have any concerns or do not agree that the prequalification processes and requirements for bidding for licences are in any way restrictive.

Regardless, a proper analysis of India's regulatory structure is critical for evaluating the India growth story.[1] This is substantiated by a finding that all the sectors with independent regulators are those where significant amounts of private investment have already taken place and are needed in the years to come for sustaining economic growth at the 12th Five Year Plan's targeted nine-percent levels.

Attracting the much-needed private investment in identified key sectors such as infrastructure calls for a well-functioning, transparent and effective regulatory regime in the country. According to a preliminary assessment of the Planning Commission, investment in infrastructure during the 12th Five Year Plan (2012-17) would need to be of the order of about US$1.025tn, or a share of around 10 percent of gross domestic product (GDP).[2]

The present debate in the 2G spectrum licencing case thus is really about the regulatory system in India and will surely affect the future of investment in telecom in India, a sector that had seen larger than anticipated investments in the first-half of the 11th Plan period; the uncertainty in the Indian telecom regulatory regime has already cooled the ardour of foreign investors in the sector.[3]

A larger discourse on independence of our regulatory institutions and its impact on sustaining investment and sectoral growth is also necessary for better governance.

The Indian regulatory story, as this chapter hopes to show, varies in different sectors/situations and has as many success stories as it has stories of abject failure. In short, it is a story of work-in-progress. It is also, in many parts, a reflection of the country's politics where regulators have often played to the tunes of the political class that appointed them. Not allowing electricity tariffs to rise to account for increasing costs or not implementing open access mandated by the Electricity Act 2003 are good examples of regulators playing to the political gallery. Perhaps learning from the telecom sector and other similar experiences, the Planning Commission in its Approach Paper on Infrastructure, 2008 and Regulatory Reform Bill, 2009, said that the line ministry can issue policy directives to the regulator in public interest.[4] This has been seen as the litmus test of independence and autonomy of the regulator.

The analysis in this chapter is issue-based, and also uses examples of regulatory failures/best practices to guide the discussion. Given that telecom sector regulations have been in news for much of the past couple of years and the sector is one of India's biggest industrial success stories, reference to the telecom regulations have been liberally drawn to illustrate points in the different sections. It certainly does not imply that the sector is more problematic; if anything, telecom still remains one of India's regulatory success stories, which could albeit do with improvement.

The rest of the chapter is divided into 10 segments, dealing with a wide range of issues, starting from the need for regulation and independence of regulators and assessment of the current state in India. It observes the global best practices in regulation and informs about regulatory impact assessment of government policies, among other relevant issues.

Why Do We Need Regulators?

Economic development policies in developing countries like India have the prime welfare objective of poverty reduction and other social objectives, in addition to facilitating economic growth. Therefore, in developing countries, introduction of regulation often originates from criteria other than economic efficiency, with equity (distribution of welfare) objectives often dominating.

Like all developing countries undertaking deregulation, regulation and competition in India were brought in by the new wave of liberalisation, privatisation and globalisation in 1991. Prior to liberalisation, economic activity in India was primarily controlled by the government. All telecommunication services, whether through phones or satellite, were the exclusive preserve of government firms; all roads were built and maintained by government ministries or departments at the level of the Centre and states; and oil exploration, drilling, refining and marketing were also a government monopoly. However, the pattern changed greatly following the reforms in early 1990s. The resulting increase in participation by private players in the newly liberalised economy pointed out to a glaring need for sector regulation. Sectors where economic regulation was then ushered included telecom, electricity, oil and gas.

Dr Manmohan Singh's 1991 Budget, apart from de-licencing, made two fundamental shifts in policy as far as infrastructure is concerned. First, it sought to achieve its large fiscal deficit reduction target by sharp reductions in capital expenditure – this meant that the larger share of new power plants, new telecom lines and so on would have to be constructed by the private sector, or not at all. Two, the overall philosophy, and not just in the infrastructure sector, was that the private sector was to be encouraged as it would contribute to efficiency gains that would benefit the overall economy.

Even at this point, not too much thought was given to creating regulators, indeed the thought was that private sector firms could come in even within the existing framework of incentives – all that needed tweaking, the thinking went, were the specific incentives. So, if a plant load factor-based incentive scheme was designed for private power firms, they would come in and invest. A host of foreign firms even came in through what was then called the fast-track independent power producers (IPP) process. All of them came a cropper for a variety of reasons, one of which was the lack of an independent regulatory process. Even one, Enron was later embroiled in corruption scandals and added to it, its parent company in the US collapsed after a massive failure.

For example, while the Maharashtra State Electricity Board (MSEB) had a litany of complaints as far as Enron-Dabhol was concerned, the IPP also felt it had been short-changed by the process. An independent regulatory process at this stage, for instance, would have brought in public hearings and tried to assess whether the electricity costs were reasonable and whether the MSEB was right in saying that the Dabhol plant was not delivering because of faulty turbines. That is also why Enron's shareholders finally went in for international arbitration when the plant was shut down and the government eventually settled privately. Indeed, many have argued that the reason of failure of the initial plans is because India's electricity reforms began at the wrong end – in generation, as opposed to distribution – and this is what the later reforms attempted to fix.

By 1994, the government decided to open up the telecom sector to private firms and that is when the TRAI was born. Since all phones, at that point, belonged to PSU firms, no new telco stood a chance if its subscribers could not connect with the subscribers of the PSUs. TRAI's biggest achievement till date is the implementation of a mandatory interconnect regime with an Interconnection Usage Charge (IUC), where the charges are fixed by TRAI and can not be manipulated by any telco, which has held up all these years. Once TRAI mandated costs for interconnect, it then did the same for long distance telephony, driving down long distance tariffs to a small fraction of what they used to be.

Over the last two decades, India witnessed drastic changes in the method of administration by the government in various sectors of the economy. Numerous regulatory laws have been enacted and consequently regulatory authorities have been set up both at the Centre and states. For instance, regulatory authorities are established for overseeing power, telecommunication, ports, natural gas, airports, highways, etc. (please refer to Annexure 3.1 on page 63 for an overview).

Broadly, three approaches are followed in setting up the regulatory framework in various sectors in India: (1) establishing independent regulatory bodies outside the line ministry (such as in telecom, electricity, seaports, banking, insurance, capital market and oil and gas); (2) placing regulatory functions in the concerned line ministry and specialised agencies within the ministry (such as in civil aviation, highways); and (3) the line ministry performs the multiple tasks of the policymaker, service provider and regulator (for example, in railways, which, however, does have an arm's length relationship between railway safety apparatus and the railway ministry, which is a legacy of the British Raj).

Highways, water supplies and railways are regulated by respective government departments; electricity is the joint responsibility of the federal and the provincial governments and separate regulatory bodies have been set up at both levels. Regulatory and quasi-judicial functions are discharged by appellate tribunals in all other sectors, except seaports, insurance and banking.[5]

India's experience with independent regulatory agencies in public services has been an institutional transplant from the industrialised world. Introduced at the behest of international donor agencies, with the World Bank serving as the dominant vector for transmission of the restructuring ideas to India, regulators in India are intended, somewhat naively, to provide an apolitical space for decision-making to assuage investor concerns over arbitrary administrative actions and thereby stimulate private investment.[6]

In other words, the main focus was to send out a signal to investors about the credibility of the investment regime – the real lesson, still not learnt however, is that the principal job of regulators is to send out signals that the system is alive to the interests of users, not just investors. In practice, however, regulators have had to negotiate a terrain over which the state has continued to exercise considerable control. Regulators have also been shaped in their functioning by national and sub-national political traditions and by administrative and political practices. The result is the emergence of a hybrid institutional form or regulation that combines politics as usual with intriguing new, and unanticipated, opportunities for political intervention.

It was not only in India that one study found that, while around five new regulators were created each year in the 1960s through the 1980s, this rose around four times in the next two decades, reaching a peak of 40 new agencies each year between 1994 and 1996. Independent regulation had become the new global consensus and India did not want to be found wanting. As the Planning Commission put it in its paper on regulation of infrastructure,[7] regulation *'may be broadly understood as an effort by the state to address social risk, market failure or equity concerns through rule-based direction of social and individual action.'*

Economists regard economic regulation by the state as necessary only when a natural monopoly exists or where a dominant player abuses monopoly power or to overcome some other form of market failure. Economic regulation is seen to be that part of regulation which seeks to achieve the effective functioning of competitive markets and, where such markets are absent, to mimic competitive market outcomes to the extent possible.' Sadly, apart from telecom, few other sectors in India that have regulators have seen the presence of robust competition.

The survey findings referred to above reveal some interesting facts running contrary to economic theory of regulation. As per the survey, only 29 percent of respondents were of the view that the regulators' role is to develop and implement rules that create a competitive environment in the market, while 39 percent of the total and the majority of the non-business respondents believed that the role of a regulator is actually to facilitate business arrangements.

Have Regulators Delivered?

There is no denying that regulators in India have produced positive outcomes. However, there are some strong counter-examples of this too. While it is important to learn from this, it is equally important to keep some perspective. After all, it took the UK nearly two decades after it began working with independent regulators to come out with a Regulatory Reform Act in 2001 and the Better Regulation Commission came about only in 2006. Reforms, and regulation, are always work-in-progress. Governments choose the regulators and they are also prone to capture over time. Call it a coincidence, but more regulators than should be the case have tended to give recommendations that the government of the day has wanted. This has happened for a variety of reasons, such as how regulators are chosen and how they can be given policy directions by the government and even how easily some can be dismissed.[8]

Be that as it may, specific legislations lay out the functions and powers of the authority and explicitly have provisions covering grant of licence, determination of tariff, promotion of competition, efficiency and economy, regulating investments, quality of service and aid and advice to the government, among others. For instance, the Central Electricity Regulatory Commission (CERC) was formed by the enactment of the Electricity Regulatory Commissions Act, 1998.

Other reasons for regulatory ineffectiveness have been that, in many sectors, the principal actions had been taken before the regulators were set up. Most of the existing regulators are stifled and have not been effective through constant political interference and ill-defined powers. The Airport Economic Regulatory Authority (AERA) was set up after major airports in Delhi, Mumbai, Hyderabad and Bangalore were set up (AERA is still battling with some of the huge favouritisms cleared by the government); the Delhi Electricity Regulatory Commission's hands were tied to an extent because the Delhi government entered into a five-year contract with Bombay Suburban Electric Supply Ltd (BSES) and the North Delhi Power Limited (NDPL) on what rates of return were to be guaranteed to them; and the Petroleum and Natural Gas Regulatory Board (PNGRB) has been set up without allowing it to regulate prices of various non-sensitive petroleum products even though this is within its remit.

The most obvious success of regulation by independent regulators, as has already been pointed out, is that of interconnection and the IUC by TRAI. IUC was critical if India's telecom sector had to take off. While IUC allows customers from one network to speak to customers on another, what follows from this is roaming, where customers of one telco can use another telco's network to remain connected while travelling, in return for a fee that the parent telco will pay its interconnect partner on your behalf.

And while roaming works on outstation network, Mobile Number Portability (MNP) that has been introduced allows customers to change the service provider without changing the number, in effect roaming between service providers depending on service quality. All of this could take place because the telecom regulator prescribed certain rules/ principles and then ensured the industry adheres to them.

Recently, a Delhi trial court summoned top officials of three telecom majors: Bharti Airtel, Idea and Loop for not abiding by the TRAI regulations on MNP on a complaint by TRAI that they have been continuously rejecting and delaying the number portability request of their subscribers with no valid reasons. More such active steps by regulators are expected for going forward.

In the case of electricity, the Electricity Act 2003 tried to implement the same portability with its concept of Open Access, which allows consumers to move between discoms for the purpose of power purchase, while retaining the connection with the original service provider. In this case, again at a rate determined by the regulator, discoms will need to pay its competitors a certain charge for using its electric wires to deliver electricity to its former customer. The TRAI enforced interconnect and roaming (except for BSNL, where it has had no success).

Until recently, electricity regulators had been unsuccessful due to political interference, while the Ministry of Power operationalised it recently after eight long years, and its implementation will still be dependent on the state electricity regulatory commissions, state governments and the state power utilities, which will need to cease to determine the retail energy tariffs and restrict themselves to determining only the wheeling charges and cross-subsidy surcharge.[9]

The Union Power Secretary had to recently ask the Appellate Tribunal for Electricity to direct the state regulators to give information on how often they have used their *suo motu* powers to hike tariffs.[10] States are predictably protesting the move. Recently, all the discoms in Rajasthan simultaneously came out with circulars with changes to the open access mechanism, which will obviously make the Centre's open access proposition a non-starter. Also, the requirement to have the discom the supplier of last resort will be critical in making open access a reality.[11]

The power regulators in India also face compliance problems. Dubash (2008) points out that, while the Karnataka Electricity Regulatory Commission (KERC) issued 23 directives in its very first tariff order, 19 were either challenged or ignored, while the regulator threatened to withhold further tariff hikes, it never really enforced this. The Andhra Pradesh Electricity Reforms Commission (APERC) issued 12 directives in FY 2001, of which only one was complied with and six partially complied by the following year.

By FY 2005, 10 directives remained un-complied with or only partially complied with, but the APERC had ceased tracking and monitoring compliance. The introduction of the availability-based tariff (ABT) lowered the incentive payments got by PSUs like NTPC and lowered tariffs.[12] The introduction of strict and automatic penalties has, similarly, meant India no longer has the rampant problems of grid indiscipline (states would routinely draw extra power from the grid during harvest season and, as a result, the grid collapsed).

State regulators, on the other hand, also had some notable successes. While paring the expenses planned by the three power companies in the capital on various occasions, the DERC found evidence that the two BSES firms had overcharged ₹533 crore of capital expenses on a total expense of ₹1,233 crore – given the small equity base of the company, this represents a gargantuan return on capital.[13] The regulator's decision to help keep tariffs lower (more on this in the next section) by creating what are called 'regulatory assets' (a part of expenses are not considered for the purpose of calculating tariff hikes, but are put aside as 'regulatory assets' and a nominal interest is paid on this) has created a serious crisis in the capital and a power hike that cannot possibly be accepted by anyone.

Dubash (2008) points out that, in one year, the KERC returned all seven proposed schemes on grounds such as procedural errors, unrealistic implementation schedules and expenditure targets. In its scrutiny of a High Voltage Distribution System (HVDS) project, the APERC pointed out how incorrect assumptions on numbers of unauthorised connections led to an overestimate of savings from the project.

The biggest benefit from the system of regulatory governance, of course, is the fact that regulatory bodies proffer a right to appeal. If, in the past, the government turned down an application to set up a power plant, there was no other recourse. The applicant could not even know

Table 3.1: Powers of Different Regulators in India

Sector	Relevant Statutes	Regulatory Authority
Transport	**No Sectoral regulator**	
• Roads	• National Highways Act of India 1998 • Central Road Fund Act, 2000 • The Control of National Highways (Land and Traffic) Act, 2002	No Regulatory Authority. NHAI acts as the regulator as well as the operator. States have floated their own corporations or agencies. Investors have no recourse to an independent regulator.
• Rail	• Indian Railway Board Act 1905 • Railways Act 1989	Railways act as the operator as well as the regulator. Investors have no recourse to an independent regulator.
• Airports	• Aircraft Act 1934 • Airport Authority of India (AAI) Act 1994	AAI is the operator. Director General of Civil Aviation regulates safety and technical aspects only. Independent regulator, AERA, has been set up and came into existence in 2009.
• Ports	• Indian Ports Act 1908 • Major Port Trust Act 1963	Tariff Authority for Major Ports (TAMP) has the sole function of tariff setting. Investors and users have no recourse to an independent regulator on other matters such as dispute resolution. Performance standards, consumer protection and competition.
Energy	**No holistic regulator**	
• Power	• Electricity Act 2003	Regulatory Commissions at Centre and states with very extensive functions and powers. Track record not as yet convincing.
• Oil & Gas	• Petroleum and Natural Gas Regulatory Board (PNGRB) Act 2006 • Petroleum Act 1934 • Petroleum and Minerals Pipelines (Acquisition of Right of User in Land) Act, 1962	The PNGRB will regulate the refining, processing, storage, transportation, distribution and marketing of petroleum products. Director General of Hydrocarbons licences and regulates the exploration and optimal exploitation of hydrocarbons.

Contd...

Sector	Relevant Statutes	Regulatory Authority
• Coal	• Coal Mines Nationalisation Act 1973 • Coal Mines Conservation and Development Act 1973	No regulatory authority. Control by ministry and through nationalised corporations.
Communication	• Communication Convergence Bill 2001	The draft Bill proposes a sector regulator. It is currently being reviewed in consultation with stakeholders.
• Posts	• Indian Post Office Act 1898	No regulatory authority. Proposal to create a new regulatory body. A draft amendment bill is open for consultation.
• Broadca-sting	• Prasar Bharati Act 1990	Private participation allowed in the FM radio sector through licensing. No regulatory authority exists for radio and TV broadcasts. A draft bill is currently being subjected to consultations with stakeholders.
• Cable TV	• Cable Television Networks Regulation Act 1995	Provides for the regulation of carriage and content of cable TV broadcasts. TRAI has the responsibility of tariff-setting and interconnection for cable operators.
• Telecom and Internet	• Telecom Regulatory Authority of India Act 1990	TRAI has been given the responsibility to regulate telecom and internet service providers.

Source: Planning Commission, updated by the author

why the application was rejected. In the regulatory process, every recommendation/decision has to be reasoned. So, in principle, each decision can be appealed. Table 3.1, adapted from the Planning Commission,[14] summarises the main powers available with regulatory bodies in the country today.

Are the Regulators Independent?

As per the survey findings, around 30 percent of the sample surveyed felt that reducing political interference is the most important requirement for improving the quality of regulation in the country.

This is, however, challenging in a democracy, where the executive is responsible to the electorate, through the minister, who is responsible to the Parliament, and regulators cannot be fully independent either (see Annexure 3.2 on page 65 for some best practice for independent regulators). For instance, in the telecom sector, the regulator has expressly the power only to recommend. Similarly, the selection of regulators which is done by the government is usually influenced by the line ministry.

However, in view of the recent debacle in the 2G spectrum allocation, the Planning Commission[15] has plumped for giving regulators more powers, making them directly accountable to Parliament, that their accounts be audited by the Comptroller and Auditor General of India (CAG), and that all licencing and monitoring of licences be done by the regulator. As discussed earlier, it is recommended that the respective ministry lays down the policy and targets. The regulator should then arrive at appropriate licensing rules to help achieve the policy objectives and targets.

As part of his response to the Anna Hazare movement against corruption, Prime Minister Manmohan Singh accepted the Planning Commission's suggestions and said the government planned to bring in a legislation on this – he stressed the legislation would be to make regulators more accountable and did not mention taking away powers from line ministries. However, it is a good idea to wait and see the final contours of the said legislation.

Under the law as it stands today, regulators have limited powers to implement the law. In most cases, the regulators have delivered what the political masters wanted.[16] In the event that there is a conflict, the functioning of regulators takes a hit, as was the case with the Telecom Disputes Settlement and Appellate Tribunal (TDSAT) in 2007, where a face-off between the ministry and regulators over TDSAT's composition resulted in a situation where the TDSAT was unable to function because it did not have enough members for some time.

It is widely claimed that regulators in India spend most of their time struggling with each other or with the government organisations in court, rather than concentrating on its day-to-day functions, thus burdening the courts with new disputes, instead of resolving them. In a case involving a feud between Forward Markets Commission (FMC) functioning under the Consumer Protection Act (COPRA) and the CERC under the Electricity Act, the High Court held that both authorities/commissions cannot deal in futures/forward contract in electricity excluding the other and/or independently.

Further, it reiterated that both authorities/commissions under the respective acts may not be in a position to control and regulate the futures contract in electricity exclusively, unless those acts and regulations are amended/revised and reframed. However, both cannot have exclusive jurisdiction, as claimed in the present scenario in India.

Further, the judgment provided: *"it is not only a question of resolving the conflict between two entries and/or mandates of the respective specialised Act, but actual and physical workable solution to permit and/or to allow either authorities/ commissions/exchanges to deal with the electricity in the futures/forward market which could be done if an experts body was constituted and specialised rules and regulations are framed."*

This vision must be extended to other sectors as well, where such spats are more than just occasional.

For instance, a recent dispute between two regulatory authorities, namely, the Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA), over Unit Linked Insurance Products (ULIPs) also found its way to the Supreme Court, as they locked horns over which of them has the power to regulate these hybrid investment products. This dispute between SEBI and IRDA did raise hue and cry all around, starting from the government to the investors who find themselves trapped in the midst of the quarrel.

Finally, the government was forced to intervene and settled the tussle by passing an ordinance maintaining that ULIPs would be regulated by IRDA. It should be remembered that independent regulators without adequate powers do not promote investment or support growth. There needs to be some strong action taken vigorously to empower these regulators and make it really independent in its true spirit for the betterment of the country and its economy.

In India, regulators are legally empowered with independence, through enactments, though such sovereignty is limited in various aspects. Besides, there exist vast differences between mandated and delegated independence, with the latter much lower than the former, due to control exercised by the executive. Functional independence is often cramped because of various reasons, which includes the dependence of regulators on the concerned ministry for budgetary allotments, endorsement of staff appointments and the need for the former to report to the latter and so on.

In addition, there is no uniformity in the independence and funding of different regulators. While a few of the government departments are proactive in providing adequate funding and resultant independence to the regulators reporting to it, this attitude is largely missing in many others.

The electricity regulatory commissions get funding as budgetary support from the government using the consolidated fund of India and are, therefore, subject to same procedures for getting budget approved as other departments of the government. Various studies/reports have highlighted that this dependence on funds have sometimes affected the commission's ability to work efficiently. This is similar in the case of other regulators like the Competition Commission of India (CCI), AERA, TRAI and the PNGRB. Such dependence of regulators on the government for using the Consolidated Fund of India to perform its day-to-day task even exists in the recent proposed legislations like the National Road Safety and Traffic Management Board Bill, 2010, and the National Commission for Heritage Sites Bill, 2009.

However, financial independence is granted for the National Accreditation Regulatory Authority for Higher Educational Institutions under its proposed 2010 Bill. Although, the Civil Liability for Nuclear Damage Bill, 2010, is silent regarding this aspect, there is no provision with reference to financial support in the entire bill.

Powers of Regulators

Despite so many years of having independent regulators, there are still no uniform powers across regulators. Various electricity regulators have large powers to make rules, issue licences, enforce discipline, impose penalties, etc. The telecom regulator, on the other hand, has only recommendatory powers and the port regulator, as discussed later, has even rules which determine how profits are to be shared. Tenures of regulators also differ widely and, according to the Planning Commission document, *op. cit.*, in the case of electricity appellate tribunals, members can be reappointed for another three years after their original terms are over – in no other case is this allowed. And, as has been pointed out earlier, several sectors like roads and railways have no regulators at all.

Independence becomes rarely absolute when the related legislations have provisions (without any guidelines) explicitly granting the power to the Central government to issue directives to a regulatory board. This power to issue guidelines needs to be controlled specifically in the legislation itself, if the regulator has to be independent and autonomous of the government. Either such a proviso should be totally done away with or any such directives should be issued only after due consultation with the regulator. This responsibility to consult the regulator is mentioned only in the TRAI Act, the IRDA Act, the Securities Contracts (Regulation) Amendment Act and the National Accreditation Regulatory Authority for Higher Educational Institutions Bill.

But alas, even here the proviso merely states that the government should give the authority an opportunity to express its views before any direction is given and the decision of the Central government, whether a question is one of policy or not, shall be final. Thus, it is not legally mandatory for the government to accept the recommendation of the regulator while issuing a policy directive. To address this, a proviso could be incorporated further stating that the government should place in the public domain the comments received from such authority and other stakeholders and provide specific reasons for the issue of the directives. Transparency is the supposed leitmotif of the government, as also enshrined under the RTI Act, but it remains a biblical recommendation.

The discretion of the governments in power has always been exercised with impunity, especially in the case of TRAI during the regime of the NDA government. The governments that followed have not been too different in how they treat regulators. The Nhava Sheva International Container Terminal (NSICT) is another good example of how governments choose to regulate regulators. When NSICT was being privatised, the government called for bids and the company that promised to share the highest proportion of revenues with it won the contract. The revenue-share could not be taken into account as an expense by the regulator – if it was, anyone could win a bid by offering to share 99 percent of topline revenue with the government.

The NDA government, however, directed TAMP to consider the revenue-share royalty as a cost. In 2005, the UPA government formalised this, stating that, while royalty payments would not be treated as costs for deals struck after July 29, 2003, they would be treated as a cost for deals before this date, if the royalties resulted in a loss for the new concessionaires.[17]

Indeed, the regulations are made in such a way that the regulator's powers are severely circumscribed. Guideline 2.4.1 of the rules, which determines TAMP's functioning, states 'This would, therefore, naturally exclude any comparison of an operator … with … different operators.' Guideline 2.13, which deals with unforeseen profits of the type received from traffic projections exceeding the actuals, states that a company gets to keep half of these.

A draconian clause that is present in almost all legislations is the power of the government to supersede the regulator on flimsy grounds. This Draconian provision severely undermines the independence of the regulators and should be removed. There are only few legislations in India that are silent in this regard, like the PNGRB Act, the TRAI Act, the Electricity Regulatory Commissions Act, the Right to Information Act, the Agricultural and Processed Food Products Export Development Authority Act and the recently proposed legislations like the National Road Safety and Traffic Management Board Bill, the Civil Liability for Nuclear Damage Bill, the Atomic Energy Act and the National Commission for Heritage Sites Bill.

Tenure/Dismissal of Regulators

After its initial poor (from its point of view) experience with the telecom regulator, where the government had to dissolve the TRAI, it has made sure it does not repeat the same mistake with other regulators. The provisions of the bill introduced to set up the airports regulator, for instance, provide for its easy dismissal by the government, dependent only on an internal inquiry. In the case of the appellate body, by contrast, the chairman and members can only be dismissed after a reference is made to the Supreme Court. The same internal inquiry is sufficient to dismiss the newly-appointed petroleum regulator.

Integrated Policy for Regulatory Regime?

There is little uniformity in the powers of regulators. Electricity regulators have more powers than the port or the telecom ones and their tenures also differ greatly (from three to five years). The selection process differs, as does the power to dismiss them. In addition, there are sectors – coal, railways, post and telegraph and roads – that do not even have regulators (see Table 3.1 for details). Similarly, the real estate sector is largely unregulated. However, the draft Real Estate Bill is clearly a huge positive step towards creating and bringing about the much-needed transparency in this sector.

Similarly, according to a KPMG study, retail is the second-largest employer in India, after agriculture, providing work for more than 30 million people. Secondly, the relationship between the regulators with the CCI is fraught with turf wars, adding to further problems in the existing regulatory environment.

The present competition statute in India is the Competition Act of 2002. Prior to this, it had a competition law in the form of the Monopolies and Restrictive Trade Practices (MTRP) Act since 1969. However, in an environment of widespread state-owned public sector monopolies in the utilities and financial industries, there was relatively little application of competition law in India.

The Competition Act of 2002 (as amended) created two competition institutions: the CCI and the Competition Appellate Tribunal (CAT). Liberalisation of national economies and privatisation of state-owned monopolies resulted in a wave of sector legislation in telecommunication, energy, transport and the financial and banking industries and the creation of quasi-independent sector regulators.

With lack of clarity in the roles of the competition authorities and the multiplicity of sector regulators, India has also experienced court challenges to the decisions made by individual institutions. In a Delhi High Court case, for example, after losing a bid to rivals, Reliance Industries Ltd filed a complaint with the CCI alleging that its rivals – the Indian Oil Corporation Ltd, the Bharat Petroleum Corporation Ltd and the Hindustan Petroleum Corporation Ltd had been engaged in a cartel arrangement in the supply of aviation fuel for Air India. During the course of the investigation of the case by CCI, the three companies filed a suit in the Delhi High Court challenging the competence of the CCI to hear the matter claiming that the case was matter for PNGRB, the sector regulator. The High Court gave an interim order that CCI did not have jurisdiction over the matter.

Also, in many cases, the competition law followed the sector regulations, giving a sense of ownership/turf over all matters pertaining to the sector, including competition-related concerns, to the sector regulatory authorities. For this reason, the Department of Telecommunications (DoT) and the RBI are demanding exemptions from CCI over merger matters in their respective sectors.

While the current framework rightly provides for consultations between the two regulatory authorities, it is not adequate. Section 21 of the Competition Act provides that any statutory authority may[18] make a reference to the CCI and its opinion be rendered in 60 days, which shall be considered by the statutory authority. The problem envisaged is that it is optional for the regulator to consult CCI, and not mandatory.

In one of the recommendations to the Planning Commission Draft Regulatory Reform Bill, which has been doing the rounds for over two years now, CUTS International has, therefore, emphasised on the need to introduce a chapter on regulatory overlaps and to hold mandatory consultations between CCI and the sector regulators on matters which are overlapping in order to avoid conflict. The starting point, however, is for both to try and appreciate the difference between technical and competition issues. The sector regulators should have the leading role in regulating technical issues.

Thus, for structural issues, which in most cases are *ex ante*, sector regulators should take a leading role. But, for competition issues, which are largely behavioural and *ex post*, competition authorities should take a leading role. Further, if the sector regulators and competition authorities fail to resolve the issues amicably, the same will be resolved by a committee comprising chairpersons of relevant appellate tribunals – the CAT, the Securities Appellate Tribunal and the Appellate Tribunal for Electricity.

Global Experiences on Independence of Regulators

Regulators in the US have been created by Congress and, as in the case of India, they are not uniform in either scope or design. But, regulatory agencies are closely supervised by the Congress, which ratifies appointments and scrutinises each action through the committee system. Regulators can create and enforce rules, fine and even jail people for violating their regulations.

In the UK, there was an overlap between various regulators in the 1980s and 1990s and, unlike in the case of India, some of the regulators' term and autonomy are not necessarily enshrined in the law. For example, the electricity and gas regulator has no statutory guarantee relating to its terms or conditions of service. Since the mid-1990s, however, the government has tried to undertake regulatory reform and multi-sectoral regulators – in gas/electricity and telecom – have been set up. The Regulatory Reform Act of 2001 required regulators to develop a code of practice which encodes regulatory procedures and enforcement.

A *Better Regulation Task Force* oversees the implementation of the Act and establishes best practices in the sector (in 2006, this got converted into a permanent body, the Better Regulation Commission). This means regulators need to, by law, do impact assessment reports of all existing rules and when new ones are added or old ones deleted. The Utilities Act 2000 regulates three utilities industries by specifying precise sectoral goals to be achieved by each regulator. It also streamlines the appointment and dismissal of regulators, their accountability to Parliament and the regulatory processes they adopt.

Case Studies on Regulatory Subversion by Interest Groups in India[19]

(i) Universal Access Service Licences (UASL)

In the mid-1990s, technology had improved enough for fixed land licence firms to be able to just lay a copper line till a central point in a neighbourhood and then offer 'last mile' access to individual homes through wireless. This meant the firm did not have to dig lines in congested neighbourhoods. By the late 1990s, this 'last mile' could extend to 25 miles, such was the advance of technology. In 2001, taking advantage of this, the TRAI recommended and the government accepted, that fixed land licence firms be allowed to offer what was called Wireless in Local Loop (WiLL) or 'limited mobility' services on their fixed lines – no additional licence fees were asked for – and the commercial terms were also more favourable for WiLL mobiles (which is why calls on them were cheaper than on cellular mobile phones).

Even so, customers seemed to prefer cellular mobiles. One reason was that customers could 'roam' on cellular networks – the key to this was the architecture of cellular phone networks. The TRAI recommendation on this specified that the architecture of WiLL mobile networks be different, that they did not have what was called a Mobile Switching Centre (MSC). The reason for this was a simple one, cellular mobile firms had paid a licence fee that was four times that paid by the fixed land licence ones, so allowing them to offer full-blown mobile services was unfair. Yet, when Reliance Infocomm set up its WiLL network, it installed an MSC. The cellular operators protested and, in January 2001, the TRAI chief wrote to the Telecom Secretary asking him to ensure Reliance was stopped – this was many months before Reliance began to offer its service commercially. The telecom department asked the TRAI to keep quiet and did not do anything.

The Cellular Operators Association of India went to the TDSAT which gave a split verdict in August 2003. While the head of TDSAT, the only judicial member, ruled that the WiLL service had to be stopped, the other two members ruled that, while the services should not be stopped, a method should be found to ensure that the mobility offered was restricted. The government, however, refused to implement the order and, in October 2003, came up with a new policy recommending unified access. This allowed the WiLL mobile players to offer full mobility after paying a licence fee equal to that paid by the most recent cellular licencees (who were awarded the licence in an auction a few years prior to this). The penalty plus licence fee added up to around ₹2,000 crore. Reliance had, in the meantime, built up a big subscriber base, by virtue of the fact that it offered (till then, illegally) mobile services, and the value of this subscriber base was far greater than the penalty imposed.

(ii) New 2G Licences

Enough has been written about the TRAI recommendations in 2007 on issuing new licences and how these were distorted. Indeed, as soon as the then TRAI chief realised the recommendations were being distorted, several letters of protest were sent out, but to no avail. As part of these recommendations, the TRAI also said existing WiLL-mobile phone firms could be given a GSM-cellular licence under what it called 'dual-technology' – in other words, while most telcos offered just one type of service – GSM-cellular – these firms could offer both WiLL-mobile as well as GSM-cellular. Since each service was allotted a certain amount of spectrum which was in short supply, getting two mobile licences was a big advantage.

The government then gave out licences, in 2008, at the same prices they were sold at in 2001; two of the firms sold off large parts of their equity at a huge profit, as the M&A suggestions were not enforced; nor was the higher licence fee recommendations for dual technology firms accepted. Indeed, Reliance Communications was given its dual-technology licence a day before the policy was announced, a decision that the TDSAT later upheld terming this as 'early completion of formalities'.

(iii) NSICT

The Tariff Authority for Major Ports (TAMP) regulates tariffs based on the costs given by the ports and the likely traffic. Though each port promises to share a certain proportion of topline with the government, this is not taken into account as a cost – this was logical, and it was also precedent since, in 2002, TAMP refused to allow Chennai Container Terminal Limited to expense its revenue-share royalty payments. In 2005, however, the government told the TAMP it would have to treat these as costs; in 2005, the government made a distinction and said that, while royalty payments would not be treated as costs for deals struck after July 29, 2003, they would be treated as a cost for deals before this date, if the royalties resulted in a loss for the new concessionaires. In this case, the revenue-share bid of the second bidder would be taken into account.

TAMP, however, bettered even this and, in August 2005, allowed the Nhava Sheva International Container Terminal (NSICT) to expense its royalties, even though their inclusion did not lead to a loss. This would allow NSICT to, over its 30-year concession, benefit by US$1.46bn. The other way in which TAMP helped NSICT is through the manner in which it fixed tariffs. Since tariffs are based on costs and the total traffic, a higher traffic will result in higher profits than the TAMP projected. Logically, the extra profit should be taken into account while determining the tariffs for the next year. The TAMP guidelines, however, say only half the extra profit can be recouped the next year. Actual traffic for NSICT were two-thirds higher than those forecasted by TAMP while fixing their tariffs.

(iv) Pre-empting Policy

If this was not bad enough, the government did not bring in regulators while finalising its biggest deals in many areas. The airports at Delhi, Mumbai, Bangalore and Delhi were privatised without there being a regulator which could examine the costs given by each operator. The sharp hikes in costs for some of the players have been quite controversial.

Regulatory Impact Assessment

Regulatory impact assessment (RIA) is a tool by which governments learn how to deal effectively with increasingly complex public policy issues in an environment of competitive and open markets.

Paragraph 11.29 of Chapter 11: Consumer Protection and Competition Policy of the 11th Five Year Plan of the Planning Commission provides:[20]

Several existing policies, statutes and regulations of the Central government restrict or undermine competition. A review of such policies, statutes and regulations from the competition perspective (this is referred to as 'regulatory impact assessment' in several countries) may be undertaken with a view to remove or minimise their competition restricting effects. Proposed policies, statutes, regulations that impact competition should also include a competition impact assessment through an internal mechanism which should form one of the inputs in any decision-making process in this regard. Regulatory impact assessment should be a precondition for introducing regulatory changes in any sector. Any disinvestment or privatisation attempt should take into account the competition dimension. In a globalising economy, incorporation of competition clauses in trade agreements will go a long way to check anticompetitive behaviour and potential anticompetitive cross-border transactions/mergers having an adverse effect in India.

On an assessment, one concludes that telecom is the only sector where, despite all the problems, competition has really flourished. From just two private phone providers, in addition to the government-owned BSNL and MTNL, there are now 12-14 firms offering mobile phone services in most telecom circles in the country. This is probably counter-productive, as it lowers profitability, with no commensurate increase in competition. A more liberal M&A policy, when it is brought in, will help, but the interesting thing here is that TRAI regularly monitors the level of competition in the industry through the HHI Index.

The same level of competition that exists in telecom, it is true, cannot be introduced for all sectors. Another airport can be built to compete with an existing one, but only after the existing airport's operations have reached full capacity; there is also a minimum distance stipulation between airports. But, few regulators, other than the TRAI, are actively doing their best. In the case of TAMP, the law prohibits benchmarking with other ports. In the electricity sector, the Electricity Act 2003 planned for competition through what is called Open Access. Similar to number portability, Open Access allows a customer of firm X to buy power from firm Y instead of using the same powerlines that go into their house. Since there is a high level of cross-subsidisation as well as theft, Electricity Act 2003 provides for payment of surcharges by Y to X. So far, no state electricity regulator has enforced this provision.

Furthermore, a welcome step has been initiated by the Planning Commission recently, in order to reach the targeted levels of growth by boosting private investments in India, through setting up of a business facilitation grid which would be a repository of all regulatory information and help in making the business regulatory framework a transparent one. It would also facilitate a channel of communication between state governments and the Centre to reform the regulatory framework through consultations.

As part of its operations, the Planning Commission has also proposed annual regulatory impact assessments by the Centre and states so that the policymakers can improve the regulatory framework in the country. Such a system to analyse the impact that the current regulatory framework has on businesses is lacking, which seeks to be remedied through this step.

Conclusion

It is tempting to conclude that the idea of independent regulators is not working. As has been observed, regulators are handpicked by the government of the day and have, too often to be a coincidence, delivered just what their political masters wanted, especially in the politically sensitive sectors like power. The electricity regulator in Delhi ensured the government did not have to suffer the consequences of tariff hikes by creating 'regulatory assets' (a part of expenses are not considered for the purpose of calculating tariff hikes, but are put aside as 'regulatory assets' and a nominal interest is paid on this) – this has created a serious crisis in the capital since not allowing regular power hikes means the hike required now is so high that it cannot possibly be accepted by anyone. While a new regulator hiked tariffs in August 2011, to keep this to a minimum, it has not considered the revenue shortfalls of the power distribution firms for 2010-11, but plans to revisit this later.

In Orissa, the power regulator allowed the state to charge other states in the country who were buying power from the state an amount that was many times more than what customers paid inside the state – and this extra amount was then used to subsidise customers within the state.

Part of the problem lies in the manner in which regulators are picked – in even the case of the high-profile Central Vigilance Commissioner appointment, where the Leader of the Opposition (LOOP) was part of the selection panel, it was seen how the government had its way, despite the LOOP's written dissent, though it is a different matter that the government suffered a big loss of face when the Supreme Court struck down the appointment. Interestingly, the Apex Court also suggested that the government can appoint a non-civil servant but the government did not followed this advice and appointed another IAS retiree.

Another part of the problem lies in the fact that almost all regulators are former bureaucrats even today – in the early days, there was perhaps no other option given and only public sector organisations were in charge of the sectors that were being opened up, so bureaucrats were probably the only people who had the required expertise. There is also the problem that many sectors (roads, railways, post and telegraph and mining) do not have regulators; in several other cases (airports), the regulators were brought in after privatisation; in others like the Oil Sector, the regulator (PNGRB) has not been fully empowered.

Yet, as has been pointed out, there are big successes of regulation as well. These include the IUC in telecom; the availability-based tariff and the use of the Unscheduled Interchange tariffs to ensure grid discipline in the power sector; the USO levy as a means to fund rural telephony in a seamless manner. Several suggestions have been made, most notably by the Planning Commission, on how to improve/fix the system.

One suggestion is to shift more discretionary powers from the line ministries to regulators who report directly to Parliament; to have each legislation by a regulator scrutinised by a parliamentary sub-committee; and the regulator's account to be examined by the CAG. Line ministries will issue only policy directions and it will be the regulator's job to come out with laws to make this happen; part of the regulator's job will be to facilitate competition (its annual reports to Parliament will give details of how it has fared on this account). As mentioned earlier, the Prime Minister said the government is actively looking at this proposal as part of its attempt to fight corruption.

The 2G spectrum case would be a good example to use to illustrate how the proposed new regulatory system should work and how it would prevent the kind of outcome witnessed on January 10, 2008, and the subsequent investigations/arrests that occurred. If the TRAI was doing the licencing and the policing of the licencing functions, first and foremost, no licences would have been issued in the manner they were. For one, there was a Cabinet decision in 2003, at the time of the issue of UASL, which said that all future licences would be issued through the auction route only. So, once the policy had been laid out, the TRAI would have had to follow that. If it did not, TRAI would have to explain why.

Similarly, unlike the government, the arbitrary and retrospective September 25, 2007, cut-off for considering applications for licences, effectively shutting out hundreds of applicants from the licencing process – as well as the change in the first-come-first-served norms – would have to be explained by a regulator. And, there would have to be a prior public consultation on all of this. While it is heartening that the Supreme Court has tried to bring back attention to the regulatory failures, it is an inefficient policy to load the country's legal system and the judiciary with the tasks that a proper regulatory regime should deliver.

Many of the suggestions for change in the proposed Regulatory Reform Bill, 2009, are in keeping with what has been happening in the UK. The Utilities Act of 2000 makes consumer protection the primary duty of the regulator. This also makes it vital that Indian regulators pay special attention to developing capacity among consumer bodies. To some extent, this is happening. Dubash (2008) reports that the tariff order of FY 2005 evoked 70 responses in Delhi, 302 in Andhra Pradesh and 5,170 (of which most were duplicates sent in by farmers) in Karnataka. Industry accounted for just 10 percent of responses in Andhra Pradesh, 17 percent in Delhi and a high of 40 percent in Karnataka.

In the 2006-07 tariff order, a total of 330 objections were filed in Andhra Pradesh – 302 were 'substantive' pertaining to issues that had to do with details of the tariff process; the largest number, 106, were by individual consumers, but substantial numbers of comments, in each case between 25 and 70, were filed by political parties (42), public entities (28), industry (36), unions (68) and consumer organisations (43).

Readers would do well to read the UK's House of Lords' study *The Regulatory State: Ensuring its Accountability*.[21] After concluding the regulation is not an end in itself, the Lords have an elaborate procedure for ensuring accountability – an interesting idea worth emulating is that before any change is made (an existing policy junked or a new one added), the regulator be asked to produce a RIA study. This study, the Lords suggests, be independently studied by the National Audit Office (our equivalent of the CAG) both before and after implementation.

A joint committee of Parliament, adequately staffed and with enough resources, be set up to examine regulatory action of an ongoing basis. Moreover, it calls for a *360-degree* view of accountability, whereby the regulator is accountable not only to Parliament, ministers and courts but also to citizens, interest groups, consumer representatives, individual consumers and regulated companies.

Other suggestions that are worth considering include getting Parliament to ratify the selection of regulators, fix uniform tenures for regulators, standardise the procedure for appointing and even dismissing regulators (it has to be made tough if the regulators are to have any teeth). Regulators have to be staffed with top brains in economics, law, finance, accounts and competition issues. There is too much at stake to carry on with the old business-as-usual method of hiring a retired bureaucrat and hope that, with the benefit of just public consultations, the generalist can deliver the desired results.

Any regulatory system that is adopted should allow the market to discover optimal price and the industry will only get the right price when they make mistakes and are allowed to fail/suffer. Government should not be playing nanny or play 'God', as it has been doing in the case of telecom by extricating private sector firms out of contractual obligations to the government to prevent bankruptcies. Above all, upholding free market operations, including exit, is an important indicator of a good regulatory regime.

Furthermore, optimum outcomes for an economy mandate the need for both competition agencies and sector regulators. Since both have a common objective, overlaps are bound to arise from time to time in their functioning. A recent example is with regards to turf wars in the banking and financial sector. The Reserve Bank of India (RBI) made it clear that it did not want the competition authority to encroach in its functioning when it argued to exempt banking mergers from the purview of the CCI. The Minister of State for Finance was quoted as saying:

"Amalgamations, reconstructions, mergers are approved in consultation with the RBI and sanctioned by the Central government under specific statutes of Parliament. The mergers are approved primarily in public interest or in the interest of depositors or of the banking system in India or to secure proper management of the banking company. RBI is of the view that reference to CCI may cause avoidable delays in the process. As timeliness is most critical and crucial, it is felt that the process of amalgamation, mergers etc should not be hampered by seeking approval from multiple authorities."

It is, therefore, necessary to design a framework so that such overlaps may be minimised in order to bring about some stability in the regulatory environment.

Finally, a significant area pertaining to regulation that requires intervention is the need to develop the assessment of quality of regulation through RIA. Lessons can be learnt here from the UK model, which has prepared a model RIA against which all government policies are assessed.

Annexure 3.1: An Overview of the Regulators in India and their Powers

Regulator	CORE Area	Punitive Powers
Competition Commission of India	To eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade in the markets of India. It is also required to give opinion on competition issues on a reference received from a statutory authority established under any law and to undertake competition advocacy, create public awareness and impart training on competition issues.	In the event of non-compliance with an order or direction issued by CCI, Competition Appellate Tribunal, a quasi-judicial body, is empowered to impose monetary penalty or with imprisonment up to three years.
Telecom Regulatory Authority of India	Decides tariffs, sets standards of quality of service and decides on interconnection between operators and issued orders and directions on various subjects like tariff, interconnections, Direct To Home (DTH) services and mobile number portability.	Not much, Telecom Disputes Settlement Appellate Tribunal is empowered to impose monetary penalties if any person wilfully fails to comply with the order of the tribunal.
Central Electricity Regulatory Commission	Regulates tariffs fixed by power utilities and facilitates investments and expansion of capacities for enhancing power supply	Electricity Appellate Tribunal, a quasi-judicial body, empowered to impose punitive measures on revocation of licence, non-compliance of directions, failure of licensee to meet standards of performance, maliciously wasting electricity or injuring works etc.
Petroleum & Natural Gas Regulatory Board of India	Regulates the refining, processing, storage, transportation, distribution, marketing and sale of petroleum, petroleum products and natural gas so as to protect the interests of consumers and entities engaged in specified activities and to ensure uninterrupted and adequate supply in all parts of the country and to promote competitive markets and for matters connected therewith or incidental thereto.	Appellate Tribunal is empowered to punish for contravention of directions of the board, unauthorized activities , wilful failure to comply with orders of Appellate Tribunal, wilful damage to common carrier or contract carrier etc.
Tariff Authority for Major Ports	Regulates tariffs of all cargo and passenger vessels and rates for lease of properties in major port trusts	Empowered to notify the rates and define the conditionalities governing these rates. Union Government is empowered to modify the Authority's Order or issue 'policy directions' on matters relating to port pricing.
Airports Economic Regulatory Authority	Regulate tariffs of aeronautical services and ensure quality of services	Empowered to penalise companies that run airports and provide services in airports and government departments, also penalises for wilful failure to comply with the order of the Appellate Tribunal or Authority or the act.

Contd...

Regulator	CORE Area	Punitive Powers
Directorate General of Civil Aviation	Responsible for regulation of air transport services, safety and airworthiness standards	Empowered to suspend licences of airlines
Forward Markets Commission	Keep forward markets of commodities under observation along with regulating the commodity exchanges	Have the powers of a civil court while trying a suit in respect of summoning and enforcing the attendance of any person, among others. Commission is empowered to penalise for contravention of provisions, for owning or keeping place used for entering into forward contracts in goods, & penalise companies prohibited offences.
National Highways Authority of India	Responsible for the development, maintenance, operation and management of 71,772 km of national highways	Empowered to penalise highway developers for project delays and other non-compliances
Securities & Exchange Board of India	To protect the interests of investors in securities and to promote the development of, and to regulate the securities market	It can investigate and pass orders against persons found to be guilty of manipulating markets, prosecute and judge directly the violation of certain provisions of the companies Act
Insurance Regulatory & Development Authority	To regulate, promote and ensure orderly growth of the insurance business and re-insurance business, protect the interest of the insurers	It can issue warnings and penalties on insurers , corporate agents and it can withdraw, suspend or cancel the registration of insurers and corporate agents
Reserve Bank of India	It is the government's banker; the bankers' banker and the banking regulator. It also plays a key role in inflation management & promoting financial inclusion policy	All banks need a licence form the RBI to carry out their business within India, and it can be cancelled on violation of certain conditions
Pension Fund Regulatory & Development Authority	Regulator for the pension sector and regulates the flagship New Pension System that offers pension solution to all individuals	It can only alter any clause it may consider necessary in the interest of the subscribers

Source: CUTS CCIER Research, 2011

Annexure 3.2: Independent Regulators: Key Attributes

Best practices for independent regulators can be defined in terms of key characteristics:

- *Powers:* Effective regulators are entrusted with significant powers to issue opinions, set rules, monitor and inspect, enforce regulations, grant licences and permits, set prices and settle disputes.
- *Independence:* Regulator's independence flows from the institutional and legal framework that defines their existence, together with provisions for their governance, including issues such as appointments.
- *Accountability:* Independence needs to be balanced with accountability. This is often achieved through procedures such as annual reports, transparent decision-making and provisions for self and external evaluation.
- *Consultation:* Effective consultation contributes to accountability.
- *Transparency and communication:* These allow parties to understand decisions and to secure confidence in the regulator's decision-making process. It may not be sufficient, some regulatory decisions may be complex and need to be fully explained and justified, in order to secure public support for regulatory actions (for example through public hearings, reports and websites).
- *Sanctions:* An important regulatory power is the capacity to impose sanctions.
- *Administrative appeals and public redress:* The existence of procedures to appeal against administrative decisions taken by regulators is important.
- *Co-ordination with the competition authority:* There is a need for co-ordination between regulators and the competition authority in order to avoid problems of overlap.

Source: OECD Reviews of Regulatory Reform: Sweden – Achieving Results for Sustained Growth, OECD, 2007

Annexure 3.3: Policy-making, Regulatory and Operation Functions in India – Scenario in Different Sectors

Sector	Scenario
Telecom	All functions separated; Regulator and SOE report to the line ministry
Electricity	All functions separated; Regulator and SOE report to the line ministry
Oil and Gas	All functions separated; Regulator and SOE report to the line ministry
Water Supply & Sanitation	Only operation separated; service provision is by local governments
Road Transport (public passenger)	Only operation separated; SOE reports to the concerned state government department
Airports	Regulation and operation are separated
Seaports	All functions separated; Regulator reports to the line ministry, and port authorities to the Central/state governments
Railways	No separation

Source: Mehta Pradeep S (2009) (ed). Creating Regulators is not the End, Key is the Regulatory Process, Ch1, pp 28-29

Endnotes

1 Worryingly, the Indian government is making soothing noises to the firms affected by the 2G scandal, as if the way to improve India's investment climate is to rescue foolish investors.

2 The revised projection of investment for the 11th Plan is almost equal to the initial target. This was possible on account of the higher investments in the telecom sector and oil and gas pipelines. While the revised projections in electricity, irrigation and airport sectors are close to the initial targets, there are significant shortfalls in roads, railways, ports, water supply and sanitation. Source: *Investment in Infrastructure during the Eleventh Five Year Plan*, Secretariat for Infrastructure, Planning Commission, January 2011. http://infrastructure.gov.in/pdf/inv-infra.pdf

3 On the other hand, the SC verdict is expected to reduce competition in the short term and lead to a rise in tariffs from incumbent telecom companies who were cautious in raising tariff rates so far, given the weak economic outlook and as a result share prices of some domestic incumbent telecom firms have risen.

4 It provides that such directions can only be of a general nature and not on any regulatory decision and be issued only after consultation with the regulator and be made public. Furthermore, as a check on bureaucratic arbitrariness, the directive should have been approved by the minister and the Prime Minister.

5 Mehta, Pradeep S. (ed) (2009). 'Regulatory Environment in India', in *Creating Regulators is not the End, Key is the Regulatory Process*, CUTS International, Ch 5, pg 238.

6 Dubash, N. (2008). 'Institutional Transplant as Political Opportunity: The Practice and Politics of Indian Electricity Regulation', CLPE Research Paper No. 31/2008, 04(06). While negotiating for the Orissa power loan, the World Bank argued the role of the regulator was '...to ensure the sustainability of tariff reform ... inter alia to attract sufficient private investment and protect the interests of consumers ... to insulate Orissa's power sector from the government and ensure its autonomy'. In 2003, and as a result of the above experience, the Electricity Act (2003) was passed which endowed regulators with a range of responsibilities including tariff setting, issuance of licences, definition and enforcement of standards, promotion of renewable energy, among others.

7 http://planningcommission.nic.in/reports/genrep/infra_reglawl.pdf

8 http://bsl.co.in/india/news/telecom-secretary-heads-for-tdsat/301496/, http://businessstandard.co.in/india/news/telecom-tribunal-in-race-against-time/295785, www.indianexpress.com/news/acts-of-independence/703632/0; also read *Regulatory Roulette*, India 2009, BS Books.

9 Open access in the power sector, which the Indian government operationalised on November 30, 2011, vide a letter entitled 'Opinion from M/o Law and Justice on the operationalisation of open access in power

sector', can be a game-changer for large consumers only if critical changes are made to power trading platforms and regulators put some key checks and balances in place. Some analysis in: www.business-standard.com/india/news/arijit-maitraone-megawatt-conundrum/462544/. It may also be noted that Open Access and retail competition in power sector is not universal, especially in developing countries. For example, Philippines hopes to start the scheme only by September 2012 (http://business.inquirer.net/33881/open-access-and-retail-competition-in-power-sector-to-start-in-september-2012).

10 www.financialexpress.com/news/apex-power-regulator-asked-to-pull-up-sercs-over-tariff/784345/

11 The 48 hour prior notice requirement is a big hindrance. At the same time, the 24-hour block provision will make the purchase of power from power exchanges un-viable. The higher tariffs will hurt too. 'Open Access Faces Hurdles from Discoms in Rajasthan', REConnect blogpost, February 9th, 2012, http://reconnectenergy.com/blog/2012/02/ and http://reconnectenergy.com/blog/2011/12/open-access-in-all-states-may-finally-become-a-reality/

12 www.indianexpress.com/ie/daily/20000326/ied25063.html

13 www.business-standard.com/india/news/delhi%60s-discom-disaster/318456/, http://articles.timesofindia.indiatimes.com/2009-10-10/delhi/28063992_1_derc-bses-rajdhani-discom-bses, www.derc.gov.in/ordersPetitions/orders/Tariff/Tariff%20Order/MYT_TO_07/distribution/Complete%20Order/BRPLannexure.pdf

14 http://infrastructure.gov.in/pdf/approach_to_regulation_of_infrastructure.pdf

15 Regulatory Reform Bill, 2009

16 For a fuller exposition, please see Regulatory Roulette, Business Standard India 2009

17 Details in Salotra, B. (2007). Case Study of NSICT Concessions, http://infrastructure.gov.in/pdf/NSICT.pdf

18 The Committee on National Competition Policy and allied matters has recommended that the words in Section 21 of the Competition Act, 2002: 'may' be substituted by 'shall' thus making it mandatory. However, the proposed amendments to the Act are yet to be adopted

19 Summarised from *Regulatory Roulette*, Business Standard, India 2009. Annexure 3.3 gives a snapshot of the Scenario in Policy-making, Regulatory and Operation functions of regulators in India

20 http://planningcommission.nic.in/plans/planrel/fiveyr/11th/11_v1/11v1_ch11.pdf

21 www.publications.parliament.uk/pa/ld200304/ldselect/ldconst/68/68.pdf

CHAPTER 4

Is there a Case for the Essential Facilities Doctrine in India?*

Introduction

The Essential Facilities Doctrine (EFD) has been widely invoked across a number of jurisdictions all over the world and has generated a good deal of attention among people interested in competition and competition policy. In popular jargon, this is also referred to as Third Party Access or Open Access. The doctrine requires a monopolist/dominant firm to grant access to a facility (which is difficult to replicate) that it controls and that is necessary for effective competition. Such liability indeed militates against the conventional right of a firm to conduct unfettered economic activity. Thus, if the doctrine is to have substance it is very important that it be sufficiently circumscribed. The doctrine has been in practice for around 100 years now, and originates from the American anti-trust law.[1]

Cases implicating the EFD arise when a vertically integrated firm that is a natural monopolist in one market refuses to provide access to the monopolised input to a rival/competitor in the same/adjacent market.

Although such activities can be dealt under 'refusal to deal' case, but traditional 'refusal to deal' cases differ from 'essential facilities' cases. While the former are based on the proviso that a dominant firm and its competitors have had a previous business relationship, essential facilities cases arise where there may not be such a business relationship already. Essential facilities cases are viewed as involving a structural problem in the market, which means that the issue must be addressed for the sake of the effective functioning of the market.

Perhaps the pivot over which EFD cases revolve is to decide when the shared use becomes essential. Under what conditions such a use should be granted in order to be able to compete profitably in the relevant market? And, of course, which are those *exceptional* circumstances that may justify

* This chapter is based on a paper 'Reviving an Epithet: A New Way Forward for The Essential Facilities Doctrine', Sandeep Vaheesan, Duke University School of Law.

the competition authority's intervention, without undermining the objective justifications by a dominant undertaking in refusing to allow such access.[2] In the end, the answer to the above question regarding the legal background of granting access to essential facilities is one which sets out the general conditions for a *duty to share*, namely:

- Is access to the necessary facility essential to compete?
- Is there sufficient available capacity to provide access?
- Does the owner fail to satisfy an existing market demand or does he impede competition on the market?
- Is the company demanding access ready to pay a reasonable access fee?

Therefore, unless the answers to the above questions are not all affirmative, the duty to share access does not turn into an obligation imposed on dominant undertakings.

With this brief introduction of the doctrine and its economic foundation, this chapter analyses the justification and viability of invoking/implementing the EFD in India. It outlines the specific nature of network goods which turn network industries as prime candidates for the application of the doctrine, leading to the suggestion that envisioning competition in relation to these goods may crucially involve some version of the EFD.

The chapter also looks at two other important areas which build the case for the application of the doctrine: pharmaceutical industry and the issue of access to medicines; and infrastructure goods (proposing infrastructure goods as important candidates for invoking EFD is largely an American economic-legal scholarship).[3]

This is followed by an articulation of the contents of the doctrine in various jurisdictions. It begins by discussing the origins of the doctrine in the US,[4] leading to a description of the varied interpretation of the doctrine in the American courts.

In India, so far, the ideas associated with EFD have been incorporated in the regulations governing the telecom, electricity and natural gas sectors, and in the intellectual property laws or in their reference to the Competition Act, 2002.[5] Finally it discusses the efficacy of the doctrine in India and its potential ambit, and also briefly explores the potential role of the India's competition law in this respect.

Building the case for the Essential Facility Doctrine

Network Goods and their Specificities[6]

It turns out that EFD application and its motivations are best articulated from an understanding of the economics of network goods. Network goods are characterised by the value of the good/service to a consumer being dependent upon the number of other consumers. Put simply, I am likely to value my cell phone more, if more of my friends possess it. In the present-day, world network goods and services are ubiquitous – some key instances include telecommunications, the internet, computers and computer software; from the transport sector services such as those provided by airlines, railroads, shipping and delivery; from financial sector products such as bonds, equities, derivatives, credit and debit cards ATMs; and from energy sector grid activities such as electricity and natural gas production and distribution. While not exhaustive, a reflection of this cursory list attests to the importance of network goods in the contemporary economy.

For a summary understanding of the nature of network goods it is useful to break the definition into separate demand and supply components. In the demand side of the definition, the special feature of network goods is that they exhibit increasing returns to scale in consumption. To illustrate, consider a simple phone network in a town where a generic customer A wishes to call another similarly generic customer B – the service comes to have economic value in so much so as A connects to a switchboard which is also connected with Customer B so that when Customer A calls B she uses a complementary good consisting of her connection to the switchboard as well as B's connection to the switchboard. Furthermore this complementarity gives rise to the characteristic *network effects* or *network externalities* associated with network goods, where the value to the buyer of an extra unit of the good increases as more units of the good are sold.[7]

Unlike in the standard formulation of demand curve (which slopes downwards), in the presence of network effects, as more units are sold the willingness to pay for the last unit may end up being higher as the utility of the user/customer increases in a larger network. In the supply side definition of network goods, the inherent composite and complementary nature of these goods makes *compatibility* or *interoperability* across networks a crucial constituent of competition in network goods. A typical network good consists of complementary components, when one good will be of value to the customer if it is compatible with its complement (such as software and hardware of a computer system). Thus, while links over a network allow the potential imagination of a complementary composite good, it is the manifest compatibility or interoperability that actualises the complementarity.[8]

Since firms typically involved in network good production will decide on the degree of compatibility strategically, unfettered choice in this regard is likely to favour incompatibility where network effects are very intense, particularly because this strategy tends to award them with very large benefits if they capture a substantial chunk of the market. In fact the theoretical literature predicts that in equilibrium, network good markets gravitate towards 'winner takes all' or at least 'winner takes most' outcomes, particularly when firms choose to make their products incompatible with those of their competitors and thus harnessing all the benefits accruing from the increasing returns to consumption referred to earlier.[9]

The classic real world example of this is the dominance of Microsoft's Windows as the *de facto* operating system for PCs all over the world in recent times. The European Court of Justice (ECJ) in its 2004 ruling on Microsoft indicated that Microsoft's refusal to disclose interoperability information created significant barriers to market entry, owing to indirect network effects, and is thus an abusive conduct. The interoperability decision may be seen as the remedy to the denial of an essential facility to other operating system developers. In network industries especially, this decision is of great importance, though the exceptional market situation in the *Microsoft case* need to be appreciated before intellectual property right holders are forced to licence their exclusive right to competitors. After the EC fined Microsoft with US$666mn convicting the company for bundling Windows Media Player with Windows in 2003-04, the EC also licenced many protocols used in Microsoft's products. However, EC labelled delayed protocol licencing as violating fair, reasonable and non-discriminatory (FRAND) terms.

In 2006, Microsoft appealed to the ECJ of First Instance, but it was dismissed and the company began providing interoperability information as required. In the 'winner takes most' market scenario one firm dominates the market with a few small firms continuing to operate. It is important however to note that such dominance may not always be established by practicing 'anticompetitive acts', and could be the natural outcome in markets characterised with intense network effects.

If patents are essential to an industry standard, the standards-setting organisation in charge will typically require that everyone has access to those patents FRAND terms. This licencing obligation (called FRAND licence in the EU and RAND licence in the US) is invoked to ensure that compatibility, inter-operability and pro-competitive nature of the industry. Intention is to prevent abusing monopolistic advantage arising out of the patent rights.[10]

Last month, EC warned Motorola and Samsung over abuse of essential patents in smartphones wars threatening sanctions against companies that use "essential" patents for standards as weapons in courtroom litigation - a reflection of current cases going on between Apple, Motorola and Samsung.[11]

Last year in October, a Dutch court quashed Samsung's hopes (Samsung uses atleast 13 different FRAND-pledged 3G patents) when it declared that

Samsung would not be able to win an injunction against Apple's products based on standards-essential, FRAND-committed patents. A notable case involves Microsoft which recently filed a complaint with the EC, alleging that Motorola Mobility is violating a pledge to licence its standards-essential patents under FRAND terms.[12]

FRAND comes as an explicit credible commitment not to misuse monopoly power inherent in a standard to impose unfair, unreasonable and discriminatory licencing terms, which have potential to damage competition. It is natural to imagine how a standard, which is adopted soon, can translate into an indispensable norm. This power of owners of such standard essential patents can easily be misused. FRAND is an exercise to check this, falling clearly within the ambit of EFD. Indeed the standards setting organisations play significant roles to encourage compliant products to work together. Standards lower costs by increasing product manufacturing volume, and they increase price competition by eliminating 'switching costs' for consumers.

The welfare comparison of non-compatible network good markets against hypothetical perfectly competitive outcomes suggests a greater total surplus (summation of consumer and producer surplus) under the former configuration but such market outcomes are also characterised by a high levels of inequality in distribution of benefits. Instead, if firms choose to be compatible with competitors or are compelled to be so through policy instruments, it turns out that the inequalities are much lower with a higher consumer surplus and a more evenly distributed producer surplus. This is a very crucial point to understand in relation to policy regarding network markets, whether the policy is in the form of regulation or competition/antitrust law.

The key to policy intervention is not to push for the traditional antitrust orientation where the encouragement of free entry ostensibly lowers prices and competition reduces profits. If this was encouraged in relation to network industries, entry may not lead to the elimination of dominant firm profits – one firm could still continue to dominate the market. Instead to improve market outcomes, the role of antitrust is to ensure and encourage compatibility across all producers so that not only do consumers benefit but producers also share in the rewards.

In addition to this compatibility or standardisation, over the network platform is important for encouraging innovation. However, if antitrust law or a policy instrument is to perform this role, it needs to legally counter the proprietary right of producers to design their platforms and exclude others. It may be noted that adapting network theory to law is interesting for a simple reason that these very efforts are indeed difficult.[13] EFD may be useful in this context.

Infrastructure

Infrastructure is another area where EFD is/can be invoked at multiple levels. Primarily, most infrastructure goods are capital-intensive and therefore not easily replaceable. This logic is traditionally given for engaging into EFD debate for electricity, telecom, gas pipe lines, roads/bridges and other such major infrastructural works. However, academically, there are sound economic arguments that build a case for EFD.

Traditional approach to the EFD is to approach the issue from the 'supply' side. Instead if 'essentiality' were approached from the 'demand' side the doctrine ends up gaining a lot more substance, particularly in infrastructure. According to Frischmann and Waller,[14] the demand for infrastructure is influenced by infrastructure good being (a) non-rival in consumption – the marginal cost of allowing a marginal user is zero,[15] (b) driven by downstream production and is not in itself a commodity for direct consumption, and (c) an input into a wide variety of goods, private, public and non-market goods, suggesting that the social value created by its use is substantial but also very difficult to measure.[16]

Thus, the social benefits derived from the downstream uses of transport, electricity (and also other goods that are characterised by the abovementioned attributes like basic research, environmental ecosystems and the internet) is best kept in a state of open access as is possible.

However, the case for open access is stronger for public or social infrastructure because measuring demand for such infrastructure is difficult due to information and appropriation problems – consumers are not willing to pay the full value of the positive externalities and to the extent that they are willing to pay, it will be an amount lower than that which will maximise social welfare. In other words even if transaction costs of measuring demand were zero, suppliers would favour existing use and applications that involve appropriable and observable benefits at the expense' of applications that generate positive externalities. Therefore, support (subsidy) for such infrastructure goods is important or it will be undersupplied. The particular conceptual insight here is that with an orientation towards open access neither the government nor the markets choose any winners, rather the open access accords benefits to all.

Thus, there may be two roles for the EFD. First, in case the infrastructure is purely commercial, the MCI test (emanating out of a case between MCI and AT&T in the US) is sufficient, so one can begin by screening to check if the issue involves infrastructure and if so, traditional legal tests provide the appropriate test. However, it must be noted that this orientation would inhibit the use of the test in relation to access to non-infrastructure assets as was the case in Aspen Skiing.

Second, if the infrastructure that additionally yields public and/or non-market goods ultimately, the EFD should play an even greater role and allow greater access to reap the benefits of positive externalities. Thus, an infrastructure orientation would expand access, and therefore liability, to infrastructure assets, products, platforms, networks and processes that support downstream positive externalities and thus the promise of dynamic growth

The Essential Facilities Doctrine – Cross-country Analysis

American Origins and Development of the Doctrine

It appears that initially as the EFD was being formed, the US Supreme Court did not invoke the doctrine by name, though three cases are conventionally mentioned as having applied the doctrine establishing case laws.[17] In all these three cases the US Supreme Court said that the defendants denied access to a facility that they controlled, access to which was needed for competition and therefore violated antitrust law.

In the earliest of the judgments – *Terminal Railroad (1912)*[18] the Court said that the railroad company that owned a bridge across the Mississippi (leading in and out of St Louis) must give rival companies access to the bridge on equal and non-discriminatory terms. Similarly in *Associated Press (1945)*[19] the Court told a news network to open membership on non-discriminatory terms to rival newspapers. Likewise in the case of *Otter Trail (1973)*[20] the Court found an antitrust violation when a regulated power company refused to transmit power from rival companies to localities that wanted to buy cheaper power.

However the EFD was articulated explicitly for the first time by the Seventh Circuit Court's opinion in the *MCI case (1983)*.[21] This case was the outcome of an attempt by MCI to compete with AT&T in long distance calls at a time before AT&T was divested and had a monopoly in long distance as well as local calls. MCI had gained technical expertise in the long distance market but needed to use AT&T's local loop to complete calls, which was denied. In the resulting case the Court affirmed the liability incurred by AT&T in refusing 'to provide the necessary interconnection' which it saw as a violation of Section 2 of the Sherman Act, basing the liability on the EFD. The court listed conditions that defined the doctrine or in other words formulated a test, by stating that for the doctrine to kick in it must be shown that: (1) a monopolist controls an essential facility, (2) the facility cannot be reasonably duplicated, (3) the monopolist has denied access, and (4) it was feasible for the monopolist to share the facility.

Subsequently as the lower American courts came to engage with the doctrine, there arose an unusual case of *Aspen Skiing (1985)*.[22] The case dealt with a situation that arose when the defendant, who owned three of four ski slopes and the plaintiff, who owned the fourth slope, and after initially selling joint tickets to customers (enabling them to ski on all four slopes), later retracted from the agreement. The court applied the test formulated in the MCI case, finding that the monopolist controlled the essential facility, that there was an inability to duplicate the facility on account of environmental restrictions, that the denial of access was without justification and that feasibility of access was demonstrated by past practice.[23]

Though on the whole courts tended to reject absurd essential facilities claims,[24] the doctrine of Essential Facilities came under a series of academic attacks and finally in 2004 the US Supreme Court expressed its own displeasure (albeit as dicta) with the doctrine in the *Trinko case.*[25] This case was a product of a class action suit brought against the telecom company Verizon on the grounds that the company failed to adequately share its network with rivals as required by the Telecommunication Act of 1996. The US Federal Communication Commission found Verizon in breach of the Act and fined it for not providing *inter-connect* facilities to rivals. The Supreme Court stated that non-compliance with the Telecommunication Act, 1996 was not a valid basis for antitrust liability and that the defendant did not have a general duty to deal with rivals with whom it had not dealt before.

In relation to the EFD, the Court stated that the doctrine may be present in the lower courts but it refused to recognise or rebut the doctrine. Instead it said that even if the doctrine were valid, it would be applicable only when there was no means of access and that in the case on hand, the Telecom Act already mandated access or in other words the doctrine was not applicable in a regulated industry.

The Trinko judgment was of course in consonance with a series of academic attacks – one particularly prominent attack by Areeda famously states that the EFD is less a doctrine than an epithet 'indicating some acceptation to the right to keep one's creations to oneself, but not telling us what these acceptations are.[26] Since the US Supreme Court disavowed previous case laws, the US Congress set up a review commission to look into the doctrine which however came up with the decision that such matters are best left to the courts.

Here it is useful to discuss the well-known work of Frischmann and Waller which has attempted to rejuvenate the EFD both by providing sound economic rationale and also by connecting it with other fields of law.[27] They draw up an important link between the doctrine and Intellectual Property (IP) law. As is well known, IP law is an attempt to strike a balance between open access (which promotes widespread borrowing, sharing and participation in creating ideas) and exclusion (without which innovators may abandon their efforts for fear of free riding).

It is argued that a similar tension is evident in antitrust when the EFD says that a liability is incurred by a dominant firm when it refuses access to a facility on a non discriminatory basis, specifically in situations where sharing is feasible and competitors cannot easily make a facility of their own – marking an analogous tension between open access and exclusion.

To achieve the right balance Frischmann and Waller go on to interpret the ‘public interest’ principle of Anglo-Saxon law as being tantamount to access to assets understood as infrastructure. In these goods, they argue, an orientation towards open access generates significant positive externalities and any move to further the ‘internalisation’ of the externalities by pushing for regimes of maintaining strong property rights are inefficient.

In other words supporting regimes oriented towards open access to infrastructural resources support society’s economic interest in wealth maximisation and allocative efficiency. Thus, it is argued that if there is a refusal to grant access to infrastructure, which is manifestly a move to acquire or maintain a monopoly position, antitrust liability should ensue.

It is worth mentioning that interoperability in network goods has had its impact on EFD jurisprudence in the US. In the final settlement worked out under the supervision of the courts in Microsoft case, Microsoft was required to licence interoperability information to producers of non-Microsoft servers – this was clearly a reasoned move to encourage ‘open access’ with the hope that it would encourage continuing innovation.[28]

The Essential Facilities Doctrine in Other Jurisdictions[29]

Europe

The European Union recognises essential facilities as a principle associated with the abuse of dominant position (Article 82 of the Treaty of Rome), so much so that recent European guidelines on abuse of dominance consciously endorse the doctrine.[30] However, until 1998, the ECJ had not formally granted constraint force to EFD. In the last 15 years the European economies have been largely affected by regulatory reforms aiming for introducing competition in markets where the existence of essential facilities constitutes a hard barrier to entry in natural monopoly industries such as telecommunications, electricity, gas, railways, and the postal sector, etc.

The first case in Europe (European Union) was the *Commercial Solvents Corp v. Commission of the European Communities* to apply the principle.[31] This 1974 judgment said that a dominant supplier of an input abused its dominant position when it refused to supply the input to a customer, the supplier’s competitor in the downstream derivative market, ‘with the object of reserving such raw materials for manufacturing its own derivatives, and therefore risks eliminating all competition’ from that competitor. Over time, among other things, the European Commission has imposed liabilities on owners of ports, harbours, tunnels etc. who prevented downstream competition through their control of the infrastructure.[32]

The European Union has also introduced the notion of 'exceptional circumstances' to counter the privileges of intellectual property rights (IPRs) when such rights are perceived to counter competition. One of the early cases in this regard was *Volvo v. Veng*[33] where it was held that the dominant firm's refusal to grant a licence of its 'protected design' for car body panels, standing alone, could not constitute abuse of dominant position, since the right to exclude 'constitutes the very subject-matter of [the IP holder's] exclusive right' under Intellectual Property law. However in this case it was also held that such a refusal could be considered abusive in limited situations, including an 'arbitrary refusal to supply spare parts to independent repairers'. The notion that a higher standard must be met before a dominant firm can be compelled to licence its IPRs was more clearly expressed in *Magill*[34] and *IMS Health.*[35] In these two cases, the courts held that 'exceptional circumstances' must exist for any refusal to licence IPRs to be countered.

The exceptional circumstances requirement was translated into a three-part test: (1) the refusal prevented the emergence of a 'new product', which the dominant firm did not offer and for which there was potential consumer demand; (2) the refusal allowed the dominant firm to reserve for itself 'the secondary market ... by excluding all competition on that market'; and (3) the refusal was unjustified. IMS Health further clarified that the conditions must be cumulative for 'exceptional circumstances' to be found.

Subsequently such arguments were used to require open access to information for interconnecting with the dominant Microsoft networks. While the European Commission has been developing the essential facilities doctrine in this manner, it has also notably not extended open access in cases where firms can create their own facility either on their own or in cooperation with other producers.[36] It can thus be maintained that overall the European Union has applied the EFD requiring access to infrastructure largely for instances where there are significant downstream externalities.

Australia

Australia is an example of countries that have institutionalised explicitly the EFD by using the route of mandated regulation rather than through the interpretation of competition law or regulatory laws.[37] This was a result of *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd.*[38] The defendant *Broken Hill Party* (producer of 97 percent of Australia's steel output) manufactured Y-bar steel which it sold exclusively to its subsidiary *Australian Wire Industries*. In turn *Australian Wire Industries* produced fence posts out of the raw material and sold them. The plaintiff *Queensland Wire Industries* sought steel from *Broken Hill Party* to competitively produce fence posts for the rural market but the prices charged were so high that the plaintiff moved the courts with the plea that this amounted to a 'refusal to sell'. However the judiciary was not convinced about this being conduct that misused market power and more importantly went on to categorically state that the EFD is not accommodated by the terms of Section 46 (both High Court and Full Federal Court declined to accept EFD).[39]

An important fallout of this was that the Australian government formed the *Independent Committee of Inquiry into Competition Policy in Australia* which brought out the Hilmer Report that recommended a legislative regime to facilitate third party access to 'essential facilities'. Given the judicial pronouncement on the relation between Section 46 of Trade Practices Act 1974 and Essential Facilities, the Hilmer Report (in contrast to other jurisdictions such as the US and EU) felt that access issues and disputes were better resolved with an administrative solution rather than by relying on a judicial mechanism.

In tandem with the Report, Part IIIA of the Trade Practices Act 1974 (Cth) was incorporated in the existing Australian competition law to create a national access regime. This regime attempts to balance the interest of both the suppliers as well as the purchasers and firms with natural monopolies that are vertically integrated are liable to provide access. The access regime provides for commercial negotiations of terms and conditions. When they fail, then arbitration is sought from Australian Competition and Consumer Commission.

Thus, it is evident that Australia follows a national access regime whereby access requirements are limited to the natural monopolies and the whole process is governed by an administrative rather than the judicial process. Indeed the doctrine has been pronounced variously – judicially and/or required administratively, in various parts of the world, including New Zealand, Canada, South Africa, Israel, Japan, Turkey, Russia and even Guatemala.[40]

Essential Facilities Doctrine and India

The Presence/Application of the Essential Facilities Doctrine in India

The presence of the EFD in India is intimately linked with infrastructure provision (in addition to Indian Patents Act's compulsory licencing regime), albeit not as a doctrine upheld by Indian courts but rather in the regulatory statutes associated with certain infrastructure goods, in particular in the Telecom Regulatory Authority of India (TRAI) Act, 1997, the Electricity Act, 2003 and the Petroleum and Natural Gas Regulatory Board (PNGRB) Act, 2006.

Distinguishing Regulation and Competition Law

Since regulation is very important in relation to the EFD in the Indian context and as of yet there is no competition law case where this doctrine has been invoked, as a first step it is important to clarify the relationship between competition law and infrastructure regulation. This relationship can be understood by recognising the contrast of an *ex-post* intervention of competition authority as against an *ex-ante* intervention by regulators.[41]

The former seeks to 'repair' markets by imposing liability whereas the latter intervention type of a regulator aims to 'build' markets. It is this *ex post* role which is very important in the case for India where in network-infrastructure sectors, pre-liberalisation monopolists own networks of transmission and any new entrant cannot easily replicate such a system and secure a reasonable return to investment. Once a regulator has established a competitive market the regulatory institution should disappear and the erstwhile regulated industry should be subject to competition law for any anti-competitive behavioural issues.

This point is hard to specify but before discussions thereon, it would be worthwhile to first describe the various regulatory provisions wherein the pattern of essential facility provision have been enabled by the Indian regulatory regime.

Telecom

Before liberalisation, this sector was largely owned by the government. However, reforms in this sector moved progressively by first opening some value added services (like email to private players) and then moving on to the formation of the National Telecom Policy in 1994 whereby, private participation was encouraged in paging and cellular mobile telephone services, etc. Soon, in 1997, the first regulatory body in the country TRAI was formed.[42]

Consequently, to encourage further private investment in the sector, interconnect issue was delegated to the regulator. In the TRAI Act, 1997 essential facilities concerns are dealt by the provisions dealing with interconnection. As has been emphasised earlier, it is important to join interoperable systems such as linking of two or more communication units, systems, networks, links, nodes, etc. because this enhances competition and maximises benefits for consumers.

Under Section 11(1) (c) and Section 11(1) (l) of the Act, it is the duty of the regulatory authority to ensure interconnection and technical compatibility between various service providers and maintain a register of such agreements. For this purpose, TRAI enacted the *Telecommunication (Broadcasting and Cable Services) Interconnection Regulation, 2004* which enumerates the arrangements that guide the interconnection and revenue share among service providers.[43] Further, TRAI has also enacted *The Telecommunication Interconnection (Reference Interconnect Offer) Regulation, 2002* under which the terms and conditions on which interconnection of its network with that of other service providers seeking interconnection are specified.

The interconnect requirement for each of the service providers is met by enabling access to incumbent's subscribers. As per international regulatory practice, interconnection is provided to new service providers at a price which is determined through a cost based approach. However, in India the amount to be paid by the new operator was stated in the licence agreement itself. This pre-empted the delay that would have been caused by perpetual negotiations to arrive at a mutually agreeable price. The downside was that there was no known basis for the price in the agreement and it was often confused with user charges or inter-operator tariffs.[44]

The vague price mechanism became an instrument for the incumbents to deter new entrants. TRAI took note of this and passed a *Telecommunication Tariff Order in March, 1999* and a regulation on *Interconnection Charges and Revenue Sharing in the May, 1999* according to which mutual bargaining was permitted and if both the parties failed to reach an agreement, then intervention would be done by the Authority. Even though, Department of Telecom sued TRAI for possessing overreaching powers and won the case,[45] in 2000 an amendment ordinance restored TRAI's power to regulate tariffs and arbitrate interconnect issues.

Subsequently, the *Telecommunication Interconnection Usage Charges (IUC) Regulation, 2003* was passed under which cost based approach for interconnection charges using audited cost for the operators instead of a complicated cost model and a regular consultation with stakeholders to preserve coherence in the interconnection regime was followed. This success of the interconnect regime engineered by the telecom regulator is reflected in the growth of the sector as well. The number of subscribers has increased to 764.77 million in 2010 from merely 76.54 million in 2004.[46] Private sector participation which was 5 percent in 1999 has increased to 84.5 percent in 2010.[47] Growth rate of rural telephones has also increased from 16 in 2004 to 32.81 percent in 2010 of which 84.5 percent of telephone connections are provided by the private operators.[48]

Natural Gas

The gas transmission grid in India was initially restricted to western, central, northern and north-east regions owing to lack of customer base for natural gas coupled with short supply. Moreover, lack of private participation deterred the expansion of gas network at the national level. Gas Authority of India Limited (GAIL) owned 70 percent of the market share with other companies like Gujarat State Petronet Limited and Oil India/Assam Gas Company concentrating on regional consumer base.[49] To this effect, in order to liberalise the sector, the New Exploration Policy was introduced in 1999 whereby, mandatory state participation in exploration and production was withdrawn and international competitive bidding was allowed.

Subsequently, *the Petroleum and Natural Gas Regulatory Board Act (PNGRB), 2006 Act* was formulated. In this Act, the idea of essential facilities is evident in the definition of 'common carrier' i.e. under Section 2(j) there is non-discriminatory open access given by the Board from time to time to pipelines for transportation of petroleum and petroleum products. Correspondingly, Section 2(m) defines 'contract carrier' as "such pipelines for transportation of petroleum, petroleum products and natural gas by more than one entity pursuant to firm contracts for at least one year as may be declared by the Board from time to time." Further, the board can regulate the open access and transportation rate under Section 61(e).

To boost competition in the sector, in October, 2008, the Ministry of Petroleum and Natural Gas issued a draft regulation encouraging sharing of infrastructure. According to the draft, once an infrastructure is declared common user facility, it is compulsory for the body owning the capacity to share it with the other users. The first right to use remains with the controlling entity and it is the remnant spare capacity which will be utilised by other entities. This encouraged private players to participate in the network and led to explorations off the East coast and development of new Liquefied Natural Gas terminals like Dabhol and Kochi.[50]

Moreover, private companies like, Reliance Gas Transportation Infrastructure Limited constructed a 1,385 km long East-West pipeline which is second largest in the country. In 2010, India's gas transmission grid stood to 11,148 km with 273.8 mmscmd capacity, which is truly remarkable.[51]

Indeed as a result of such regulations, the natural gas industry has expanded over time and solicited considerable levels of investment. The natural gas production increased from 32.2 to 47.5 billion cubic meters from 2005-06 to 2009-10.

Electricity

The passage of the *Electricity Act, 2003* governed the entry of private players into a sector previously dominated by the public sector. The Electricity Act, 2003 expresses certain dimensions of EFD which can be observed in the way it defines 'open access' [stated under Section 47(2) of the Act]. In relation to electricity, open access implies non-discriminatory provision of distribution or transmission to any licencee, consumer or a person engaged in generation in accordance with the regulations specified by the Appropriate Commission.

The Act provides open access to a person to carry electricity from his captive generating plant to the destination of his use subject to availability of adequate transmission facility as determined by Central or State transmission utility under Section 9(2). The Government of India has recently proposed that open access will be applicable to power demands of beyond one MW and that regulatory commissions need not interfere with the tariffs because the same would be settled between the supplier and the consumer.[52] The matter is yet to be settled due to inter-ministerial consultations.

Further, the Act under Section 38(2)(d) directs the Central Transmission Utility to provide non-discriminatory access of transmission to the licence or generating company on payment of transmission charges and to any consumer when open access is provided by State Commission. A similar provision is made for the State Transmission Utility and Transmission Licence under Section 39(2) (d) and 40(2) (d) respectively.

Likewise, open access is highlighted for distribution as well under Section 42(2) whereby '[t]he State Commission shall introduce open access in such phases and subject to such conditions, (including the cross subsidies, and other operational constraints) as may be specified within one year of the appointed date by it and in specifying the extent of open access in successive phases and in determining the charges for wheeling, it shall have due regard to all relevant factors including such cross subsidies, and other operational constraints.' Thus, the legislation incorporates the basic idea of essential facility to encourage generation, transmission and distribution of electricity efficiently.

However unlike the other sectors the mandated open access has not translated into the kind of robust position we see in telecom or even natural gas. The Act encourages open access in transmission and distribution, presumably in order to introduce competition in the sector. It does so with the belief that if charges are paid to the utility that owns the infrastructure, multiple players will get access to the existing capacity which in turn will imply efficient use of existing infrastructure and thus alleviate power shortages.[53] Consequently, the competitive market so created would ensure lower costs to consumers.

However, bringing down the cost paid by consumers involves a series of measures including the minimisation of transmission and distribution losses, decreasing operating costs alongside maintaining low cost for additional power purchasing. In actuality, on the one hand, the cost of purchasing power has actually been increasing and on the other hand, the High Tension (HT) tariff has been lowered to cover average cost, leaving only a nominal margin, if any. Naturally therefore, utilities suffer a financial loss as there has been overdependence (over burden) on HT consumers to cover the losses.[54] If the HT tariff were raised this would deter commercial and industrial consumers from purchasing electricity from open access sources resulting in significant financial liability on the government in terms of providing subsidies to agricultural and domestic consumers.

Moreover, as electricity sector has limited grids, open access surges cause congestion in transmission lines leading to interrupted power supply.[55] Hence, the problems present within these networks have to be dealt with to bring out an effective mechanism for development of the sector. Unlike the telecom sector the regulation of prices has not provided a regime of easy 'interconnect'.

Compulsory Licence under Patents Act, 1970

The concept of the EFD doctrine can be inferred in the Indian Patents Act as inherent, among other provisions, in the compulsory licence provision in Section 84(1)(a) read with relevant clauses of Section 84(7). A plain reading of the following texts of the said provisions establishes this point.

Section 84. Compulsory Licences – (1) At any time after the expiration of three years from the date of the grant of a patent, any person interested may make an application to the Controller for grant of compulsory licence on patent on any of the following grounds, namely:-

(a) that the reasonable requirements of the public with respect to the patented invention have not been satisfied, or ...

(7) For the purpose of this Chapter, the reasonable requirements of the public shall be deemed not to have been satisfied –

(a) if, by reason of the refusal of the patentee to grant licence or licences on reasonable terms, –
  (i) an existing trade or industry or the development thereof or the establishment of any new trade or industry in India ... is prejudiced; or
  (ii) ....; or
  (iii) ...; or
  (iv) the establishment or development of commercial activities in India is prejudiced; or

(b) if, by reason of conditions imposed by the patentee upon the grant of licences under the patent... the manufacture, use or sale of materials not protected by the patent, or the establishment or development of any trade or industry in India, is prejudiced; or

In general, the message is that if "refusal to deal" by the patent holder is 'trade restrictive' or amounts to 'entry barrier', particularly (but not only) with respect to goods not protected by the patent, then it can be a ground for compulsory licence. This goes with the basic facets of the EFD.

The Role of Competition Commission

Divergent examples above show that while such mandated presence of the EFD can be introduced into the regulations of select industries, it is not an easily replicable exercise. The *ex-post* regulation under the competition law is needed not only as markets mature but as potential new market develop. No case associated with the EFD has come before the antitrust authority in India as yet.[56] However, it is our understanding that the *Competition Act, 2002* has sufficient structure for the judiciary to invoke the EFD if it needs to do so. Of course the doctrine is not mentioned in the Act, but like the European legislation (that appears to have inspired the Indian law), the Act has clauses that prohibit the abuse of a dominant position – Section 4(c) asserts that denial of market access to others by a dominant player would be an abuse of dominant position.

In addition, under Section 18 and 19, it is the duty of the Commission to abolish practices that have adverse effect on competition. Specifically, sections 19(3) and 19(4) deal with determining factors that restrict emergence of competition viz. creation of barriers to new entrants, driving existing competitors out of market, etc. and criterion to ascertain the dominant position through market share of the firm, size and importance of competitors, etc. is also specified. One important suggestion however, is to recognise that the Competition Commission can take cognisance of Section 18 along with section 64(1) to formulate a regulation to provide free access to common facilities under the EFD. Given this scope it is up to the judiciary to invoke the doctrine in a case where it needs to be aptly invoked to enhance downstream spill-over which enhances social welfare.

Conclusion

It has been pointed out here that there is a good case (welfare enhancing) to be made for a policy that ensures compatibility or interoperability across the links that form the complementary composite of a 'network good', infrastructure good/service and pharmaceutical patents. The problem with any such policy is that it has to balance incentives to innovate or invest against access to the good/service. In this context, the EFD imposes a legal antitrust/antimonopoly liability on monopolistic/dominant firms to share facilities that may be difficult for rivals to duplicate easily. It has been suggested that such liability is particularly important if the good in question acts as an infrastructural input into a series of downstream products and has a public interest and not-so-easily-replaceable characteristic.

It has also been noted that the doctrine has been put into effect across various jurisdictions all over the world either as an expression of the antimonopoly law or through administrative means using provisions of industry-specific regulation. In India, the doctrine is addressed by incorporating it into laws governing key infrastructure sectors such as telecom, gas and electricity where interconnectivity across nodes of a network. The concept of EFD can also be read into the Patents Act, 1970, which can apply to any sector.

Notwithstanding relative successes and failures of such interventions, as the Indian economy grows and matures it is inevitable that for wider and more complete encouragement of competition, the EFD will need to flow in from the Competition Commission and competition law which is adequately structured to uphold the doctrine.

In addition if we look at the issue of compulsory licencing from the lens of EFD, there is a need to bring the matters to the table of competition law. It is then for both the competition authority and the courts to balance the economic and competitive interests of the parties involved, in the light of the public interest in opening up the market to competition.

Endnotes

1 The essential facility is an exception of general duty that Section 2 of Sherman Act imposes on the business

2 Chiriþã, Anca Daniela (2011). 'Access to Essential Facilities: A Comparative Competition Law Perspective of Shared Use and Recent Margin Squeeze Cases', *Competition Survey: Studies, Researches and Analysis,* Vol. 1: 32-41

3 Frischmann, B. and Waller, S. W. (2008). 'Revitalizing Essential Facilities', *Antitrust Law Journal*, 75(1):1-65

4 Although EFD is basically considered originating from US case laws, EC is credited with developing a more perfect and comprehensive criteria during the application of EFD

5 Section 3.(5) (i): the right of any person to restrain any infringement of, or to impose reasonable conditions, as maybe necessary for protecting any of his rights which have been or maybe conferred upon him under....(various IPR laws)

6 This section draws extensively from Economides, N. (2008). 'Public Policy in Network Industries' in Paolo Buccirossi (ed.) Handbook of Antitrust Economics, The MIT Press: Cambridge, Massachusetts

7 For a typical example of a network good pointed out, *see* Katz, M. L. and Shapiro, C. (1985). 'Network Externalities, Competition, and Compatibility', *American Economic Review*, 75:424

8 For a detailed discussion on this, see Economides, Nicholas (1996). 'The Economics of Networks', *International Journal of Industrial Organisation*, 14:673-74

9 Studies show that even when many firms compete in a network good setting, there is a feedback loop that often causes the market to 'tip' in favour of one player. Shapiro, C. and Varian, Hal R. (1999). *Information Rules: A Strategic Guide to the Network Economy*, Harvard Business School Press, Cambridge, Massachusetts.

10 *See for an overview.,* Layne-Farrar, Anne; Padilla, A. Jorge; Schmalensee, Richard (2007). "Pricing Patents for Licensing in Standard-Setting Organizations: Making Sense of Fraud Commitments," 74 *Antitrust Law Journal* 671

11 *See,* "EC Antitrust Chief warns over abuse of 'essential' patents in smartphones wars," *Guardian* 10 February 2021

12

13 See pg 485 in Lemley, M. A. and McGowan, D. (1998). 'Legal Implications of Network Economic Effects', *California Law Review*, 86(3):479-611.

14 Frischmann, B. and Waller, S. W. (2008). 'Revitalizing Essential Facilities', *Antitrust Law Journal*, 75(1):1-65 (*Supra* n. 4)

15 This is subject to the condition that no congestion externalities emerge

16 This discussion around infrastructure draws on Frischmann, B. M.(2004). 'An Economic Theory of Infrastructure and Commons Management', *Minnesota Law Review*, 89.

17 While the law review literature on Essential Facilities is quite extensive, some of the most pointed and detailed description of the doctrine is presented in Lao, M. (2009). 'Networks, Access and "Essential Facilities" from Terminal Railroad to Microsoft', *S.M.U. Law Review*, 62(2).

18 United States v. Terminal R.R. Ass'n of St. Louis, 224 U.S. 383 (1912).

19 Associated Press v. United States, 326 U.S. 1 (1945).

20 Otter Tail Power Co. v. United States, 410 U.S. 366 (1973).

21 MCI Commc'ns Corp. v. AT&T, 708 F.2d 1081 (7th Cir.), *cert. denied,* 464 U.S. 891 (1983).

22 Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 738 F.2d 1509, 1519-22 (10th Cir. 1984), *affd on other grounds,* 472 U.S. 585, 611 (1985).

23 The case did reach the US Supreme Court on other matters but the Court did not engage with the 'Essential Facilities' aspect of the case

24 A list of such dismissed cases can be found in Lao (2009), *op. cit*

25 Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 410-11 (2004)

26 Areeda, P. (1989). 'Essential Facilities: An Epithet in Need of Limiting Principles', *Antitrust Law Journal,* 58(3):841-853. In addition to this much quoted attack on the doctrine, others who have written against the doctrine include: Boudin, M. (1986). 'Antitrust Doctrine and the Sway of Metaphor', *Georgia Law Journal*, 75:397-403; Werden, G. J. (1987). 'The Law and Economics of the Essential Facility Doctrine', *Saint Louis University Law Journal*, 32; Hylton, K. N. (1991). 'Economic Rents and Essential Facilities', *BYU Law Review*; Gilbert, R. J. and Shapiro, C. (1996). 'An Economic Analysis of Unilateral Refusals to Licence Intellectual Property',

Proceedings of the National Academy of Sciences, 93; Mc-Gowan, D. (1996). 'Regulating Competition in the Information Age: Computer Software as an Essential Facility Under the Sherman Act', *Hastings Comm. and Ent. Law Journal*, 18; and Lipsky, A. B. and Sidak, G. J. (1999). 'Essential Facilities', *Stanford Law Review*, 51.

27 Frischmann and Waller (2008), *op. cit.*

28 A detailed account of the Microsoft case can be found in Lao (2009), *op. cit.*

29 Some of the following discussion draws from Waller, S. W. and Tasch, W. (2010). 'Harmonizing Essential Facilities and Refusals to Deal', *Antitrust Law Journal*, 76(3); and Lao (2009), *op. cit.*

30 For instance the guidelines state "The Commission will consider these practices as an enforcement priority if all the following circumstances are present: the refusal relates to a product or service that is objectively necessary to be able to compete effectively on a downstream market; the refusal is likely to lead to the elimination of effective competition on the downstream market; and the refusal is likely to lead to consumer harm. Communication from the Commission (2008): Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Treatment by Dominant Undertakings"

31 Joined Cases 6/73 & 7/73, Commercial Solvents v. Commission, 1974 E.C.R. 223.

32 See, Case IV/34.174, B&I Line PLC v. Sealink Harbours Ltd. & Sealink Stena Ltd., 5 C.M.L.R. 255 (1992); Commission Decision (EC) No. 94/19, Sea Containers v. Stena Sealink, 1994 O.J. (L 15) 8; Commission Decision (EC) No. 94/119, Port of Rodby, 1994 O.J. (L 55) 52; Commission Decision (EC)No. 354/66, Eurotunnel, 1994 O.J (L 354) 66

33 Case 238/87, AB Volvo v. Veng, 1988 E.C.R. 6211.

34 Case C-241/91, Radio Telefis Eireann (RTE) v. Commission, 1995 E.C.R. 1-743, 4 C.M.L.R. 718 (1995).

35 Case C-418101, IMS Health GmbH & Co. v. NDC Health GmbH & Co., 2004 E.C.R. 1-5039

36 For instance see Case C-7/97, Oscar Bronner GmbH & Co. v. Mediaprint Zeitungs, 1998 E.C.R. I-7791, 4 C.M.L.R. 112 (1999). This case, of course, importantly restricts the scope of the essential facilities doctrine by requiring that apart from the owner of the facility being a dominant firm, the facility be indispensable for the doctrine to kick in. However the point also to be noted is that the case in particular demands that a test be performed to see whether the refusal to deal will lead to a monopolisation of the downstream market. See Day, J. (2003). 'Essential Facilities in the European Union: Bronner and Beyond', *Columbia Journal of European Law*, 10.

37 The Australia discussion draws on Marshall (2004).

38 [1987] ATPR 40-180 (Fedral Court); [1988] ATPR 40-841 (Full Federal Court; (1989) 167 CLR 177 (High Court).

39 Section 46 of the Trade Practices Act, 1974 was invoked in this case because it prohibits taking advantage of the degree of power for the purpose of eliminating or damaging a competitor, preventing the entry of a person into a market or deterring or preventing a person from engaging in competitive conduct in a market.

40 See Waller and Tasch (2010), *op. cit.*

41 Frison-Roche, Marie-Anne (2011). 'Regulation *versus* Competition', *The Journal of Regulation*, I-1.30:550-560.

42 Malik, P. (2010). 'Evolution of Interconnection Regime in India', Lirne Asia Working Paper.

43 Section 3(2) of the Act asserts that 'Every broadcaster shall provide on request signals of its TV channels on non-discriminatory terms to all distributors of TV channels….'

44 Uppal, M., Nair, S.K.N. and Rao, C.S. (2006). 'India's Telecom Reform: A Chronological Account', IIPA Working Paper.

45 Gupta, S. (2007). 'Competition Policy in Telecommunications in India', CCI paper

46 Economic Survey (2010-11), Government of India.

47 *Ibid*

48 *Ibid.*

49 Credit Analysis and Research Ltd., Press Release - Indian Gas Transmission Business

50 Bhattacharyya, D. and Singh, D. (2010). India, *The International Comparative Legal Guide to: Gas Regulation 2010*, Global Legal Group: UK.

51 Credit Analysis and Research Ltd., Press Release- Indian Gas Transmission Business.

52 www.biharprabha.com/2012/01/govt-bent-to-allow-open-access-to-all-power-consumers-above-1-mw/

53 Electricity India.com: www.electricityindia.com/powertrading.html

54 Power Today: www.powertoday.in/News.aspx?nId=icLQ70X98l4HbklCdQGdPQ==

55 Rajamani, G.S. (2004). 'Power Trading: Open Access key to Success', The Hindu media update

56 Something akin to the EFD has been noted by the Supreme Court, albeit not in the context of antimonopoly law but the duty of private bodies performing public functions. In the case of *VST Industries Limited v. VST Industries Workers' Union and Anr.* It was held "it is noticed that not all the activities of the private bodies are subject to private law, e.g., the activities by private bodies may be governed by the standards of public when its decisions are subject to duties conferred by statute or when by virtue of the function it is performing or possible its dominant position in the market, it is under an implied duty to act in the public interest (emphasis added)…." Further, the court asserted that any private company in India that is controlling infrastructure facility through concession agreement as awarded by the government will be considered as performing a public function and thus is expected to act in public interest. If the company refuses to deal with any competitor then it would be under judicial scrutiny for performing an arbitrary action of a body discharging public functions. (2001) 1 SCC 298.

Chapter 5

Regulation of Microfinance Institutions in India*

Introduction

Microfinance institutions, (MFIs), have become increasingly important for meeting financial inclusion goals in developing countries. According to Consultative Group to Address the Poor (CGAP), only 30 percent of adults in developing countries are estimated to have access to basic deposit services and even fewer to credit, insurance and other financial services. Consequently, the poor have to rely on more costly informal financial services to save and to borrow. MFIs straddle this chasm. Currently MFIs in India serve 31.4 million clients, with ₹207.5bn loans outstanding.[1] These institutions aim to provide services to poor clients, maintaining an average loan size under ₹10,000.

MFIs in India have grown tremendously in terms of size, outreach, and financial maturity since their emergence in the 1980s. Recent RBI reports in regard to microfinance activities noted that: alongside self-help group (SHG)-bank linkage programmes, MFIs such as non-government organisations (NGOs) and non-banking finance companies (NBFCs) have emerged as important sources of microfinance delivery in India. Consequently, incentives have been provided for penetration of banking into unbanked areas and encouraging MFIs as intermediaries.

In 2009-10, around 691 MFIs were provided loans worth ₹80.63bn by banks. The growth under MFI-linkage programmes in terms of both number of credit-linked institutions and the amount of loans was much higher than the corresponding growth under SHG-bank linkage programmes. However, though MFIs have grown at tremendous rates, the growth has been geographically disproportionate.

The Malegam Committee[2] report noted that distribution of microfinance penetration is very high in the Southern region, while the Western and

* This chapter is based on research by Santadarshan Sadhu, Kenny Kline and Justin Oliver, IFMR Centre for Micro Finance, Chennai

Northern regions show very little penetration. Southern region has a little over half of the total MFI portfolio while the Eastern region has over one fourth of the total MFI portfolio. SHG penetration shows a similar trend. Even within regions, microfinance services are often concentrated in certain districts. The report, however, shows the encouraging trend of MFI diversification into other regions at a rate of growth comparatively higher than the rate of growth in the Southern region.

The MFI model in India is implemented primarily through private initiative. In the 1980s, MFIs took the form of societies, trusts, and local area banks. The enactment of Mutually Aided Cooperative Societies (MACS) Act at state level in some of the states like Andhra Pradesh, in 1990s permitted registration of cooperatives and provided permission to lend. MACS enjoy the advantages of operational freedom and virtually no interference from government because of the provision in the Act that societies under the Act can not accept share capital or loan from the state government.[3]

As these MFIs grew in size, many transformed to become NBFCs. NBFCs must adhere to more stringent audit and disclosure requirements, which make them more suitable for performing financial operations and for attracting additional funding through capital markets. Also of importance is the SHG-Bank Linkage Model (SHG Model), which was started in 1991 by the National Bank for Agriculture and Rural Development (NABARD). The model was quickly adopted by banks, and by 2005 over one million SHGs were a part of the linkage model. Currently, 62.5 million clients are linked to banks through SHGs, with ₹306.2bn loans outstanding. The scope of this paper is restricted to regulation relating to the MFI model.

As MFIs quickly scaled up in size and number, the way these institutions function and the potential harm that accompany their services came into question. Coercive collection practices, usurious interest rates, and use of selling practices that result in over-indebtedness for consumers are the primary customer complaints that led to a crisis. Current regulations in the sector do not address these issues, and hence official action cannot be taken, prolonging repayment issues, liquidity issues, and general uncertainty.

In Andhra Pradesh during the later half of 2010, MFIs were accused of engaging in abusive practices that resulted in borrower suicides. State and local politicians encouraged non-repayment, and passed the Andhra Pradesh Microfinance Ordinance 2010,[4] which put additional constraints on MFI practices at the state level. The Andhra Pradesh Micro Finance Institutions (Regulations of Money Lending) Act 2010 replaced the Ordinance and also included a list of actions which constitute coercive action. The main features of the enactment are as follows:

a. every MFI has to register before the designated registering authority of the district
b. penalties for failure to register and for coercive acts of recovery
c. prohibition on use of agents for recovery or use coercive methods of recovery
d. all MFIs have to submit a monthly statement to the registering authority giving specified details
e. no member of an SHG can be a member of more than one SHG
f. no MFI can give a further loan to a SHG or its member without the approval of the registering authority where there is an outstanding bank loan

As a result, funds stopped flowing to MFIs, resulting in a liquidity crisis in the sector. Since no clear regulation prohibits such acts from government and legislatures in other states, investors and banks reasoned that similar crises were possible across India. Thereafter, there were many calls for regulatory reform to address pending issues in the sector that led to this situation. It is pertinent to provide here the comparative findings of 'Global microscope[5] on the microfinance business environment' where the ranking of India on the index slid from 8 in 2010 to 27 in 2011.

The 2011 study notes that the lack of credit discipline by lenders and poor regulatory oversight led to a surge in micro-loan portfolios, prompting the state government to issue a draconian decree that sharply curtailed MFIs' lending operations and impeded their ability to compete with state-sponsored microfinance providers.

Various provisions of the Andhra Pradesh Micro Finance Institutions (Regulations of Money Lending) Act, 2010 violate a fundamental competition principle of competitive neutrality. For instance, the mandatory registration is applicable only to MFIs, which include mainly private players, and not to State sponsored Society for Elimination of Rural Poverty (SERP)[6] and Mission for Eliminating Poverty in Municipal Areas (MEPMA).[7] The positive side as observed by 2011 report is that Indian microfinance sector has continued to grow, although the crisis in the sector in Andhra Pradesh in 2010 led to calls for better and stricter regulation. Thus, such reactive measures by the state to regulate the sector can have adverse effect on the sector.

As Malegam Committee also observed that the purpose of regulation should not be confined merely to the prevention of abuses but should also examine methods by which the efficiency of operations can be improved. Further, the Committee rightly notes that while regulations are important, they cannot by themselves be the sole instruments to reduce interest rates charged by MFIs or improve the service provided to borrowers. Ultimately, this can only be done through greater competition both within the MFIs and without from other agencies operating in the Microfinance sector. The sector calls for a comprehensive and positive regulation.

There is also much debate surrounding the proliferation of for-profit MFIs, specifically the high returns earned by some promoters and the compensation of top level management. Some for-profit institutions receive priority sector lending, which may be interpreted as a use of public funds to generate individual profit. Any new regulation will need to better define which institutions and assets qualify for priority sector lending with respect to microfinance services.

In response to demand for new regulation, Malegam Committee developed a set of recommendations that was released in January 2011; the Malegam panel put forth its recommendations for an orderly functioning of the micro-credit industry. RBI broadly accepted the report in May, and drafted a new regulation specifically for identifying MFIs which qualify for priority sector lending. These recommendations aimed to address all major regulatory concerns of the sector. A draft of the Microfinance Institutions (Development and Regulation) Bill, 2011 (henceforth Microfinance Regulations Bill) was released in July 2011, and proposes the appointment of RBI as the regulator of all MFIs, which is analysed later.

The chapter gives an overview of the existing microfinance regulatory structure in India, and then identifies their limitations. There is a discussion on other countries to see how regulation has addressed similar limitations across the globe, and how these methods affect the local sector. It outlines the issues a microfinance regulation should consider, discusses the global best practice regulations and presents an analysis of the henceforth Microfinance Regulations Bill. Drawing from this analysis, the chapter concludes, with some recommendations for regulatory amendments.

The Microfinance Regulatory Structure in India – Overview and Limitations

Legal Structure of MFIs

A MFI in India acquires permission to lend through registration (Table 5.1 provides details of the registration requirements). MFIs are registered as one of the following five types of entities:[8]

- NGOs engaged in microfinance (NGO MFIs), comprising of Societies and Trusts;
- Cooperatives registered under the conventional state-level cooperative acts, the national level Multi-State Cooperative Societies Act (MSCA 2002), or under the new State-level Mutually Aided Cooperative Societies Act (MACS Act);
- Section 25 Companies (not-for profit);

Table 5.1: MFIs by Type of Registration

Category	Type of MFI	Registration
Not for Profit	NGO MFIs: Societies &	Registered under Societies Registration Act, 1860 and / or Indian Trust Act 1882
	Section 25 Companies (10)	Section 25 of Companies Act, 1956
Mutual Benefit	Cooperatives (100)	Registered under State Cooperative Societies Act or Mutually Aided Cooperative Societies Act (MACS) or Multi-State Cooperative Societies Act, 2002
For-Profit	NBFC (50)	Companies Act, 1956 & registered with RBI
	NBFC-MFI	RBI Circular, May 2011

Source: M-CRIL Microfinance Review 2010, www.m-cril.com/Backend/ModulesFiles/NewsEvents/M-CRIL-Microfinance-Review-Nov2010.pdf

- For-profit NBFCs; and
- NBFC-MFIs.

NGO MFIs: There are around 500 NGOs that provide microfinance services and operate as non-profits, although many of these NGO MFIs perform non-financial operations as well. NGO MFIs can be registered as a Society under the Societies Registration Act of 1860 or as a Trust under the Indian Trust Act of 1882.

Cooperative Societies: Approximately 100 MFIs in India operate as Cooperatives, registered under the Cooperative Societies Act of the respective state, the Central Multi-State Cooperative Act, 1984, or the new state-level MACS Act. The MACS Act was pioneered by Andhra Pradesh, which sought to prevent political interference in cooperative societies' operations. Some large cooperatives have acquired a banking licence from the RBI to operate as cooperative banks.

Section 25 Companies: Many NGO MFIs achieve a more formal corporate structure by registering under the Companies Act, 1956, as a Section 25 Company. These companies offer a structure that can more easily transform into an NBFC. They can accept equity investments, though they cannot offer dividends, and equity investments cannot be withdrawn at the closing of the company. Thus, these institutions often have difficulty attracting equity investments.

NBFCs: The mainstream financial sector in India is divided primarily into two categories, banks and NBFCs. Banks adhere to much more stringent regulation than NBFCs because they are all permitted to accept public deposits, and are considered to have consequent systemic risk. The NBFC encompasses many different types of financial companies, which are all subject to the same regulation requirements. Many MFIs have recently registered as NBFCs to take advantage of access to capital markets. NBFCs account for the great majority of the microfinance market in India, with about 50 NBFCs responsible for 80 percent of all microfinance portfolios.

NBFC-MFIs: For-profit institutions that qualify for priority sector lending funds are registered as NBFC-MFIs. This NBFC sub-category was created by RBI in May 2011 to classify NBFCs operating as MFIs which meet certain requirements. Currently, it is unclear how many NBFCs will elect to register as NBFC-MFIs, and how many will continue to operate as NBFCs. At this point, only priority sector funding requirements have been made applicable for NBFC-MFIs, though it seems that all existing NBFC regulations also apply to NBFC-MFIs.

Current MFI Regulations

This is a very uncertain time for microfinance regulation, since there exist a significant amount of pending regulation. The Malegam Committee recommendations have been 'broadly accepted' by the RBI, though the specifics of the regulation have only been released for items relating to priority sector lending status. The draft of the Microfinance Regulations Bill 2011 has been released as well, and though the bill has been generally well received by practitioners and policymakers, its passage is still awaited.

As sectoral regulation stands now, all the legal structures listed in the previous section face minimal regulatory requirements, except for NBFCs and NBFC-MFIs. Annexure 5.1 tabulates the major regulations applicable to NBFCs as stipulated by the RBI. Major regulatory aspects discussed include priority sector lending, deposit mobilisation, access to capital, the Money Lending Act, and state level regulations.

Priority Sector Lending: Priority sector lending is a government initiative which requires banks to allocate a percentage of their portfolios to investment in specified priority sectors at concessional rates of interest. Currently only MFIs registered as NBFC-MFIs are designated as a priority sector. The number of priority sectors has recently been reduced, which suggests that banks will be relying more heavily on lending to MFIs to meet the priority sector requirements. In order to register as a NBFC-MFI, an institution must meet requirements specified by the RBI.

RBI requires that a minimum of 75 percent of a NBFC-MFI's loan portfolio must have originated for income-generating activities. Additionally, an NBFC-MFI must have 85 percent of its total assets as qualifying assets (excluding cash, balances with banks and financial institutions, government securities and money market instruments). A qualifying asset is a loan which meets the following criteria:

- Borrower's household annual income does not exceed ₹60,000 or ₹1,20,000 for rural and urban areas respectively
- Maximum loan size of ₹35,000 (first cycle) and ₹50,000 (subsequent cycles)
- Maximum borrower total indebtedness of ₹50,000
- Minimum tenure of 24 months when loan exceeds ₹15,000
- No prepayment penalties
- No collateral
- Repayable by weekly, fortnightly or monthly installments at the choice of the borrower

An NBFC-MFI must also adhere to the following pricing requirements:

- Margin cap of 12 percent
- Interest rate cap of 26 percent
- Only three pricing components
- Interest rate
- Processing fee (maximum 1 percent)
- Insurance premium
- No penalty for delayed payment
- No security deposit or margin can be taken

Banks are responsible for ensuring that the institutions receiving priority sector funds adhere to these requirements, with verification through a quarterly Chartered Accountant's Certificate. Securitised assets may also qualify as priority sector assets if an institution meets these requirements. It is assumed that NBFC-MFIs must also adhere to general NBFC requirements.

Deposit Mobilisation: Regulation stipulates that only NBFCs and Cooperatives are permitted to accept public deposits, though NBFCs must adhere to additional stringent regulations,[9] and Cooperatives are only permitted to accept deposits from its members. There also exists what is called a deposits limited for NBFCs linked to the institution's Net Owned Fund (NOF). No MFI registered as an NBFC currently accepts deposits because regulation requires that institutions must obtain an investment grade rating, which no MFI has obtained so far.

Access to Capital: MFIs in theory can raise capital through various methods, including borrowing from domestic and foreign debt markets, obtaining grants and loans from subsidised lending funds, attracting foreign equity investment from capital markets, though legal structure of MFIs may restrict capital acquisition from some of these sources.

NBFCs can receive both equity and debt investments. NBFCs can raise foreign equity investment, though a minimum investment restriction requirement of US$500,000 applies, also with a cap of not more than 51 percent stake in the institution. Grants and subsidised onward-lending funds from domestic and foreign sources are not restricted, provided that the foreign grants do not exceed the ceiling of US$5mn per year.

Section 25 companies have difficulty attracting equity investments because they are unable to offer dividends and exit opportunities are difficult to predict. They can access External Commercial Borrowing (ECB) up to US$5mn, though the amount that institutions will lend to a Section 25 company is dependent on existing equity. Due to this leverage restriction, many Section 25 company's end up borrowing significantly less than the US$5mn limit.

MFIs can also access priority sector lending funds. Banks are required to lend 32-40 percent of their net credit to priority sectors identified by RBI at a rate lower than the prime lending rate. Microfinance businesses qualify for priority sector lending,[10] and can mobilise this capital much more freely than banks.

Money Lending Act: The Indian Moneylenders' Act 1918 has been adapted by various state governments to restrict interest rates charged by moneylenders. Although the primary purpose of this Act is to protect vulnerable section from the usurious interest rates that moneylenders charge, some states have applied the Act to Societies and Trusts to restrict their lending activity. Other states have applied the Money Lending Act to other forms of MFIs. Gujarat, for example, applied the Money Lending Act to NBFCs in early 2011. Different states have made different provisions while adapting the Act, often restricting interest rates and requiring licences for conducting a money lending business.

State Level Regulation: In late 2010, the Andhra Pradesh government enacted the Andhra Pradesh MFIs *(regulation of money lending)* Ordinance, which was later enacted into Act, to regulate the activities of MFIs. The Act stops MFIs from collecting old loans and originating new loans until the institution registers with the district authorities where they operate. The Act also mandates an interest rate cap such that the total interest charge can not exceed the principal amount of the loan. The Act also entrusts a great deal of discretionary power to the registering authorities and imposes restrictions on collection practices.

In a perception survey carried out under this project, a semi-structured questionnaire-based survey of key stakeholders/experts in the sector was conducted, selected from the industry, academics/consultants and policy practitioners, through in-person interviews/meetings and telephonic consultations. The interviewees were asked to rank, among other things, the regulatory impediments to competition and growth in the sector. The majority of stakeholders (68 percent) were of the opinion that MFI sector in India needs to be regulated. To control the on-going problem of over-borrowing and unsustainable debt of MFIs (as MFIs in India give multiple loans to borrowers), majority of the respondents (63.7 percent) in the perception survey suggested that the creditor should conduct an ability to pay test (a.k.a the know your customer or KYC exercise) before extending multiple loans.

Competition Analysis

This section provides a brief analysis of competition assessment of the current regulations. Ensuring fair competition in markets is very important for the sector's development of a country like India. Yet the government policies, rules and regulations often pose a threat to fair competition. Anticompetitive practices and policies prevailing in both public and private sectors must be addressed to ensure fair competition. The objective of 'competition assessment' is to examine the potential harm/benefit that might be caused to competition by the rules and regulations laid down by regulatory agencies. Table 6.2 summarises the competition assessment of the microfinance sector in India:

Table 5.2: Competitive Analysis

Factors Impeding Effective Competition	Present Status
1. Barriers to Entry	A company must have ₹2 crores Net Owned Funds (NOF), which is equal to shareholder equity plus internally-generated reserves, to register as an NBFC under the Company Act of 1856. These requirements are an obstacle for smaller institutions that may want to transform to a structure to more easily access capital markets. However, the minimum NOF is not unreasonable, and is necessary to control the number of qualifying NBFCs.
2. Limiting Product Scope	Regulation greatly restricts the type of products that can be offered, particularly relating to deposits. To be able to accept deposits, an NBFC must obtain a specified minimum credit rating (FA from CRISIL, MA from ICRA, BBB from CARE, tA from FITCH), minimum capital adequacy ratio of 15 percent, and two years of completed operations. For qualifying institutions, additional ceiling limits exist based on credit rating. Furthermore, the period of a deposit, payable interest

Contd...

Factors Impeding Effective Competition	Present Status
	rates, brokerage incentives, and demand deposits are all strictly regulated. Section 25 MFIs are not permitted to take deposits. Due to these restrictions, no MFIs are currently mobilising public deposits. This regulation also restricts other product offerings where MFIs have outstanding obligations to customers, such as insurance or pension products.
3. Barriers to raising finances	RBI's Foreign Investment Promotion Board (FIPB) has set foreign direct investment (FDI) rules for start-up companies not traded publicly on a stock exchange, which includes NBFCs: ● For FDI up to 51 percent, minimum initial capitalisation of US$0.5mn ● For FDI 51 percent-75 percent, minimum initial capitalisation of US$5mn ● For FDI 51 percent-75 percent, minimum initial capitalisation of US$7.5mn and capitalisation of US$50mn within 24 months ● FDI above 75 percent is allowed for companies with capitalisation greater than US$50mn These restrictions greatly affect investment opportunities for medium and smaller MFIs, which may not be able to attract such large investments.
4. State Government Intervention	Currently, state governments can intervene and enforce additional regulation on MFIs regarding permissible products, methods of collection, and code of conduct. A lack of nation-wide regulatory structure makes the MFI's expansion into multiple states difficult to manage, and much less transparent. A case in point is the recent Andhra Pradesh MFIs Act, 2010. This Act requires all MFIs to register with the Andhra Pradesh government, and subjects them to a number of additional regulations specific only to Andhra Pradesh.
5. Product Transparency	Currently, there are no uniform product transparency requirements that would make institutions provide essential financial information, such as effective interest rate or possible future fees.

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Factors Impeding Effective Competition	Present Status
	Product transparency is essential to ensuring fair competition. A customer must be able to access information regarding product benefits and risks, so that institutions' offerings can be compared.
6. Priority Sector Lending	Only select institutions which meet a number of regulatory requirements qualify for priority sector lending. Companies that wish to provide products and services outside the scope of these (narrow) requirements do not qualify for priority sector lending, and thus face significantly higher financing costs.
7. NBFC Status	Many institutions operate as NBFCs for financial and regulatory benefits; however these licences are greatly restricted by RBI. The licences are notably difficult to obtain, even if all requirements are met, and many companies end up opting for NBFC status just for the privilege of operating as an NBFC.

Limitations of Current MFI Regulations

As evident from Table 6.2, an important limitation of current regulations is the lack of clarity on Central and state regulatory jurisdiction. During late 2010 and early 2011, following the early 2010 eruption of the microfinance loans related deaths and the resultant furore, both Andhra Pradesh and Gujarat passed legislation barring specific microfinance practices within the state, requiring specific consumer protection policies and capping interest rates. States currently have great discretionary power as to how to interpret the Money Lending Act. Stability and confidence will elude the sector until this regulatory ambiguity is resolved.

Lack of consumer protection regulation is another limitation of the current structure. There is no regulation that has resulted in a functioning redressal procedure for borrowers to provide feedback on improper collection practices and abusive lending techniques. More than 57 percent of stakeholders in the perception survey agreed that the sector/consumers suffer because of the coercive practices and high interest rates charged by the creditors. Furthermore, standard regulation that explicitly defines appropriate customer protection rights and penalties for violations does not exist.

A major problem in the industry today is over-indebtedness of the customer. A functioning credit information system would be the best way for MFIs to predict a customer's ability to pay. There are several initiatives to start credit bureaus, and some existing microfinance credit bureaus are rapidly expanding their information base, however no regulation requires or incentivises institutions to submit information to credit bureaus.

Lack of diversification of funding is also problematic for MFIs due to current regulation on access to capital. Regulation allows NBFCs to raise capital from foreign equity investment, however the minimum investment is very high, and the minimum investment cannot account for more than 51 percent of the company. This requirement excludes a large number of foreign investors that may want to direct their funds to the sector. The restriction on ECB for NBFCs also greatly reduces funding options for MFIs.

Finally, the inability for MFIs to take deposits from the public is a missed opportunity for the sector. Accepting deposits is a service to both clients and institutions. Clients will have a more convenient way to accumulate funds, which will benefit them for emergency protection and saving purposes. Institutions accepting deposits will have a cheap source of funding, thus allowing for potentially lower costs for customers and extension of services to underserved areas. Regulation should allow for qualified institutions to accept public deposits while meeting strong prudential requirements.

Model Microfinance Regulations and Evaluation of the Microfinance Regulation Bill

Regulatory Issues that Microfinance sector needs addressed

Regulation of the financial sector is commonly divided into two categories: prudential and non-prudential. Regulation is prudential when it intends to protect the financial system from systemic risk, and to protect deposit safety. Prudential regulation by nature requires a regulator with sophisticated financial knowledge and experience, and one that is comfortable addressing issues such as capital adequacy, liquidity, reserves, and treatment of assets, in order to ensure the soundness of financial institutions. Non-prudential regulation addresses issues relating to the behaviour of financial institutions with respect to their conduct of business. These principles are equally applicable for the microfinance sector. For this analysis, selected prudential and non-prudential areas for regulation from a study conducted by the CGAP are relevant.

Prudential Regulations

Minimum Capital: There are often minimum capital requirements to attain normal bank licences to ensure that institutions have a base level of capital that will allow them to cover fixed costs. Investors and donors that support MFIs may not be able to contribute enough to attain a normal bank licence, thus these requirements may be adjusted to suit MFIs accordingly.

Capital Adequacy: Capital adequacy refers to the amount of capital that is held relative to the assets of the institution. The microfinance model differs greatly from traditional banking methods, so regulators must decide how much capital institutions should hold based on the unique challenges of the industry, such as high repayments but greater and unknown risks and shorter history of operation.

Loan Documentation: Requiring MFIs to follow the same loan documentation process as commercial banks would greatly burden institutions. Documentation requirements thus must strike a balance between useful and constraining, with regulation considering the lack of personal documents of borrowers, lack of financial statements for businesses, and structure of microfinance loans and repayments.

Non-Prudential Regulations

Permission to Lend: Sometimes lending is permitted because it is not explicitly outlawed. In such circumstances, an institution would have permission to originate and service microfinance loans. In other legal systems, a system cannot lend unless it is given permission to do so. Regulation directly or indirectly needs to address the institution's ability to lend.

Consumer Protection: The two primary consumer protection issues in microfinance that regulation should address are abusive lending and collection practices, and truth in lending. Abusive lending practice refers to abusive loan techniques, where the collector unfairly intimidates, harasses, threatens, or harms the customer. Abusive lending practice also applies to lenders which induce customer over-indebtedness, either intentionally or through lack of repayment assessment.

Truth in lending regulation relates to the transparency of products being provided by institutions. Often multiple fees and different interest rate computation methods make it difficult for consumers to understand the risks of products, and to compare a product to other products, or similar products provided by other institutions.

Credit Reference Services: Often called credit bureaus, credit reference services collect financial information on clients' status and history and supply this information to institutions to improve risk analysis and mitigation. Regulation may create a credit bureau, or require participation from MFIs and merchants. Customer privacy must be made a priority, and a customer's access to his own information should be permitted to ensure data accuracy.

Interest Rate Limits: MFIs charge much higher interest rates than commercial banks, citing higher administrative costs, higher service costs, and greater risk. However, regulators at times set interest rate limits for loans. These limits can differ based on institution specifics such as size of the institution, registration of the institution, demographic the institution serves, and institution cost of funding.

The existing regulatory structure that applies to MFIs in India currently does not adequately address all of these points.

Global Best Practices

The microfinance sector has unique challenges, which are distinct from the challenges of the traditional consumer and commercial financial sectors. Microfinance services are often provided to people who do not have any collateral security to offer, and who may lack identifying documentation and credit history. Transaction costs are also much higher than the traditional sector, since agents need to meet customers at all hours and at unorthodox locations as they extend financial services to areas that previously had none. A country which implements successful microfinance regulation does not simply enforce existing financial regulation, but designs regulations factoring these unique challenges.

Microfinance practices and challenges also vary between countries. There is no one set of regulation that can be considered as an all-encompassing answer to the needs of the sector. Every country may confront similar issues, however how these issues are dealt with will vary, based on the financial environment and priorities and goals of the sector. Many countries have a substantial number of people without access to formal financial services, though microfinance models vary greatly. Further, many countries have formal microfinance programmes, though some countries have primarily non-profit institutions, some have a sector dominated by for-profit institutions, and some have government-led initiatives.

MFI models vary from country to country as well, even varying greatly within some countries. In the global best practice section, regulatory issues are examined that every country must address, and look to other examples around the world for successful regulatory implementation.

Prudential Regulations

Prudential regulation almost always only applies to MFIs that accept deposits, since MFIs are not large enough to pose systemic risk to the financial system of a country. Applying prudential regulation to institutions that do not take deposits results in unnecessary costs for both regulators and institutions.

Minimum Capital Requirement: Nearly all countries that enforce prudential regulations have a minimum capital requirement to ensure that institutions have capacity to cover the fixed costs associated with deposit taking, such as additional reporting and risk management required. Regulators also use the minimum capital requirement to roughly control the number of qualifying institutions.

Bolivia used the minimum capital requirement for MFIs well in this regard, initially requiring a relatively small minimum capital amount, and then increasing this amount as MFIs grew in size and maturity. Currently, Bolivia's minimum capital requirement is US$6mn, which is significantly higher than most countries with a less-developed microfinance sector. The minimum capital value is most often determined by a regulator, the central bank, or legislators, depending on the country's preferences. The entity which controls the minimum capital requirement must set and adjust the amount according to the number of qualifying institutions and to keep par with economic measures, such as inflation and foreign currency rates.

Minimum capital requirements can differ within a country as well, as in Pakistan and Indonesia. Pakistan requires minimum capital based on whether the institution operates within a district, within a province, or nationwide, with different requirements for different districts and provinces.[11] Honduras bases minimum capital requirements on urban agglomeration. These approaches allow for more growth potential and privileges for MFIs that are serving underserved or rural areas.

Capital Adequacy: Capital adequacy requirements are used by nearly all countries to reduce the leverage and thus risk of MFIs that are subject to prudential regulation. The actual percentage of assets required varies amongst countries, though the requirement is almost always higher or equal to those of domestic commercial banks. Countries that have higher requirements often contend that microfinance banks have a shorter track record, and that microfinance portfolios are riskier than commercial bank portfolios. Common capital adequacy requirements in selected countries are shown in Table 5.3. It may be noted that exact definitions of terms must be examined for each country for a full understanding of the implications of the requirements and their impact.

In all the countries except Ethiopia, MFIs must hold at least the recommended 8 percent capital. Uganda clearly has the tightest requirement with 15 percent for core capital (the Basel Committee recommends 4 percent for this) and 20 percent for total capital. An interesting case is Nepal, which uses both a leverage ratio and a capital adequacy ratio. The aggregate amount of all deposits and advances from members of cooperative societies has been limited to ten times the amount of core capital.

Such a ratio does not rule out the possibility of increasing leverage by borrowing money, as it does not include debt. This ratio is a more crude

Table 5.3: Capital Adequacy Requirements – A Cross-country Comparison

Country	Risk Weighted Capital Adequacy Ratio for Type of Institution	Remarks
Bolivia	8 percent for Private Financial Fund;From 10 percent for Open Savings and Loan Cooperatives to 20 percent in (CAC) Category 1 to 4	Net equity as percent of risk-weighted total assets and contingencies
Ethiopia	12 percent for Micro Financing Institutions	Minimum capital adequacy ratio; applicable to re-registered MFIs
Ghana	6 percent for Rural Bank; 10 percent for Deposit-taking NBFI	Primary and secondary capital to adjusted asset base Supplementary and core capital to risk weighted asset
Indonesia	8 percent for BPR	Primary capital and supplementary capital, with the latter not being larger than the former
Nepal	5 percent for Cooperative Society; 10 percent for Limited Banking	For core capital and total capital, Licence
Pakistan	15 percent for Institutions providing MF servicesunder MFI Ordinance	Equity (paid-up capital, share premium, reserves and unappropriated profits) to risk weighted assets
Uganda	15 percent for Micro Deposit-Taking Institution	For core capital and total capital, respectively

Source: Staschen, S. (2003). Regulatory Requirements for Microfinance, GTZ.

measure than the capital adequacy ratio, as it does not use risk-weights to reflect the differences in risk associated with different kinds of assets. Indonesia's BPRs are subjected to a rather low CAR of 8 percent. To give BPRs an incentive to hold more capital, a current proposal is to reward a higher CAR of, say, 12 to 15 percent with a better overall soundness rating and permission to open new branches.[12]

Non-Prudential Regulations

Permission to Lend: Permission to lend is granted through registration in countries with more advanced regulatory frameworks. Many countries offer a special microfinance window for registration of MFIs, which allow regulation and legislation to be specific to these MFIs. Some countries offer multiple windows to allow for different types of institutions. Nepal has three windows which separate microfinance NGOs, cooperative societies, and development banks. Ghana's registration allows for nine different types of institutions, with several offering microfinance services. Each country will have a different approach, but best results have come when regulation is able to address the specific challenges associated with institutions offering microfinance services.

For lending business, some countries stipulate a maximum loan size, expressed as a percentage rate of capital or as an absolute amount. The two extreme cases are Ethiopia and Indonesia. Ethiopia's MFIs are only allowed to lend up to a fixed amount of US$600 to a single borrower, while the same limit for Indonesia's BPRs is currently at 20 percent of total capital (which is likely to be reduced in the future).

In addition, BI is considering placing an aggregate limit (on total capital or on total loans outstanding) for the largest borrowers. In some countries, the limit depends on the kind of security available. Honduras' FPDOs may grant loans of upto 2 percent of equity capital if secured by a surety, and upto 5 percent of capital if secured by other means. In Ghana, rural banks can lend up to a limit of 25 percent and 10 percent of capital in the case of secured and unsecured loans respectively.

In Uganda, the loan size limit depends on whether the loan is granted to an individual (1 percent of core capital) or to a group of borrowers (5 percent). The rationale is that group loans are typically larger and that the regulatory framework should not favour one lending technology over the other.

Nepal allows for larger consecutive loans with the second loan being double the amount of the first, and the third and all following loans being again double the size of the second. Even though such a requirement takes the graduation principle of many MFIs into account, it might be difficult to control for the supervisor.

Finally, Pakistan limits the size of loans to a single borrower to a fixed amount of US$1,725 irrespective of the size of the microfinance institution/ bank.

Consumer Protection: Successful consumer protection regulation levels the information gap between institutions and consumers. Regulation must protect consumers and allow for innovation, while not imposing excessive costs. Regulators in several countries provide consumers adequate information and allow for consumer complaints to be heard and addressed. Cambodia, Peru, Ghana, and many countries in Eastern Europe and the former Soviet Union have recently implemented new price disclosure rules that strive to ensure these objectives.[13]

Peru is an example of a country who has implemented a successful consumer protection policy. In Peru, the financial regulatory authority puts policies and procedures in place regarding how institutions receive, manage, and resolve consumer complaints. In 2008, approximately 99 percent of 400,000 consumer complaints were handled by this financial regulatory authority. Consumers may also take their complaints to the courts, the banking association's financial ombudsman, or a consumer protection agency. Peru combines these opportunities with adequate supervision and financial literacy campaigns and projects. Off-site supervision of institutions assures that relevant and adequate information is disclosed. As a result of these policies, consumer complaints dropped by 32 percent since 2004.[14]

Malaysia also focuses heavily on consumer education and response to consumer complaints. Financial information is disseminated to schools, community groups, and through various media sources to develop financial literacy. Financial institutions are required to have a complaints unit, with services targeting youth, involvement of the financial industry, credit counseling, and debt resolution. The central bank also receives complaints and offers advice.[15]

According to the CGAP Access to Finance Survey 2010,[16] Regulators most frequently require countries to have plain-language, to provide documentation in the local language, describe recourse rights and processes. For deposit products, regulators can require that institutions provide annual percentage yield and interest rate, method of compounding, minimum balance requirements, fees and penalties, and early withdrawal penalties. For credit products, regulators can require that institutions provide an annual percentage rate using a standard formula, all applicable fees, computation methods, and required insurance.

Credit Reference Service: The great majority of countries believe that credit reference services would improve conditions for both customers and institutions. However, regulation will determine what is required for these bureaus. Some countries require financial institutions to submit customer information. Peru initially required submission of information on borrowers with loan amounts greater than US$5000, which excluded micro-loans. However, regulation was later amended so that customer information is required to be submitted for all loans. Thus, institutions can check for credit history when extending a micro-loan.

Interest Rate Caps: Interest rate caps, though intended to protect the poor, often results in a reduction of financial services to the poorest of the poor and to those in rural areas. The costs of making very small loans and servicing rural areas is greater than making larger loans and servicing more urban areas, thus when an interest rate cap is implemented, MFIs in many countries have reduced these services to maintain profitability. Interest rate caps can also result in less product transparency, since institutions may try to add charges or penalties that make it more difficult to understand product risk.[17]

When an interest rate cap of 27 percent was implemented in South Africa, institutions immediately withdrew from rural areas and focused on less expensive areas to serve. Nicaragua's MFIs' portfolio annual growth fell to 2 percent from 30 percent when an interest rate cap was introduced in 2001.[18] An UK's Department of Trade and Industry policy paper[19] shows

Table 5.4: Interest Rate Caps in Select Countries

Jurisdiction	Date	Nature of Change	Reason for Change and Implication
Columbia	2006 (effective 2007)	Ceiling (34 percent) for microloans higher than the general ceiling	Higher ceiling to encourage microcredit. Implementation of the new ceiling has not occurred, microfinance portfolios and institutions still expanding.[20]
Japan	2006 (effective 2009)	Lowers maximum rate to 20 percent for consumer lending	Has already caused major changes in the consumer credit sector, including consolidation and failures of smaller lenders.
West Africa	1990s	27 percent ceiling	MFIs immediately pulled out of rural areas, and increased average loan size. Eventually found ways to circumvent with fees.
Nicaragua	2001	The Central Bank publishes interest rates every month	Growth decreased to 2 percent annually to 30 percent annually. Several MFIs pulled out of rural areas.

that even in a developed country like the US, interest rate caps restrict the diversity of products offered and the ability of lenders to offer products to different segments. Table 5.4 shows the interest rate changes, and the implications for microfinance loans as well as loans in selected countries.

The Micro Finance Institutions (Development and Regulations) Bill, 2011

It is in the above light of limitations of current regulations, the desired regulatory interventions and lessons from a cross-country evaluation of MFI regulation practices that the Microfinance Regulations Bill, 2011[21] is evaluated. This Bill is an updated version of an earlier 2007 Bill. The Bill has been re-drafted several times, with the most recent draft released in July 2011 incorporating the most recent RBI regulation. The Bill aims "to provide access to financial services for the rural and urban poor and certain disadvantaged sections of the people by promoting the growth and development of MFIs as extended arms of the banks and financial institutions and for the regulation of micro finance institutions and for matters connected therewith and incidental thereto".

The Bill acknowledges that the microfinance sector lacks a formal statutory framework for its financial activities, and that it is expedient to provide a formal statutory framework for the promotion, development, regulation and orderly growth of the micro finance sector and thereby to facilitate universal access to integrated financial services for the un-banked population. The Bill encompasses all legal forms of MFIs, providing a comprehensive legislation for the sector. The Bill includes:

- Designation of RBI as the sole regulator for all MFIs
- Power to regulate interest rate caps, margin caps, and prudential norms
- All MFIs must register with RBI
- Formation of a Micro Finance Development Council, which will advise the Central government on a variety of issues relating to microfinance
- Formation of State Advisory Councils to oversee microfinance at the state level
- Creation of Micro Finance Development Fund for investment, training, capacity building, and other expenditures as determined by RBI

It has been argued[22] that in its new avatar, the Microfinance Regulations Bill appears to be a comprehensive piece of central legislation that aims to resolve the long standing challenges that the microfinance sector has faced.

The Bill establishes: (a) the supremacy of RBI as the key regulator for the microfinance sector by clearly treating microfinance as an extension of banking services (by indicating a departure from treating microfinance as credit-alone business and through this clearly making a distinction between microfinance industry and money lenders, the latter are controlled by state regulations); (b) introduces measures for consumer protection and grievance redressal by introducing obligations and putting in place extensive monitoring and reporting requirements (additionally the Bill gives RBI the power to recognise the Code of Conduct for MFIs through a self-regulatory organisation and a client protection code); and (c) ensures that microfinance as a business must have limits to profitability and while scale is important the investors must not make disproportionate profits, by retaining two key recommendations of the Malegam committee on capping the interest rate and putting in place margin caps.

In the last, however, an inadvertent fallout could be that an artificial limit (on interest rates) is in place as the benchmark for performance and the margin cap may limit incentives for the MFIs to rework their cost structures and use technology to bring down their costs once they have reached a certain benchmark.

The chief features of the Bill are that every institution in microfinance should register with the regulator, transform into a company when they attain a significant size, be subject to a variety of prudential and operational guidelines that are introduced by the regulator, provide periodic information to the regulator and face penal action for violation of law or any rules framed. The Bill provides flexibility of RBI to apply different measures, vary the same and delegate the powers of regulation to NABARD.

The designation of RBI as the sole regulator is a positive step forward for the sector. Though the specifics of regulation are yet to be determined, having one respected regulatory who is acknowledged as in charge of all aspects of the sector would lead to a great reduction of regulatory uncertainty. If the bill passes, a greater challenge will remain; RBI must effectively regulate and monitor a great number of MFIs that have previously been subject to very little regulation.

Conclusion and Recommendations

Clearly, the current regulatory structure requires reforms, and the Microfinance Regulations Bill seems to meet most of the requirements as can be identified from the cross-country analysis of best practices. An ideal regulation should require registration for all MFIs, encourage extension of services to under-served populations through priority sector lending qualification, clarify state and central regulatory jurisdiction, require institutions to submit information to a credit reference service, address consumer protection issues, enable qualified MFIs to accept deposits, and encourage diversification of funding for institutions. Clearly, addressing these issues will allow MFIs to expand financial services to more clients, and to protect more vulnerable clients from potential unethical behaviour. It would also help reduce the risk of political backlash and repayment crises.

Regulatory Recommendations

After reviewing the principles of regulation, the current regulatory structure, and global best practice, a series of regulatory recommendations have been developed that address the most pressing issues in the sector. These recommendations address institution registration and structure, priority sector lending, state vs. central regulation, the need for a credit reference service, consumer protection standards and implementation, interest rate caps, deposit collection, and diversification of funding for institutions.

Registration and Structure: The Bill rightly requires mandatory registration for all institutions that are providing microfinance services, irrespective of their legal structure, to ensure regulatory oversight and supervision. However, the current NBFC minimum capital amount (₹2 crore) should not be significantly increased so that for-profit MFIs do not face an overwhelming barrier to entry. For MFIs registered under other legal structures, a small minimum capital requirement and easier documentation is required to ensure that institutions can meet regulatory reporting requirements also.

Once registered, the institutions could be asked to follow uniform disclosure reports, which present minimal basic information to RBI. This registration process will be essential for enacting other types of regulation, such as credit reference service reporting requirements, consumer protection requirements, and qualification for priority sector lending.

Priority Sector Lending: Regulators should use priority sector lending funds as a tool to incentivise MFIs to serve underserved areas and income levels. For micro credit, assets qualifying for priority sector lending could be identified by district or region. MFIs that serve districts with lower financial services penetration could qualify for more priority sector funds. Additional requirements for these assets will be needed to ensure that this funding is directed towards services to the poor and underserved population. Qualifications could be determined regardless of geographic location as well, to invent institutions to serve the poorest of the poor.

State vs. Central Jurisdiction: Regulatory uncertainty is primarily caused by a lack of clarity on what is state jurisdiction and what is central jurisdiction. RBI must clarify the extent of its jurisdiction so that issues can be dealt with fairly and expeditiously by the appropriate advisory body.

Credit Reference Service: Though a credit bureau takes time, great energy and expenditure to develop, the sector should act now so that resources are available in the near future. Sharing loan information amongst participating institutions is a primary measure to ensure responsible lending. A few primary private credit bureaus should be selected to be the central repository for all microfinance services. Within six months, regulation should require that customer information is reported to credit bureaus, so that information can be accumulated for future use. This credit bureau should eventually collect both negative and positive information on borrowers from banks, retail outlets, and MFIs.

Once a functioning credit bureau is in place that represents a significant portion of the population, regulation should require institutions to check a customer's information when he is applying for a loan. The implementation of the credit bureau will be the best protection against consumer over-indebtedness.

Consumer Protection: RBI must outline more specific definitions of coercive collection practices, adequate product transparency, and abusive selling practices. While proposals of the Bill are being put in place, a good short-term solution is to entrust industry associations (such as Sa-dhan, MFIN) with enforcement of uniform consumer protection standards for their member MFIs. This enforcement will come in the form of code of conduct development, employee training review, and random checks at offices and field sites. The associations should send periodic information regarding the institution's consumer protection compliance to regulators, who could then determine if an institution is eligible for certain privileges, such as priority sector funds or permission to lend.

Also, the existing framework established by the Consumer Protection Act (COPRA) could be improved so that microfinance clients can overcome legal expenses and lender-small borrower relationship obstacles. This could be done by holding court proceedings at a local level, and sending legislative representatives to villages regularly to gauge MFI conduct.[23]

Interest Rate Cap: Implementing an effective and appropriate interest rate cap would be very challenging for a regulator. Other than discouraging performance improvements and use of technology as the MFIs near the performance benchmarks, using a universal cap could be detrimental for the sector, since it would most likely result in exclusion of financial services in various areas and populations where returns would not justify the operating costs. An interest rate cap should take into account various factors that typically affect the cost of operation, such as area of operation, average loan amount, legal form, and size of the MFI. An interest rate cap that accurately captures these factors would be nearly impossible to implement in India, thus it is recommended that the sector should continue without an interest rate restriction.

Deposit Collection: Both MFIs and customers would benefit if qualifying institutions were able to offer savings products. The Microfinance Regulations Bill identifies that MFIs are extended arms of the banks and that "Micro finance services" means one or more of the following financial services involving small amounts to individuals or groups: (i) providing micro credit; (ii) collection of thrift; (iii) remittance of funds; (iv) providing pension or insurance services; and (v) any other services as may be specified.

One way to accomplish this is to allow MFIs (specifically NBFCs, which are subject to prudential lending requirements) to qualify for deposit-taking by attaining a rating through selected rating agencies that specialise in microfinance.[24] Such rating agencies have a better understanding of the microfinance model, and the specific challenges and risks associated with this model. The amount of deposit collection permitted could be linked to the rating, or to the capital of the institution.

Diversification of Funding: MFI funding is primarily acquired through commercial lending from domestic banks. But regulation should promote the diversification of funding sources to encourage equity and foreign debt investments. With an unambiguous regulatory structure going forward, other investors will also come forward to invest, thus reducing sources of funding and overall amount of funding, particularly in times of crisis.

The minimum foreign equity investment amount should also be lowered to allow for equity investment possibility for smaller institutions. If this amount is reduced, a whole new set of investors will be able to access the market, thus increasing diversification of capital. NBFCs should also be permitted to access External Commercial Borrowing.

In conclusion, microfinance is a service that aims to address the financial needs of under-served clients. Regulation and institutions should both focus on providing these clients with easily accessible financial services that cater to the specific needs and challenges that these clients face. A clear well-thought out regulatory structure is the best way to achieve India's goals of financial inclusion.

We agree that the new regulation is necessary for MFIs and should be expeditiously implemented; however, we do not see the need for a complete regulatory overhaul. The system has functioned well, allowing MFIs to prosper and grow to serve many more customers. The new regulation, should therefore, resist the temptation to overhaul the entirety of microfinance regulation, and should only make changes where current regulation is lacking.

Annexure 5.1: NBFC Regulation

Parameter	Provisions
Capital adequacy	- NBFC having net owned fund exceeding ₹100 cores and not accepting public deposit is required to maintain a capital adequacy* ratio of 15 percent - Any NBFC accepting public deposits needs to maintain capital adequacy* ratio of 15 percent - No capital adequacy requirements for NBFC with net owned fund less than ₹100crore and not receiving public deposit. *Note: Eligible capital consists of Tier I and Tier II Capital with the total of Tier II Capital not more than 100 percent of Tier I capital.
Prohibition on loans	- NBFC is prohibited from lending against its own shares - NBFC that has defaulted on deposit obligations is prohibited from lending
Restrictions on investments	NBFC that accepts public deposits can invest a maximum of 10 percent of its NOF in land and building (except for its own use), and 20 percent of its NOF in unquoted shares of companies other than subsidiaries and companies in the same group.
Ceiling on concentration of credit/investments	- Maximum 15 percent of NOF may be lent to a single borrower - Maximum 25 percent of NOF may be lent to a single group of borrowers - Maximum 15 percent of NOF invested in shares of a single company - Maximum 25 percent of NOF invested in shares of a single group of companies
Accounting requirements	The NBFCs have to comply mainly with the following accounting requirements - Income recognition - Income from investments - Accounting standards - Asset classification - Provisioning requirements - Disclosure in the balance sheet
Audit committees	NBFC having assets of ₹50crore and above as per the last audited balance sheet shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors
Exposure to Capital Market	NBFC holding public deposits of ₹50crore and above shall submit a quarterly return within one month of expiry of the relative quarter in prescribed format (Format NBS-6) to the Regional Office of the Department of Non-Banking Supervision of the RBI.

Annex 5.2: The Malegam Committee Recommendations

Categorisation	Recommendations	Drawbacks
Qualify for Priority Sector Lending	• Customer household annual income does not exceed ₹50,000 • Loans do not have collateral backing • Maximum loan of ₹25,000 • Minimum 75 percent of NBFC-MFI loans must be for income generating purpose	• Creation of "NBFC-MFI" sub-category unnecessary • Narrowly defines who needs microfinance services • Restricts competition from institutions that do not meet all requirements
Over-Indebtedness	• Total indebtedness limit of ₹25,000 per household • MFIs can only lend to members of a Joint Liability Group (JLG) • A borrower cannot be a member of more than one SHG/JLG • Not more than two MFIs can lend to one borrower	• Overall reduction of credit • Reduces customer's ability to manage own financial situation
Credit Pricing	• Only interest, processing fee, and insurance premium charges permitted • Margin interest rate cap of 10-12 percent over cost of capital, depending on the size of institution • Maximum interest rate cap of 24 percent	• Will result in less credit for poorer borrowers and customers in rural areas • Restricts product innovation
Product Restrictions	• Minimum period of moratorium between granting of the loan and commencement of repayment • The tenor of the loan is not less than 12 months where the loan amount does not exceed ₹15,000 and 24 months in other cases • The loan is repayable by weekly, fortnightly, or monthly installments at the choice of borrowers	• Results in fewer consumer options • Reduces product innovation
Documentation	• MFIs must provide borrower a loan card which shows the effective rate of interest, other terms and conditions to the loan, information which adequately identifies the borrower, and acknowledgements of payments received • Effective rate of interest must be displayed in all offices, all literature, and on website • Standard loan agreement	• Potentially burdens loan process

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7 Society under mission for eliminating poverty in municipal areas

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CHAPTER 6

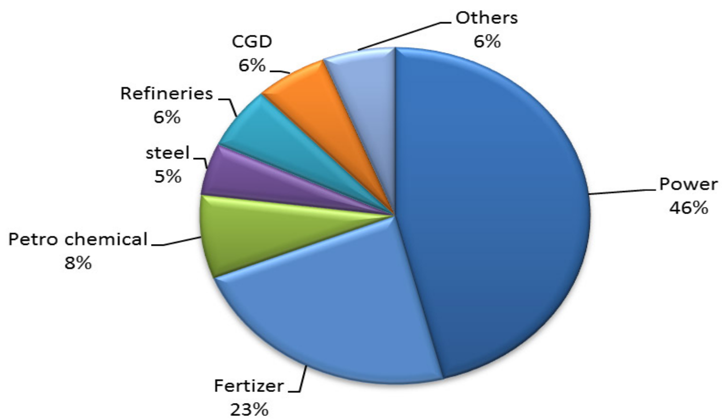
Regulatory Reforms in Natural Gas Sector*

Introduction

India is the fifth largest energy consumer in the world. However, India's per capita energy consumption is estimated to be a modest 530 kg of oil equivalent (kgoe) compared to the world average of 1800 kgoe.[1] Attaining India's targeted economic growth of 8-10 percent in the next two decades and its commitment to provide basic energy needs to all citizens' however will call for a significant growth in primary energy demand.

For sustaining the target growth rate, India's total commercial energy requirement during 2031-32 is expected to range between a low of 1351 million tonnes of oil equivalent (mtoe) to a high of 1702 mtoe (depending on the alternate growth scenarios modelled), implying a growth of 5.2 percent to 6.1 percent annually over the 2003-04 levels (of 470 mtoe). Further, India's total primary energy requirement during 2031-32 is estimated to range between a low of 1536 mtoe to a high of 1887 mtoe, implying a growth of 4.3 percent to 5.1 percent annually over 2003-04 levels.[2]

Figure 6.1: Sector-wise Natural Gas Consumption in India, 2009-10



Source: PNGRB Annual Report 2009-10

* This chapter is based on research papers contributed by Dr. S.K. Sarkar and Payal Malik.

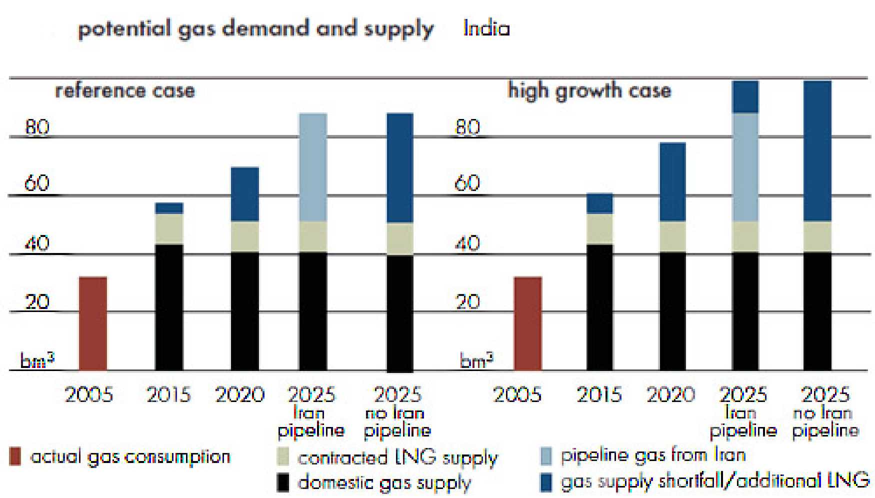
The last 30 years have seen a shift in the global energy fuel mix towards an increased role for natural gas. Attractive for its cleaner and more efficient combustion relative to other fossil fuels, gas has assumed a significant role in power generation, industrial applications, residential heating and in some cases as a transport fuel as well. In India, natural gas accounts for about eight percent of commercial energy consumption (against the world average of 24 percent), and is used mostly for power generation and in the fertiliser and petrochemical industries as feed stock.

During 2009-10, the consumption of gas by the power sector (46 percent) and fertiliser (23 percent) accounted for over 2/3rds of the total gas use; (see Figure 6.1 for details of sectoral demand). Natural gas consumption at about 61.69 billion cubic meter (bcm) during 2009-10, is expected to grow to about 86.60 bcm by 2011-12, and to 145.92 bcm by 2013-14; estimates of the projected gas demand in 2030 vary, ranging from 119 bcm (as per India Vision 2020 Report) to 405 bcm (as per Petrofed's Vision 2030).[3]

This growth in consumption is, however, dependent on gas availability and on priority sector allocation as determined by the government. India has only limited reserves of natural gas, though further discoveries are being made in recent explorations, including those of shale gas. But with rising energy needs, India's demand for natural gas is expected to grow substantially in the coming years. Translated into investment, achieving the target may require as much as US$350bn.[4]

Figure 6.2 highlights the potential demand and supply situation for gas in India; as per Australian Bureau of Agricultural and Resource Economics

Figure 6.2: Potential Demand-Supply of Natural Gas in India



Source: Australian Bureau of Agricultural and Resource Economics Study, accessed at: www.eai.in/ref/fe/nag/nag.html

(ABARE) projections, the shortfall in 2025 is likely to be almost as much as the estimated supply, even in the reference case scenario.

Due to the climate change as well as sustainable development considerations, gas use in India's transport sector is expected to go up, as also the retail penetration of gas in residential, commercial and small industrial segments. City Gas Distribution (CGD) networks supply the domestic consumption demand for gas, and the current level of consumption is expected to grow to about 20 percent in the next few years. At present, about 41 cities are covered by CGD network, which is expected to increase to about 250 geographical areas in the next 10 years. While the CGD sector is primarily dominated by the early entrants such as IGL (Indraprastha, Gas Limited), MGL (Mahanagar Gas Limited) and GGCL (Gujarat Gas Company Limited), together accounting for about 75 percent of total CGD volumes, new players have started entering this segment.

Historically, commercial utilisation of natural gas started in India during 1960s, but it picked up in 1970s after the development of western offshore fields. The Seventh and Eighth Five Year Plan periods saw a rapid rise in annual gas utilisation. An increasing trend in production of natural gas is observed: during 2009-10 production was at 47.57 bcm (8.77 bcm onshore and 38.8 bcm offshore), an increase of 43 percent over 2008-09, the growth largely the result of output from the KG-D6 block. Of the 47.57 bcm, the private sector share was about 50 percent.

The country's proven gas reserves (excluding shale gas) were estimated at 1120 bcm at the end of 2009.[5] Natural gas production in India (excluding shale gas) however, is expected to be only around 135 bcm by 2035. Shale gas is being explored in Assam, Chattisgarh, Jharkhand, Madhya Pradesh, Orissa, and Tamil Nadu. The Directorate General of Hydrocarbons (DGH) has initiated steps to identify prospective areas for shale gas exploration and acquisition of additional scientific data.[6]

India currently imports about 25 percent of its total natural gas requirements. It is expected that about 19.16 bcm of Regassified-Liquefied Natural Gas (R-LNG) would be available during 2011-12 at LNG terminals at Dehej, Hazira and Dhabol. With the use of another terminal at Kochi, this is expected to grow to 28.74 bcm during 2013-14. The high demand has led to planning of additional LNG terminals in Mundra (Gujarat) and Ennore (Tamil Nadu), and expansion of capacity of Petronet LNG at Dahej. This is further expected to get a boost with the proposed joint venture of British Petroleum and Reliance Industries Limited for sourcing, distributing and marketing of gas in India.

Natural gas use, however, is constrained by the inadequate availability of gas transmission pipelines network. The existing transportation network is of about 11,000 km with a pipeline density of 116 km per million standard cubic meter per day (mmscmd).[7] Against this, a much smaller Pakistan has a pipeline network of about 56,400 km with a pipeline density of about 1044 km per mmscmd, while the US has a network of about 18,341,138 kms with pipeline density of 1086 km per mmscmd.[8] Pipeline infrastructure is largely in the public sector.

Gas Authority of India Limited (GAIL) is a dominant player, and about 67 percent of the total pipeline is owned and operated by them. Reliance Gas Transmission Infrastructure Limited (RGTIL) and Gujarat State Petronet Limited (GSPC) own 13 and 15 percent of the pipelines respectively. If a competitive gas market is to operate in the near future, the pipeline infrastructure would have to be developed substantially, as the existing connected markets will not be able to absorb the future supplies. The current infrastructure consists of HVJ (Hazira-VIjaypur-Jagdishpur) pipeline connecting Gujarat with Northern India, and E-W pipeline of Reliance Industries from Kakinada (in Andhra Pradesh) to Hazira (Gujarat).

The gas regulator has authorised nine pipelines for construction: five to GAIL and four to RGTIL. There is, however, a need to align the gas production with project execution schedules of transmission and distribution infrastructure for effective delivery of gas to final consumers. The lack of a single agency collecting and analysing all infrastructure data is a limitation, for a comprehensive assessment and synchronised production, demand and supply of infrastructure is necessary to avoid future bottlenecks.

At the moment, since pipeline operations are monopolistic in nature, it is being regulated by the gas regulator, which also approves provisional initial gas pipeline tariffs for the existing HVJ GREP-DVIL pipeline, and for upgradation of DVIL/GREP and DUPL/DPPL pipelines of GAIL. However, the transporters have been given flexibilities to formulate zonal distribution of levellised tariff, subject to approval by the regulator.

This chapter gives an overview of the existing policies and regulatory regime, and the political economy motivations of natural gas regulations in India; analyses the policy initiatives and their impact, and also undertakes a competitive assessment for the sector; and concludes with recommendations for further reform.

Natural Gas Regulation in India: Overview and Political Economy thereof

In regulating the Indian oil and gas industry, one does not start with a clean slate. The product and services in the oil and gas sector, like other infrastructure services were under control of state-owned oligopolies, since 1976 when the government nationalised the existing three private sector refineries. However, absence of competition gave the oligopolistic (government) supplier an opportunity to set prices without providing commensurate regard to quality and protection of consumer interests. Absence of competition had led to operational inefficiencies, poor quality of services, and inefficient allocation of resources. To deal with this situation, an alternate model of governance was envisaged for infrastructure sectors.

But more importantly, it was the pragmatic and non-ideological factors that hastened the conceptualisation and subsequent implementation of the above model.[9] There were also technological breakthroughs which changed the old practice of managing infrastructure services through monopolies, as it was now possible to unbundle services and introduce competition.[10]

A quick recap on the different laws and regulations that affect the sector indicate that since Article 297 of the Constitution allows the Central government to have complete jurisdiction and governance rights on petroleum as a mineral resource, and hence the government controls the rights of exploration, licencing and marketing/distribution rights of natural gas too. The regulation for granting of exploration, licence and mining leases in respect of natural gas is exercised vide the Oil fields (Regulations and Development) Act, 1948, together with Petroleum and Natural Gas Rules 1959 and 2002 (hereinafter called PNG Rules).

The Petroleum Act, 1934 along with the PNG Rules regulates the transmission, distribution, and marketing of natural gas. These together regulate oil fields (which also cover gas fields) and the development of mineral oil resources (which also covers natural gas). The PNG Rules 1959 regulate granting of Petroleum Exploration Licence (PEL) and Petroleum Mining Leases (PML). Further, the Territorial Waters, Continental Shell, Exclusive Economic Zone and other Maritime Zones Act, 1976 regulates exploration and exploitation of resources in the economic zone and continental shell.

However, over the years, need was felt for an alternative model of governance in infrastructure sector which is aimed at providing a level playing field to operators in infrastructure sectors. The Petroleum and Natural Gas Regulatory Board (PNGRB) Act 2006 (hereinafter the Act) promotes competitive markets in the industry. Since the market structure in infrastructure services like natural gas still retains a monopolistic element, it was felt that the government should also continue to protect consumer interests, in addition to providing a level playing field and conditions for fair returns for new investors. It also became necessary to develop an enabling framework for private and public partnership (PPP) for efficient delivery of infrastructure services. In India, government continues as an important player in the gas sector. It was therefore felt that there should be an independent regulator, maintaining an arm's length relationship with all service providers and stakeholders, including the government.

Thus, the Act created an economic regulator called the Petroleum and Natural Gas Regulatory Board (PNGRB or the regulator) for regulating the sector, thereby allowing the policy maker (i.e. the government) to hive off its erstwhile regulatory functions to the regulator in the downstream sector. Thus, the regulator, set up in 2007, is tasked with regulating refining, processing, storage, transportation, distribution, marketing and sale of petroleum, petroleum products, and natural gas, excluding production of crude oil and natural gas, so as to protect interests of consumers and entities, to ensure uninterrupted and adequate supply of petroleum, petroleum products and natural gas, and to promote competitive markets.

The downstream regulator is a five member body appointed by the central government, selected through a search committee from the field of persons having experience of petroleum and natural gas industry, management, finance, law, administration or consumer affairs. The members have a fixed tenure of five years, and can be removed by the Central government. The regulator in India has issued regulations on access code for common or contract carrier, affiliate code of conduct, pipeline tariff, etc.

On some of the issues such as 'regulation for fostering fair trade and competition by sharing infrastructure', the regulations are at draft stages. The regulator has no say in determining producer prices. It regulates tariff only in the monopoly segment of the industry, such as pipelines and CGD networks, and protects consumer interests with a view to promote competition.

A comparison of the Act with the sector legislations in electricity and telecom sectors show that certain good features of regulation, viz. 'transparency' in conducting its affairs and in the process of tariff determination as envisaged in these latter two sectors are absent in the Act.[11] Furthermore, there is a need to have more clarity of demarcation of roles of the regulator and the policy maker, as the latter continues to interfere in regulatory matters. In a letter (dated July 11, 2011) to the policy maker, the regulator has questioned the government's jurisdiction to issue instructions on matters stated to be within its ambit (a decision on responsibilities of CGD entities and a gas highway authority). The policymaker's interventions, the regulator felt, appeared to be counterproductive insofar as it is likely to adversely affect its performance in fulfilling the obligations.[12] The Ministry has consistently undermined the PNGRB, and such emasculation need to be reversed at the earliest.

Unlike the regulator, the DGH[13] is a technical wing of the government in the upstream sector, and required to ensure sound reservoir management practices, review/monitor exploratory progress and development plans of national oil companies and private companies, and monitor production and optional exploration of gas fields. Objectives of DGH are to promote sound management of the oil and natural gas resources having a balanced regard for environment, safety, technological and economic aspects of the petroleum activity. However, the 'current upstream regulation provided by DGH is neither independent nor comprehensive in technical sense with respect to optimal development of hydrocarbon resources'.[14]

DGH has been entrusted with several responsibilities like implementation of New Exploration Licensing Policy (NELP), matters concerning the Production Sharing Contracts for discovered fields and exploration blocks, promotion of investment in exploration and production (E&P) sector and monitoring of E&P activities including review of reservoir performance of producing fields. In addition, DGH is also engaged in opening up of new unexplored areas for future exploration and development of non-conventional hydrocarbon energy sources like Coal Bed Methane (CBM)[15] as also futuristic hydrocarbon energy resources like Gas Hydrates and Oil Shales.

The CGD regulations provide for 25-year network exclusivity for new entrants from the date of authorisation, and also provides for marketing exclusivity for five years in the case of new entrants and 3 years for the existing players. Beyond this period, the pipeline will become a common or contract carrier, and open access should be given to third parties. In addition, the regulation also provides for 14 percent post tax return on capital employed by investors. The selection of a CGD entity for any new city is done on the basis of competitive bidding.

As per the Natural Gas Pipelines Policy 2006, the regulator is required to regulate the procedures to develop pipeline infrastructure, common carriers, capacity for transmission, and regulation of transportation tariff. Since its inception, the regulator has enacted various regulations, some of which are at draft stages: for example, Access Code for Common Carriers or Contract Carriers of Natural Gas Pipelines; Affiliate Code of Conduct for entities engaged in marketing of natural gas and laying, building, operating and expanding natural gas pipelines; draft Regulation for fostering fair trade and competition amongst entities by sharing infrastructure (hereinafter called the competition regulation); exclusivity for city or local gas distribution network (hereinafter called Exclusivity Regulation) and regulation for determination of pipeline tariff for natural gas.

Since the monopoly character exists in transmission and distribution segments, the Act rightly mandates the regulator to regulate network prices for preventing any entity from exercising its monopoly power. The regulator is also guided by 'benchmarking against a reference tariff calculated on the cost of service, internal rate of return, net present value or alternate mode of transport' (Section 22 of the Act). It has allowed introduction of new pipelines through bidding process for discovering the competitive price for use of pipelines.

Under the Act, the regulator allows the registration of entities for establishing and operating LNG terminals. The regulator has recently framed a draft regulation called the 'Registration for Establishing and Operating LNG Regulations 2009' to allow companies to use the unutilised capacities of the LNG terminals. Except this, the sub-sector is completely outside the domain of economic regulation. Resultantly, determination of regasification charges is outside the purview of the regulator. However, in many countries, such as Japan, the US, etc, such system is prevalent. Probably, the government intends to operate this sub sector on market determined principles.

Given that the LNG terminal development is not sufficient, and there are very few players, early framing of 'competition regulation' as well as finalisation of the draft regulation requiring LNG terminals to make uncommitted capacity available to other entities at mutually agreed terms, may address the problem to some extent.

Policy Initiatives and their Impact & Competition Assessment in the Gas Sector

In order to enhance energy security at all levels, the Central government has, *inter alia*, formulated various policies in oil and gas sector. The important ones are the New Exploration Licensing Policy (NELP), Natural Gas Utilisation Policy; Policy on Pricing of Natural Gas as evolved over time; Regulatory Policy in Downstream Gas Sector; Coal Bed Methane Policy; Policy for Development of Natural Gas Pipelines; Policy on Import of LNG; Policy on Import of Natural Gas through Transnational Gas Pipelines.

New Exploration Licensing Policy: In India, the exploration and production activities in the petroleum sector had been the protected domain of the public sector oil companies. Strangely, despite the nationalisation in 1976, the Ministry of Petroleum had been inviting international bids for E&P, and nine rounds of such bidding was held until 1997. Not surprisingly, the interest and response from foreign bidders was poor, as licencees had to sell their output to the government monopoly entities that controlled refining and distribution.[16]

The NELP, announced in 1997, was an instrument by which the government sought to provide a level playing field to all players for award of exploration acreages. Over the years, the NELPs have been made increasingly attractive to private players,[17] and this has resulted in increase of oil and gas discoveries. Foreign private companies are now permitted to participate in the ensuing bidding rounds, and 100 percent foreign direct investment (FDI) is permitted in the E&P sector. Many incentives were also extended to the investors, in addition to transparency in the bid evaluation system and leveling the playing field.

Till date, nine rounds of NELP have taken place. After the ninth round, the government is contemplating to introduce an Open Acreage Licencing Policy (OALP);[18] this policy is being followed in France, Thailand, Malayasia, the UK and Pakistan. The introduction of this policy is, however, dependent on the operationalisation of the national data depository, which makes data available from already awarded blocks and from the blocks to be awarded for viewing by the potential bidders.

Since June 2001, under various NELP rounds, public and private companies made 68 oil & gas discoveries[19]; apart from ONGC, private players such as RIL, GSPC and FOCUS have also contributed to the natural gas discoveries. The share of ONGC and OIL together accounted for nearly 80 percent of the total gas produce till 2008-09, which has since declined to about 60 percent during 2009-10[20]. RIL has the largest oil & gas acreage holder among private companies.

The impact of NELP rounds, on the whole, is encouraging. As on October 01, 2010, the investment made by Indian and foreign companies was of the order of US$14.8bn, of which US$7.5bn was in hydrocarbon exploration and US$7.3bn in development for discoveries.[21] However, despite the liberal regime and the incentives, NELPs have not been able to attract global majors, or bring in cutting edge technology, or even open up the frontier basin with innovative technologies. The more general disincentive to bidding is that bidders have to sell their production in India, which remains dominated by government companies.

Also crucial is need for adequate competition in exploration contracts, which is a function of ability to explorer's to sell the output in world markets. Many of the blocks (12 deep water blocks, 19 shallow water blocks and 6 on-land blocks) have in fact been relinquished by companies.[22] The absence of a domestic market is another obvious disincentive to exploration. The other important concern regarding the NELPs is that still too many clearances are needed for undertaking E&P operations. It has been estimated[23] that as many as 70 clearances are required for undertaking such operations. The industry has voiced concerns about the delay and time consuming approval process, and has urged for better coordination among the central as well as state governments.[24] Finally, the arbitrary and unpredictable fuel pricing regime and cross-subsidy obligations has discouraged private entry into the E&P sector.

National Gas Utilisation Policy: The government had notified the National Gas Utilisation Policy in 2008, listing out priority sectors for selling of gas by a private contractor. Under the guidelines (valid for five years), consumers belonging to any of the priority sectors should be in a position to actually consume gas as and when it becomes available; in case of default by a consumer under a particular category, the gas be offered to the next consumers in the next order of priority. For example, the natural gas produced from KG D6 block is being supplied according to the following order of priority:

1. existing gas based urea plants which are now receiving gas below their full requirements;
2. existing gas based power plants, any additional gas available beyond the above categories;
3. existing gas based LPG plants, a maximum quantity of 3 mmscmd;
4. gas based power plants lying idle or underutilised, up to 18 mmscmd; and
5. for city gas distribution projects, a maximum of 5 mmscmd for supply of piped natural gas (PNG) to households and CNG in transport sector.

Thus, gas produced by a contractor has to be consumed in the country as per the prevailing gas utilisation policy, although the production sharing contract (PSC) gives him a freedom to market such gas. In addition, there are legitimate concerns among the upstream investors due to lack of understanding about the impact of subsequent review of allocations on the long term supply contracts; and due to less confidence to access pipelines on non-discriminatory basis.[25] Further, gas allocation policy lacks a long term perspective, which is an important roadblock for supply; under the current policy, fuel supply agreements are for a maximum of five years. Also, there is continuing uncertainty about government's long term role in allocation of gas to various users.

Pricing of Natural Gas: The pricing system of natural gas has evolved over time. In 1960s, supplies of gas were made at a price determined by the suppliers. Over the years, gas pricing policy has been a part of the overall gas allocation system through the government. This has hindered development of gas market, as price was not based on the 'supply and demand principles'. Gas prices were set irrespective of prices of alternative fuels used by power and fertiliser industries, even when these industries are using alternative fuels at market prices. The scenario has changed now with the introduction of NELP through which pricing reforms were, to some extent, introduced to attract private investments in upstream segments.

At present, there exist two types of gas prices at the production stage; Administered Price Mechanism (APM) gas price and non-APM gas price. The APM gas refers to gas produced by companies which were awarded fields prior to the PSC regimes. These are produced by national oil companies namely ONGC and OIL, and supplied to the consumers namely power sector consumers, fertiliser sector consumers, and consumers covered under the court orders. The price of natural gas for consumers in the North East (NE) is kept at 60 percent of the price prevailing in the rest of the country.

In 1994 the PSC contracts were executed by the government with Raava Consortium and Panna Mukti Tapti (PMT) Consortium. The price of this gas is determined by the PSC signed by the Consortium with the government. The difference between the PSC price and APM price is being made through gas pool account mechanism. The different gas prices prevailing in India may be noted in Table 6.1 as under:

Table 6.1: Natural Gas Pricing in India

Natural gas	Priced at US$ per Mbtu	Priced at US$ per Mbtu
APM	4.2 (outside NE) and 2.52 (NE)	
Non-APM	Sourced from PMT	4.6 (fm RRVUNL), 4.75 (fm Torrent), 5.65 (fm rest)
	FmRaava	3.5
	FmRaava satellite	4.3
	Fm NELP	4.2
	Long term agreement@	5.76
	Spot cargo@@	5.67-11.7

Source: TEDDY 2010, TERI
Mbtu: Million British Thermal Unit
@As in February 2010. @@ range of prices from January 2009-December 2009.
PMT: Panna Mukta Tapti, RRVUNL: Rajasthan RajyaVidyut Utpadan Nigam Ltd.

Table 6.1 shows the extent of variation of gas prices in India, which are dependent on its sourcing. This has resulted in distortion in the end use markets. The producers of APM gas have little incentive to optimise costs and production profile, as there is scope of 'gold plating of costs' on investment. On the consumption side, a wide variation of prices would make certain producers competitive *vis-à-vis* others in the same industry. Distorted price signals affect investment choices in the markets and access to energy basket.

However, in May 2010, the government increased APM gas price to US$4.2 per unit thus bringing it at par with price of KG block gas. This is expected to narrow down gas market distortion, increase investment and import of LNG. The financial impact of this increase of price of APM gas on the government is stated to be not substantial.

In the power sector, the APM based power generation is a small component of the total power production in the country. The price of subsidised fertiliser is regulated and the increase of fertiliser subsidy due to increase in APM price is expected to be less than the increase in the government revenue generation from the increase in APM gas price.[26] The methodology for arriving at this price hike is, however, not available in public domain.

For NELP gas, the contractor (who develops/produces from well) can propose a selling price for the gas. The formula or basis of arriving at that price has to be approved by the government. The price is applicable for five years subject to a review thereafter. In the case of KG D 6 block, the gas price discovered by the private player was approved by the government (see Box): price fixed range from US$2.5/mbtu (at a crude price of US$25/bbl) to US$4.2/mbtu (at a crude price of US$ 60/bbl). The price discovery process was, however, not broad-based. In 2007, the Petronet LNG Ltd (PLL) had started pooling the prices of all supplies of RLNG (spot cargo and long term gas). Thereafter, a weightage average price is charged to all its final customers.

Box 6.1: Process of Gas Price Determination for D6 KG Block

In October 2002, RIL announced the discovery of natural gas (about 7 tcf) in D6 KG basin. In 2004, RIL won a competitive bid from NTPC to supply 12 mmscmd of gas for its power projects at price US$2.34/mbtu. In 2005, a MoU was signed between RNRL & RIL for supply of 28 mmscmd (and additional 12 mmscmd if it was not supplied to NTPC) at US$2.34/mbtu.

In April 2006, government refused to approve the price for the sale of natural gas, as requested by RIL. In November, 2006, RIL filed a Writ Petition in Bombay High Court and in 2009 RIL & RNRL filed SLP in the Supreme Court.

In June 2007, government decided the gas price ranging from US$2.5/mbtu to US$4.2/mbtu, and in 2008, also formulated the Gas Utilisation Policy. In May 2010, the Supreme Court held that: (a) government has a right to decide the price and utilisation priorities of natural gas; (b) the ownership of discovered gas lies with the government; (c) the family MoU was not binding on the companies owned by the family members; and (d) PSC has an overriding effect on any other contract. In June 2010, a revised agreement for supply of gas using the Gas Utilisation Policy and approved pricing was signed. The RIL-NTPC dispute is subjudice.

Source: TEDDY 2010, TERI

Given the variety of gas prices depending upon their sources, it has been suggested that a single benchmark price of natural gas would be in the larger interest of the consumers, as it would prevent shocks to gas consumers, particularly power and fertiliser consumers. Secondly, this would facilitate development of gas market. A study by Mercados Energy Market India Private Limited (January 2010) recommended creation of two sectoral pools one each for fertiliser and power sectors, for the purpose of pooling of gas prices. It pointed out that introduction of this arrangement would require setting up of guidelines for constitution and operation of pool, notifying pool operator, making transitional arrangement, and developing an oversight mechanism. It also recommended that GAIL should be the pool operator. According to the proposal, the merchant power plants can be a part of the power pool.

The Chawla Committee (May 2011) further examined this concept, and is of the view that the fertiliser sector should be assured of supplies based on government determined formula, and the peak/intermediate power requirements should be met through market discovery of the price of gas. The Committee also suggested that the development of a competitive gas market and proper regulatory oversight are necessary for operationalising the pooling process. A consensus is yet to emerge on the introduction of this concept in India's gas market.

On transmission side, the regulator regulates transportation rates for common carrier or contract carrier, is mandated to monitor transportation tariff, and is required to take corrective actions to prevent restrictive trade practices by entities. The zonal distribution of tariff is left to the transporters subject to confirmation by the regulator. The CGD network prices are also regulated. However, the price of LNG is not regulated, and reflects the short term demand and supply scenario in gas industry.

A sound gas pricing policy should be based on market value of gas *vis-à-vis* other fuels so that the gas will have the ability to compete with other fuels such as coal in power sectors, gas, or oil and LPG as industrial fuel, or kerosene and LPG in the residential segment. For development of infrastructure, the end use price is also very important. There is a need to have a holistic gas pricing policy for encouraging more competition in gas industry. Probably, this may call for decontrol of gas allocation, and revisiting the fiscal/taxation regime in the industry.

Finally, competition in the gas sector is limited by the lack of interconnection in CGD networks. For unless pipelines of different suppliers are interconnected, effective competition cannot operate between the players, as each is a monopoly supplier for the consumers. India has only one common carrier pipeline network, built by Gujarat State Petroleum Corporation through its two subsidiaries, which however serves limited parts of selected western Indian states.

Competition Assessment in the Gas Sector

The table 6.2 summarises the discussion above and examine the current policies in gas sector in a competition assessment framework, the objectives of which is to examine the potential benefit, or otherwise, of the existing rules, policies, regulation, etc. in the gas sector:

Table 6.2: Factor-wise Competition Assessment

S No	Factors impeding/ benefiting competition	Present status
1	Freedom of entry and exit	100 percent FDI is allowed in E&P as well as in laying of natural gas pipelines. To encourage import, LNG has been placed under Open General Licence (OGL) list and 100 percent FDI is permitted for setting up LNG terminals. Over the successive NELPs since 1997, incentives were given to attract players in the E&P business. Even small players are now encouraged in exploration in S type block, for which fulfillment of technical criteria was exempted with effect from the 8th NELP Round. However, there are issues regarding the NELP, as discussed in previous section, some of which is expected to be addressed by OALP. For example, the players have no choice on the size of the block nor can he identify the block of his choice. In transportation, the entry of player is subject to meeting technical and financial criteria as set by the existing rules and regulation. In the CGD, entry is subject to meeting the regulations. Recent Cairn and Vedanta controversy however shows that the exit as well as entry is a complex process and time consuming.
2	Barriers to entry	In the upstream segment, measures have been taken to reduce entry barriers over the years. Still, a large number of clearances are required to establish E&P business, which is time consuming. About 70 clearances are required before a company is allowed to drill in an exploration business in India. This may lead to delay in establishment of assets. There also exists delay in awarding Petroleum Exploration Licence (PEL) and Petroleum Mining Licence (PML) by States. Non availability of adequate pipeline infrastructure for evacuation of gas poses barrier to entry in upstream segment. India's current pipeline density is about 116 km per mmscmd. Current policy on gas utilisation by various consumer segments is a bottleneck to the growth of the CGD industry. CGD industry is highly capital

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S No	Factors impeding/ benefiting competition	Present status
		intensive and has a long gestation period, thus creating a natural barrier. A typical CGD network costs about ₹3-4 bn to service a volume of about 1.5 mmscmd. The long gestation period and low volume uptake may affect the CGD business.
3	Number of buyers and sellers of gas	The sellers are few, while buyers are many. Gas is an oligopolistic market. On production side, apart from government owned entities such as ONGC, private entities such as RIL, are the major players. On the buyer's side, power sector consumes most, followed by fertiliser and petrochemicals, etc. On pipeline network side, Government owned GAIL, and private player such as RGTIL (wholly owned by producer RIL) are dominant players. On the city gas distribution side, the operators include public and private entities. The early entrants MGL, IGL, and GGCL account for about 75 percent of the total CDG volumes. Among the new entrants are GAIL Gas Ltd., Reliance Gas Corporation Ltd., Petronet Gas, British Gas & EIL. For LNG business, there are only 2 terminals, at Dahej and Hazira. PLL (a joint venture of GAIL) is the major player in the business. In this segment, access of infrastructure on non-discriminatory basis is required as this will encourage entry of more players. In this regard, the regulator is taking steps in promoting use of LNG infrastructure on a 'common user basis'.
4	Price discovery	The price discovery for NELP gas has taken place in the case of KG block only wherein the contractor has determined the gas price based on price discovery. In this case, the price formula was approved by government. However, that price discovery process[27] was not broad based. The price discovery process needs to be rational for arriving at the true market value of the discovered gas. The allocation of NELP gas as well as its price to selected sectors (such as fertiliser, power, etc.) is determined by the empowered group of ministers (EGoM).

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S No	Factors impeding/ benefiting competition	Present status
		In the case of new transportation pipelines, bidding has taken place on competitive tariff basis. The regulator determines the tariff for existing pipeline use, and for existing city gas distribution. The regulation for tariff in the case of use of the existing pipelines and CGD network is based on cost plus mechanism. There is a need to incentivise performance using say (CPI-X) model, or a price cap model. In Canada, although the law mandates to fix transportation tariff based on 'just and reasonable' basis, the regulator encourages voluntary agreements between transporters and consumers for negotiated settlements. The import of LNG price is market based, and linked to international oil prices.
5	Grant of exclusive rights to operate	The current regulation provides that new entrants in CGD business will have 25 year network exclusively from the date of authorisation. If one assumes that the time period for laying pipeline is about two years, the authorised entity would have a monopoly over the network for about 23 years. The regulator also lays down that there will be a marketing exclusivity for five years for new players, and three years for existing players. The main concern about these exclusivities is that these may give the incumbent an added advantage or incumbency benefits over the subsequent players that are likely to enter into the market. The role of regulator would be critical to ensure that no such benefits accrue to the incumbents.
6	Limitation of provisions	There are supply side constraints due to inadequate gas discovery. Out of estimated sedimented area of 3.14 square km, about 58 percent are covered under exploration. The current capacity of transportation pipelines can accommodate only about 98 bcm per year. The growth of CGD network is dependent on quick expansion of transmission network. The imports from LNG terminals (which tripled from 3.6 bcm during 2004-05 to 12.9 bcm during 2009-10) is dependent on the availability of

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S No	Factors impeding/ benefiting competition	Present status
		KG D6 and other NELP gases. However with high demand in power sectors, there is likely to have a higher demand of LNG, necessitating the need for more LNG terminals in the country.
7	Potential for competition	With the introduction of NELP, participation of private players has increased. However, the level of participation especially in offshore and deep water blocks has been relatively low in recent NELPs. For example, in its 8th and 9th rounds, on an average, there is one bid for offshore and deep water blocks. In the latest round, most of the blocks attracted only one bid, and not more than 2 bidders participated in shallow and deep water blocks. Further, foreign investment has been consistently low over the years. However, with the introduction of OALP, the completion in upstream segment is expected to be more intense.
8	Lack of information	Lack of quality data and full information for exploration business still exists despite efforts by government to provide more, and make the bidding process more transparent. Data survey made by various agencies for various blocks is not made available to bidders. Data given out to bidders under NELP are not always updated. There is a lack of level playing field on the availability of data, especially the regional data/ sub-basin information between the foreign companies/ private companies and the government owned companies. A national data depository on reliable exploration and production data with facility for access and online data management is needed.

Source: Compiled from - TERI 2007: 'Competition in India's Energy sector'; Price Water House and Petrofed: 'Review of E&P Licensing Policy'; Desai, A. et al, 2009: 'Public Enterprises, Government Policy and Impact on Competition: Indian Petroleum Industry'

In sum, the natural gas sector has witnessed the introduction of competition in the upstream segment, and to some extent, also 'competition for' the market in the other segments with the introduction of tariff based competition for new pipelines. There are, however, issues discussed earlier that have discouraged high level participation of players under NELPs, both by domestic and foreign players, in deep water blocks as well as offshore blocks, pointing to the need for introduction of a new policy such as OALP at an early date. Competition in the other segments of the gas industry is marginal.

Conclusion and the Way Forward

Unlike other infrastructure sectors in India, the natural gas sector is in a nascent stage of development. It is also oligopolistic in nature, because of both supply and infrastructural reasons. For the development of a competitive gas market, however, augmentation of the pipeline network and its interconnection should be taken up on urgent basis. The creation of a gas market would critically depend on the appropriate infrastructure in the form of gas pipelines, regassification facilities, and a CGD network.

There is a need to have national pipeline grid, connected with regional grids with the facility of delivery of gas from any source to anywhere in the country. Today, GAIL's network is almost choked. There is just one player RGTIL in the trunk network, though there are more players in CGD and PNG markets. In the recent past, the PLL has to put in abeyance imports of LNG as there is no capacity in the network available. The infrastructure bottleneck is a major hindrance to developing a competitive gas market. This issue needs to be addressed upfront.

Second, to develop a competitive gas market, mandatory open access is a must to begin with. Open access implies that economic regulator should ensure that any spare capacity available in the pipeline is offered on a non-discriminatory basis to anyone wishing to use such capacity for transport of gas; the regulator has power to provide interconnection, fix transportation tariff, and in the case of disputes, resolve the same. In the past, open access in India's gas market was been allowed on a limited scale, but lack of open access on a large scale and in a transparent manner prevented private marketers and R-LNG terminal operators to sell gas directly to their consumers.

The situation has now changed slightly, as there is a framework laid down by the regulator for allowing third party access in transmission and distribution segments. The 'access code regulation for common carrier or contract carrier' has been issued, allowing for non-discriminatory open access for booking pipeline capacity as well as availing of any excess capacity of pipeline. There is also a provision to create additional capacity of 33 percent for open access while setting up new pipelines. This regulation further prescribes transparent and uniform principles for allowing entities to gain/allow access to the pipeline system and CGD network.

But the Access Code regulation has to be very effective. Unlike in electricity sector, there is no redressal mechanism in the Access Code in gas sector for dealing with unfair practices, delays, discrimination, lack of information, wrong information or any other matter relating open access. The Access Code should have some mechanism to address this problem. There is a need to fully separate accounts for transportation business from gas sale business.

Further, to facilitate competition, unbundling of services separating transportation of gas from its shipping should be considered on priority. The existing Access Code and the Affiliate Code should be implemented in letter and spirit. There is a need to slowly introduce competitive pricing of gas. In addition, creation of marketers such as aggregators or shippers should be encouraged at the earliest.

Third, given the limited supply of gas as against its future requirements, there is a need to reorient India's existing policies for attracting more players for exploration, discovery and production of gas in potential areas. In fact, with short supply of gas, competitive gas market will operate marginally, and only when there is adequate supply of gas, this will become a reality. A case lies in positioning independent upstream regulator for discharging the regulatory functions in that segment. The existing upstream regulator, DGH is a government wing, and is not situated at arm's length distance from it. The debate on separating and assigning DGH's regulatory power to an independent body is an old one.

In 2001 Naresh Narad Committee, and thereafter in 2006 an Expert Group on IEP (Integrated Energy Policy) argued in favour of this concept. The recent recommendation of the Chawla Committee is also in that direction, when it says that DGH may be reconstituted into a technical wing for contract management under the Ministry, and a separate independent regulator may be constituted in the upstream segment for exercising the regulatory functions. This will bring in transparency in the management of contracts, and in deals with associated issues in upstream sector. The Committee also suggested that the regulator can be a part of the PNGRB or be a separate entity with no staff to be drawn from the regulated entities for avoiding conflict of interest. However, the government appears to differ with this recommendation in view of the fact that it is the owner of natural resources and has a major role to play in proper utilisation of resources and facilitating development of the upstream sector.

Further, the government is of the view that NELP and CBM policies are providing a level playing field to all consumers and the technical monitoring of upstream segment is being done by DGH. There is a need for a wider debate on this issue.

Fourth, empowering the regulator further is important. In a closely regulated gas market, and where there used to be practically no non-government players, the role of the policy makers and the regulator in developing a competitive market continues to be critical. The gas sector would require monitoring by the policy maker as well as by the regulator, as the market is not mature and there are not too many players; both have to work in tandem. Empowerment of the regulator would make the regulator strong and effective.

Unfortunately, in recent times, the gas sector has witnessed a standoff between the regulator and the policy makers. In larger public interest, a harmonious relationship between the policy maker and the regulator is essential. The regulator also requires adequate resources for its proper functioning. The need for strengthening the regulator by way of positioning more experienced staff at its disposal/filling the vacant posts has also been highlighted. Addressing this issue early will surely strengthen the regulator.

Simultaneously, competition has to be introduced, and an enabling environment has to be created by the regulator as well as by the policy makers. Developing a long term competitive pricing policy in gas market and introducing a long term policy on gas market development are important, and for these, the policy maker and the regulator need to work in unison. Gas markets in India lack an effective price discovery mechanism. In this regard, it suggested that PSU gas producers and LNG importers may be allowed to trade gas at the landfill points for the gas that has not been already contracted on long term basis.

Further, according to the Chawla Committee, the PSC may contain provisions for auction of gas in small lots. All these measures, the Committee argued, may drive the gas market into a competitive mode. It may be borne in mind that this proposal will call for greater regulatory oversight, at least to begin with. In electricity sector, the regulator regulates the trading margin for interstate trading of electricity.

Given the nascent stage of development of gas market in India compared to the electricity sector, such oversight of the gas regulator is essential. In order to further empower the regulator for developing competitive gas market, additional legislative provisions may be considered. In the electricity sector, Section 66 of the Electricity Act 2003 says that 'the appropriate Commissions shall endeavour to promote development of a market (including trading) in power…'. A similar direct provision in the Act mandating the regulator to promote competition like in the electricity sector may further strengthen the regulator in this regard.

Fifth, the institutional issues such as overlapping jurisdiction with the Competition Commission of India (CCI), and effective coordination with other regulators should be addressed after due consultation, as these would involve legislative changes. By the Competition Act 2002, the CCI has been created to promote competition in the economy; CCI is mandated to prohibit anti-competitive agreements, abuse of dominant position, regulate combinations among/between enterprises, and oversee such transactions in the economy-wide context. The economic regulator in the gas industry is also empowered to protect the interest of consumers by encouraging fair trade and competition, and regulate access to common carrier or contract carrier facilities. This issue could potentially lead to conflicts[28] between the regulator and the CCI.

Also, the PNGRB Act contains no reference to the Competition Act 2002 nor does it provide for any consultation between the regulator and the CCI. The gas sector legislation need to be amended so as to make the guidelines and principles laid down in the Competition Act 2002 binding on the regulator, or make it obligatory for the regulator to seek the advice from the CCI on competition matters, or allow representation of the CCI in the proceedings before the regulator, or constitute a common appellate body to ensure coherence in law enforcement. The legislative gap may be suitably addressed.

Also, there exist several inter-linkages between energy sub-sectors having bearing not only on prices but also on effective delivery of services. Such inter-linkages between coal, gas and electricity, point out the need for better coordination among the energy sub sector regulators. This type of coordination has not been mandated under the present gas regulatory legislation. In this regard, Sri Lanka's example may be examined for adoption in India. Under the Public Utility Commission of Sri Lanka Act 2002 (Section 35), there is a mechanism for ensuring cooperation and exchange of information among various regulators and for securing consistent treatment of matters within their jurisdiction.

Finally, it is found that the perceptions and awareness of the existing regulations relating to gas supply infrastructure and pricing and the major issues related to the natural gas supplies, viz. open access to pipeline infrastructure, distribution and supply and supply agreements are inadequate.[29]

A possible reason for this could be that since gas prices are still regulated in the country, and the supply is deemed to be a largely government policy exercise (all the natural gas companies being PSUs), there is little interest in understanding its ramifications even among the otherwise aware business community.

The lack of private sector participation in the sector was deemed to be a function of tariff regulations (especially LPG/residential city gas subsidies) and lack of a level playing field vis-à-vis the PSUs (including the extant market dominance of the PSU players). Hence, effective participation of the consumers and transparent regulatory process is required to be ensured so that the quality of regulation is vastly improved in the gas sector. In the electricity sector, the economic regulator is legally mandated to follow a transparent regulatory process. In the gas sector, the Act does not provide this type of specific mandate, especially for the tariff determination procedures.

Further, the process followed by the regulator in gas sector at present is not very consultative. Though the applicants for pipelines tariff determination are heard in open house, a rigorous scrutiny of the tariff application as is being practiced in electricity sector, does not happen in gas sector. The scrutiny and determination of costs especially the O&M costs during the tariff determination in gas sector have to be rigorous, as otherwise, the end consumers would have to bear the costs due to 'gold plating of costs' by the pipeline owner. The input of the stakeholders as consumers should have to be incorporated at the time of determination of such costs.

Endnotes

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2 Planning Commission (2006). Integrated Energy Policy, Report of the Expert Committee, August

3 PWC (2005). The Green Imperative: Future of Natural Gas 2030, Study for the Petrofed, India

4 As a rule of thumb, the State Development Planning Commission, China assumes that each additional one bcm gas will need about one billion dollar investment

5 TERI Energy Data Directory (TEDDY), 2010

6 Economic Survey 2010-11, Government of India

7 India Infrastructure Research (2010). City Gas Distribution 2010, October, accessed at www.indiainfrastructure.com

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11 Sundar, S and Sarkar, SK (1999). Framework for Regulation: the Indian Experience, in the National Regulatory Research Institute (NRRI) Quarterly Bulletin, University of Ohio, USA

12 Information sourced from the PNGRB website

13 The DGH was established in 1993 under the administrative control of Ministry of Petroleum & Natural Gas through a Government of India Resolution

14 Integrated Energy Policy 2006. Planning Commission

15 CBM is an unconventional natural gas. The prognostic CBM resources have been estimated to be around 4.6 tcm (trillion cubic meter). The government in the fourth round awarded 7 CBM blocks and signed 33 contracts. The commercial production is now at one lakh cubic meter per day. The Economic Survey 2010-11

16 Desai, A. et al, 2009. 'Public Enterprises, Government Policy and Impact on Competition: Indian Petroleum Industry', a study for the CCI, New Delhi

17 TERI, 2007. Competition in India's Energy Sector, a Study conducted for the CCI, New Delhi

18 Azhar, Muhammad 2011. 'New Exploration Licencing Policy (NELP) in India', OPEC Energy Review, Vol. 35 (2), pp. 174-188; and Petrofed paper on 'Review of E&P licencing policy', prepared by PWC. NELPs have become repetitive, and does not appear to be attractive to foreign investors. To overcome this problem,

an alternative to NELP has been suggested by way of introducing an OALP, which offers opportunities to investors to evaluate strategies and carve out their own areas for exploration, rather than government's identifying the blocks. It thus provides for continuous bidding opportunities to investors, allows in-depth study of data, and gives liberty to the investors to choose acreage, and design own work programme

19 TEDDY 2010, TERI

20 City Gas Distribution, 2010. India Infrastructure Research, October

21 Economic Survey 2011-12

22 Dr VK Rao, 2011. 'Open acreage licensing policy - A mirage?, January 31, accessed at www.infraline.com/ong/article/Article

23 TERI 2007, op. cit

24 PetroFed 2010.Review of NELP VIII & CBM IV and Industry Recommendations for NELP IX & CBM V, August

25 S Mathur, Presentation on 'Development of Natural Gas Industry in India: Issues and Way Forward', accessed at Petrofed website

26 Answer to Lok Sabha Starred Parliament question 120, dated 3.3.2011 by MOP&NG

27 In May 2007 RIL invited bids from select consumers (in power and fertiliser plants) for sale of its gas asking them the quantity requirements and the asking price as per RIL formula. After negotiations/discussions with the government, a different formula was approved by the G\government for sale of RIL's gas for a 5 year period. Based on this formula, the price varies from US$ 2.5/mmbtu to US$4.2/mmbtu

28 In a recent case, the RIL filed a complaint with CCI alleging that the OMCs (IOC, BPCL, and HPCL) had formed a cartel to supply aviation turbine fuel to Air India. The OMCs moved before the High Court stating that the CCI has no jurisdiction and the case falls under the jurisdiction of the PNGRB. They got a stay order from the High Court against the investigation of this case by the CCI. The case is sub judice

29 On the Natural Gas regulations however, it appears that around 46 percent of the respondents suggested that partnership with supplying nations could be a better strategy for infrastructure development, whereas around 67 percent of the respondents opined that long term supply agreements may be help in a better way in this regard

Chapter 7

Indian Real Estate & Residential Housing: Case for a Regulator*

Introduction

Urbanisation in India is gaining pace, and has become an important determinant of domestic growth and poverty reduction. GDP from the real estate sector (including ownership of dwellings) along with business services witnessed a growth of 7.5 percent (at constant prices) while in terms of share, the subgroup accounted for 9.3 percent of the GDP in the year 2009-10.[1] The sector employs over 30 million people. At the moment, though India's level of urbanisation is low as the country is transitioning at a faster rate and scale than the other (Brazil, Russia, India, China and South Africa – BRICS) nations.[2]

As per the provisional estimate of Census of India 2011, the total population of the country has reached nearly 1.21 billion from the 1.03 billion recorded in the previous census of 2001. This tremendous growth in population has added to the rise in urban density, and the share of urban population has grown to 31 percent in 2011 (provisional) from 28 percent in 2001; United Nation's State of the World Population, 2007 has estimated that by 2030, 40.76 percent of India's population will be living in urban areas. India's urban population is however, underestimated, partly because of definitional reasons, and is estimated to be around 45 percent (495 million) of the population in 2011, compared to 30 percent in 2009.[3] At this rate, an estimated 854 million people will live in Indian cities by 2050, a figure which is the combined population of present day US, Brazil, Russia, Japan and Germany.

India accounts for around 17.8 percent of the world's population, but accounts for a relatively smaller share (2.4 percent) of the world's surface area. Unsurprisingly, Indian cities are not only the most populous but also among the densest urban agglomerations in the world (Figure 7.1), which poses unique challenges to the development of infrastructure and real estate;

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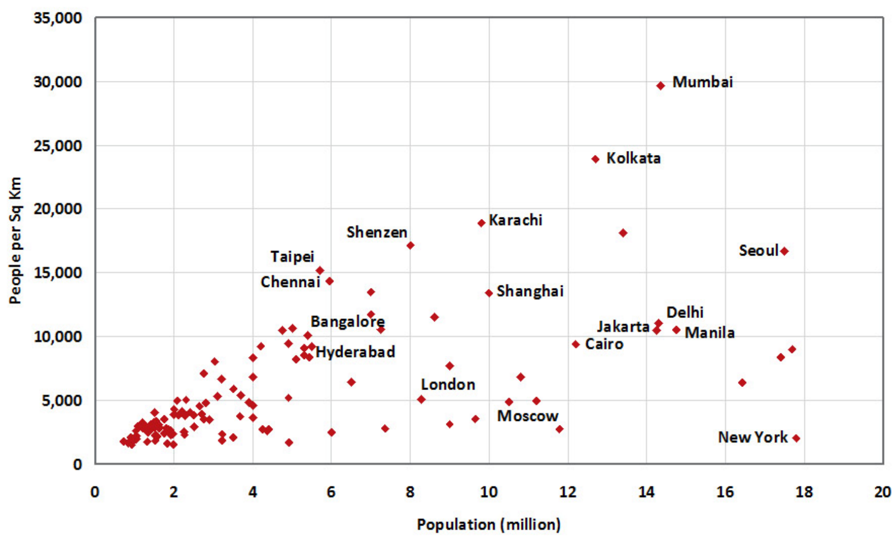
India's population density at 373 per sq km is 7.4 times of the world's and 2.7 times of China's population density, the latter being the most populous country in the world. Creation of dense informal settlements within the city, impractical low cost housing at the suburbs or high-rising verticals are also nothing but a manifestation of the inevitable economic migration of people from rural to urban areas.

Figure 7.1: Urban Density in Large Metropolitan cities around the World



Source: City Mayors 2010

Simultaneously, while Indian metropolises are seeing a fast evolving skyline with tall skyscrapers and iconic architecture, the smaller towns and cities are witnessing an unprecedented metamorphosis through expansion of roads, flyovers and open areas. Thus, key urbanisation challenges continue to be in the development of adequate infrastructure, efficient civic governance, availability of adequate funds and affordability of real estate.

Analysis of recent trends in urbanisation and rural-urban migration in India indicate that in 1971-81 and 1981-91, natural increase (population growth) as a component of urban growth contributed respectively 41.7 and 59.9 percentage points in the decadal change in urban population, while net migration plus changes in municipal boundaries accounted for respectively 39.4 and 22.6 percent and areal reclassification 18.8 and 17.4 percent change.[4] Urbanisation is pulling people out of rural poverty, but the process is knife-edged: failure will lead to chaotic cities, unfulfilled aspirations, and slower growth. Also housing affordability is important to the aspirations of the burgeoning mid and upper-mid segment of the urban population, which desires a higher standard of living. This rapid urbanisation is expected to offer large-scale opportunities for commercial and residential development in Indian cities, as well as access to a large pool of skilled workforce from the suburbs. It, however, needs to be acknowledged that India's rapid urbanisation has not been accompanied by a commensurate increase in supply of basic urban services and housing.

To create an environment friendly to foreign investors, foreign direct investment (FDI) up to 100 percent was allowed in 2005 in townships, built-up housing and construction development projects with the liberalisation of FDI regulations; the regulations call for a minimum US$10mn in wholly owned subsidiaries and US$5mn for joint ventures with Indian partners. By 2008, FDI worth US$16.3bn were committed for the real estate sector, the majority of the commitments being from the West Asian region. But a major limitation for project execution has been noted in the lack of rationalisation of the real estate regulations and their governance across states.

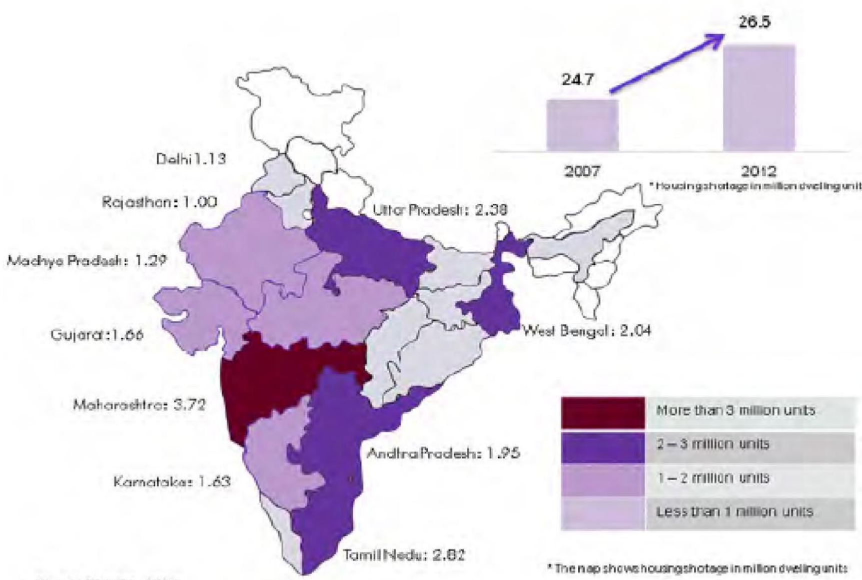
Besides, land prices are rising across India. It has been estimated that once easier conversion from agricultural to urban use is permitted (reform of the Non-Agricultural use Clearance or NAC), arguably a difficult regulatory process notwithstanding the provisions of the proposed Land Acquisition, Rehabilitation and Settlement Bill, 2011, land prices can jump twenty-fold. The solution, therefore, may not lie in tightening land conversion regulations, but in acting counter-intuitively to:

(1) improve urban land usage and urban planning processes;
(2) allow public (secondary) sale of acquired land in auctions; and
(3) go with market dictum and improve the supply of accessible land through better transport. Institutional and regulatory reforms are therefore urgently required from master planning modalities in India's urban spaces to improvements in basic local services (water, sanitation, roads, public transport, safety, low-cost housing), and greater independence and accountability of locally elected city managers, as intended under the 74th Constitutional Amendment Act for urban local bodies (ULBs).

The housing shortage in urban areas in India is enormous; the shortage increased from 10.6 million housing units in 2001 to an estimated 26.53 million[5] housing units during the 11th Five Year Plan Period (2007-2012) in India (Figure 7.2). Of the 26 million plus homes that are projected to be required by 2012 to meet the existing housing need, 99 percent are needed by households in the Economically Weaker Sector (EWS) and Lower Income Group (LIG).[6] If the current increase in backlog of housing continues, a minimum of 30 million additional homes will be required by 2020. While some of this additional demand will be taken up within the existing housing stock, many more millions of homes (in the non-luxury and low-cost categories) will need to be built if India is to fulfill the vision of becoming slum free.

For the growing housing shortage is a culmination of the high rate of urbanisation with the majority of housing stock catering to the premium segment, thereby incapacitating a large section of society from owning homes. The high cost of real estate, unimaginative land use policies, limited resources and inaccurate product offerings targeted at consumer groups have collectively contributed to the EWS and LIGs being severely underserved in the present system.

Figure 7.2: Housing Shortage in India



Source: MHUPA, 2007

From the consumer perspective, there are issues which have been highlighted across media, especially after the order by the Competition Commission of India (CCI) levying high penalties on market players. Consumers have been at receiving end due to some malpractices prevailing in the sector. Such practices start from the advertisements for project launch itself. There have been project launches without the land being actually purchased and without taking prior approval of competent authorities. The specifications related to total area of the plot/flat/house indicating clearly the carpet area and utility area are not provided in a transparent manner.

There is no fair, participatory and transparent mechanism to tackle any substantive and major changes in the project mid-way and the consumers are left in lurch after the collection of money from them. Most of the times the amounts collected from the customers are not deposited in a designated escrow account. There have been reported cases of inordinate delay in execution of the project and if the project is delayed without previously agreed valid reasons, no provisions exist that would entail pre-determined amount of penalties on total project to be paid to the consumers.

As observed in the order by the CCI, the consumers get locked in the contracts which are completely one-sided and favour the developers at every stage. Most of these specified practices in the sector are intended to be addressed by the Draft Real Estate (Regulation & Development) Bill, 2011 which will be discussed in detail.

The chapter gives an overview of the existing policies and regulatory regime, and the political economy motivations of Real Estate regulations in India, that affect and frustrate the attainment of 'affordable housing for all'. It describes and discusses the draft Model Real Estate (Regulation & Development) Bill, 2011, from the perspective of the competition and regulatory concerns that needs redressal. It also provides a brief competition analysis of the legal framework of the sector.

Figure 7.3: Global Real Estate Transparency Index

Transparency Level	2010 Composite Rank	Market	2010 Composite Score
High	1	Australia	1.22
	4		1.25
Transparent	16	Singapore	1.73
	18	Hong Kong	1.76
	25	Malaysia	2.30
	26	Japan	2.30
Semi-Transparent	33	Taiwan	2.71
	39	Thailand	3.02
	41	India Tier I	3.11
	42	South Korea	3.11
	44	Macau	3.13
	45	China Tier I	3.14
	48	Philippines	3.15
	49	India Tier 2	3.17
	54	China Tier 2	3.38
	55	India Tier 3	3.39
	57	Indonesia	3.46
Low	65	China Tier 3	3.73
	76	Vietnam	4.25

Source: Compiled by Jones Lang LaSalle Research team, 2010

Tier I cities – Mumbai, Delhi, Bangalore and ChennaiTier II cities – Hyderabad, Kolkata and Pune Tier III cities – 30 other prominent Indian cities

Real Estate Regulations in India - Overview and Political Economy thereof

The organised private Indian real estate segment is only about two decades old, although with the recent economic imperatives and government support, formalisation of the sector is happening at a much rapid rate. The organised segment was primarily with the government entities until 1980s, and the private sector forays started in earnest post-1991 liberalisation initiatives.

A joint study by Price Waterhouse Coopers and Urban Land Institute of India has cited India as one of the high-growth emerging markets for the real estate sector in the Asia Pacific region and ranked its Tier I cities high in terms of city development prospects for the year 2011. The study has however classified India as semi-transparent market in the Asia Pacific region, and the Tier I cities of India were ranked at 41st on a global transparency scoring scale (See Figure 7.3 for details). The reason for the lower transparency ranking primarily arises out of the existence of a large number of regulations and entities governing the sector, and the lack of reforms therein.

Land and urban planning in India is a state subject, and local development bodies and housing boards wield significant influence in real estate issues. The different Central Government policies and laws governing the real estate sector are: National Urban Housing & Habitat Policy, 2007; Land Acquisition Act, 1894 National Rehabilitation & Resettlement Policy - 2007; Indian Contract Act, 1872; Special Relief Act, 1963; The Indian Easements Act, 1882; Indian Registration Act, 1908; The Transfer of Property Act, 1882; Consumer Protection Act, 1986; Indian Stamp Act, 1899; Urban Land (Ceiling and Regulation) Act, 1976 & Urban Land (Ceiling And Regulation) Repeal Act, 1999; The Benami Transactions (prohibition) Act, 1988; The Building & Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996; The Building & Other Construction Workers' Welfare Cess Act, 1996; The Rent Control Act (different State laws); etc. In addition, several State laws and municipal regulations on urban planning and housing apply.[7]

Reportedly, a real estate developer/promoter needs to acquire around 52-56 different approvals, from multiple government organisations, and acquiring which could lead to delays of 2-3 years, the number and time of delay differing from state to state. There is no single window clearance system, the approval procedure is not time bound and could take up to two years, and there is no provision for online submission of documentation.[8] Some industry participants opine that, Indian real estate is an over-regulated sector, with multiple laws which hold back the growth of the sector. At a recently held national consultation organised by the Ministry of Housing and Urban Poverty Alleviation (HUPA), industry players sought fast-tracking of project approvals.

However, despite the need for multiple regulatory approvals from diverse departments and local regulatory bodies, the sector is not governed by any defined regulatory mechanism that oversees and controls the licensing, registration requirements and conduct of developers or brokers/architects; also, no alternate dispute resolution mechanism or sectoral consumer redressal forums exist for the benefit of the consumers, other than the consumer courts and the country's formal judicial-legal system. Such unregulated growth backed by high demand has bred corruption and builder malpractices are more of a norm than exception.

Thus, there is an urgent need not only for regulatory reform, but an emphasis on institutional reform, procedural reforms, improving infrastructure services, market transparency and making land accessible for real estate development is necessary to unlock the land value for the community/country.

As a response to meet the burgeoning low-cost housing deficit and facilitate land reforms, the Central government in 2005 launched the Jawaharlal Nehru National Urban Renewal Mission (JNNURM), which funds infrastructure projects in 65 cities in India, making JNNURM the largest city modernisation scheme launched by the Government of India in recent times. In its mandate under *Urban Infrastructure & Governance*, a total ₹602bn has been approved till February 2011 across 530 projects in 62 cities. Of this, ₹279bn is committed and ₹122bn has already been released. Over 100 projects related to urban infrastructure have been completed under JNNURM in the last five years. This is in addition to the market-led private sector initiatives in real estate/urban infrastructure development, as the majority of the real estate industry in India still operate in the unorganised (and unregulated) sector.

The JNNURM is a reforms-driven programme. As against commitments to achieve reforms by the fifth year in accordance with their respective Memorandum of Agreements (MoAs), 29 out of 29 States/UTs have repealed the Urban Land Ceilings Act, 21 out of 29 have constituted District Planning Committees, 15 out of 15 have rationalised stamp duties to five percent, and 17 out of 26 States have transferred/integrated water supply and sanitation functions. Also 42 out of 62 ULBs have shifted to double-entry based accounting system.[9] However, the project remains limited due to the limitations in local capacity and in PPPs to fund investments, as well as weak financial management and procurement systems.

Of the optional reforms required under JNNURM, to be undertaken by cities that are receiving funds, critical ones are the creation of Property

Title Certification System (PTCS) (zero achievement) and the introduction of computerised process of registration of land and property (58 percent achievement). But a major failure of the JNNURM has been the dismal achievement by states in the implementation of the 74^{th} Constitutional Amendment Act (Constitution of Metropolitan Planning Committee) and the Reform of the Rent Control Acts. Annexure 7.1 lists the status of the different reforms proposed under JNNURM, while the Annexure 7.2 shows state-wise commitments on *Urban Infrastructure & Governance* under JNNURM.

Furthermore, the Ministry of Urban Development has proposed a series of reforms in related areas to create an enabling legal environment for speedier implementation of urban development schemes and for attracting larger participation of the private sector. Some key proposals are:

- Amendment of the Land Acquisition Act, 1894 to speed up the process of acquisition and to delink the process of taking over possession of land from the process of determining compensation.
- Amendment of the Transfer of Property Act, 1882 to bring the concept of categorisation of mortgages in line with recent practices of housing and financial institutions, lay down uniform mortgage documents, introduce speedy and predictable system of foreclosure of mortgages and to give legal shape to rights of owners in multi storeyed apartments.
- Amendment to the Indian Stamp Act, 1899 and the Indian Registration Act, 1908 to delink the process of registration from the payment of stamp duty, to liberate the registration process from the requirement of various no objection certificates and to rationalise stamp duties on various instruments.

That said, the biggest impediment to project execution and completion faced by the Indian real estate sector (organised as well as unorganised) is that of land acquisition. Official estimates indicate that around 70 percent of the 190 delayed projects (including those by the Indian Railways and National Highways Authority of India) are due to land acquisition problems, while recent surveys by Confederation of Indian Industriy (CII) indicate that as much as 81 percent of the stakeholder-respondents point to land acquisition as the most important impediment to project implementation.

Thus, it is understandable that land related governance is an important reform; it is also evident that more governance and regularisation is called for in the Indian real estate sector, though the diversity of the country, the fragmented political structure and the control of different states by different political parties calls for localised rather than centralised governance. Be that as it may, the issue of the acquisition, use and development of urban and peri-urban land in the country has emerged as an important and urgent problem for governments at all levels (national, state and local).

The problem of land acquisition by the government and the tensions that accompany such a move are exacerbated by several other issues such as underdeveloped and poorly regulated land markets, insecurity of land tenure, unclear land titles, lack of clarity surrounding the use of 'eminent domain', the related distinction between public and private uses of land, poor compensation for land acquired for 'public' projects and undervaluation of land. This lack of clarity is also slowing the development of the Indian real estate sector.

Land markets in India are underdeveloped, the regulations governing them are unclear and as cities grow, multiple interest groups stake their often-conflicting claims on scarce land, leading to conflict and contestation. These interest groups consist of both state and non-state actors (like farmers, land developers and corporate leaders) and each group represents a separate stake in land development. Even the 'state' itself is not a monolithic entity but rather represents distinct interest groups that range from city and state governments to developmental authorities. These conflicts, as mentioned earlier, are rooted in both the scarcity of land and the growing multiplicity of claims being placed on this land.[10]

In response, the Indian national government has proposed a revised 'Land Acquisition, Rehabilitation and Resettlement' (LARR) Bill that attempts to address various inadequacies in the current procedure for land acquisition and resettlement.

However, to say that land reform in India is not an easy issue to tackle is an understatement. First, there are several characteristics of land as a commodity (immobility, fixed supply, lack of substitutability, distinctive physical features, emotional and cultural significance), that make it extremely difficult to regulate.[11]

Second, land markets in India are underdeveloped and poorly regulated. There are significant issues with valuation, security of titles, misuse of the powers of eminent domain and the existence of informal and illegal markets that further complicate matters.[12] Moreover, regulatory constraints on the sale and transfer of land, especially agricultural land (the effect of an un-reformed NAC, discussed in detail), have had the effect of depressing land values; this assumes terrifying proportions when one considers that urban land area in India is only two percent of total arable land.

Third, there are multiple social, economic and political interests that are tied to land that need to be taken into account. With economic liberalisation and greater privatisation, the number of stakeholders with an interest in urban planning and development processes has also significantly increased. Any attempt to reform land regulations will have to explicitly engage with all of the issues.

Finally, valuation of land is the other issue that has been affected by the lack of a market regulator. It is also related to the issues of land use conversion and compensation for land acquisition.

While land as a commodity in India is governed by several regulatory constraints that restrict its use, transfer and development, perhaps the most restrictive of these constraints is that of NAC. NAC refers to the restriction on using agricultural land for non-agricultural purposes. As cities expand outward, the issue of land conversion is becoming an increasingly contentious one. It has been said that the NAC is a cause for concern because it distorts the real value of land and often leads to inequity in land transactions, especially as the strict constraints on who is granted the NAC and when, determines who benefits from the increase in value, post-conversion.[13]

Moreover, the NAC is only granted once the land has been acquired. The issue of conversion of land from non-urban to urban uses is specifically an issue of the urban periphery, the latter being one where diverse and often conflicting stakes compete with each other for the same land: housing (especially low-income), agriculture, greenbelts, industrial zones, nature reserves and infrastructure projects covet these spaces.[14]

This tension is exacerbated by the fact that the peri-urban interface often lies in an administrative grey zone, falling between the cracks of urban and rural local government. The politics of conversion of land from agricultural to non-agricultural uses thus centers around three issues: the valuation of land, the use of eminent domain and restrictions on the sale and transfer of agricultural land.

Demand Supply and Affordability

A major concern with urban residential real estate sector has been the issue of affordability. As discussed earlier, as far as housing markets in India are concerned, what is demanded is not being supplied. Several gaps exist on account of the pressure on availability of land, in addition to those from increasing population and urban migratory trends. The total urban land supply (both in physical terms as well as the allowable floor-area ratio or FSI) has not increased at the same pace as the growth in the urban population. Also, the heavily regulated land sector in India has made the cost of transactions relatively high, thereby adversely affecting the affordability quotient of the poorer sections.

Lastly, low income housing has historically been perceived as a subject matter under the government's domain. Between the JNNURM effort and public sector schemes in some states, only about two million houses may be constructed for the EWS by the end of the 11th Plan.

Against the backdrop of severe housing shortage in the country and the need for a rapid increase in homeownership, especially in LIGs and EWS, the government has focused efforts towards 'affordable housing for all'.[15] Affordable and low-cost housing are often used interchangeably, though they have a different target audience and price points. Neither the National Urban Housing & Habitat Policy, 2007 nor the 11th Five Year Plan lay down a definition of affordable housing. As a result, it is open to interpretation by the various industry stakeholders and the end consumers. In order to comprehensively describe and create a more standardised approach on the matter, a task force was set up in 2008, which laid down the following parameters:

Table 7.1: Affordable Housing defined

Parameters	Affordable Housing	Low Cost Housing
Size of Dwelling Unit	Not exceeding 1200 sq ft on carpet area basis	300-600 sq ft on carpet area basis
Location	Within city limits	City peripheries or Exurbs
Cost	Not more than 4 time gross annual income of household	Not more than 5 time gross annual income of household
EMI/Rent to monthly income ratio	Not exceeding 30% of gross monthly income	Not exceeding 40% of gross monthly income
Category	LIG, MIG	EWS
Amenities	Basic	Bare minimum

Source: Task Force on Affordable Housing, 2008

One of the government initiatives, *Rajiv Awas Yojana* (RAY) is an urban affordable housing scheme launched in 2009 by the Government of India under JNNURM Sub Mission II – *Basic Services to Urban Poor and Integrated Housing and Slum Development Programme (IHSDP).* The schemes of Affordable Housing and Interest Subsidy on Housing the Urban Poor (ISHUP) have been dovetailed with RAY. The idea is to create an abundant housing stock, with emphasis on 'affordable housing' through compulsory property rights to people living in slums.

To facilitate this, a draft Model Property Rights to Slum Dwellers Act is under consideration which will seek to empower slum dwellers with property rights to their homes. The EWS/LIG requirement has been made a mandatory reform under RAY, towards which a Model Amendment Act on Affordable Housing has been drafted and sent out to states for adoption. The 'RAY – Slum Free City Planning' was approved with an initial budget of ₹120crore and a budget of ₹1,270crore was allocated in FY 2010-11 for the scheme. It has identified 30 cities across 16 states for initial implementation.

In addition, the government supports the concept of 'Enabling Shelter Strategies', propounded by UN-Habitat, which calls for a fundamental shift in the role of government, from being a provider to becoming an enabler. According to the strategy, an effective and large scale outcome in housing can be achieved if 'government's role is an enabling one – mobilising the resources of other actors and facilitating their deployment for the efficient provisioning of housing'. It involves facilitating the participation of formal and informal private sector, housing cooperatives and NGOs into the housing sector.

Notwithstanding these initiatives, an important regulation induced concern for the real estate sector affecting all stakeholders arises from lack of reforms at the municipality and town-planning levels. Policymakers must realise that enabling adequate supply at affordable prices needs reforms at the town-planning stage and quicker approvals as well.[16]

A laudable case in point highlighting the benefits of an efficient approval process and sensible urban planning is a micro-level successful experiment in Noida. During the two-year period 2009-11, Noida (including Greater Noida) witnessed sales of around 283 million sq ft of residential space: 2.83 lakh units at an average price of ₹2,800 per sq ft and an average home price of ₹28lakh. In addition, high density norms (i.e. higher floor-space index or FSI) enabled construction of smaller apartments, bringing down ticket sizes to the ₹25lakh and below range.

In terms of area sold, Noida accounted for nearly 54 percent of NCR home sales and 18 percent of cumulative home sales in NCR, Mumbai, Pune, Hyderabad, Chennai and Bangalore combined. During the four-year period 2007-11, the weighted average selling price in Noida rose at a CAGR of just 1 percent. Adjusted for inflation, however, prices actually declined over this period.

Several things are notable about the explosion of housing construction in Noida. First, the government built fantastic road infrastructure. Second, the density norms and FSI of residential development is the highest in the national capital region (NCR). Third, on an average, a developer can get plan sanctions and approvals in a single window in 6-8 weeks. These steps have led to a flood of supply backed by top-class infrastructure. The lessons to be learnt from the Noida experience are: planned infrastructure investment ahead of time, uniform FSI and building plan norms (limited discretion),[17] higher density and quick approvals was key to keep prices in check and the supply kept building.

The above is a clear indication that transparency in the approval processes, clear timelines set by approving authorities for sanction of proposals and effective use of Information Technology can reduce the delays in approvals, thereby improving the business environment which, in turn, helps the consumer to get timely delivery of properties at reasonable prices. Hence, it is important that an overhaul of the legislations and policies that inhibit this sector, mainly at the state level, is effected at the soonest. This will also help to infuse competition, largely by allowing more players into the market other than the limited few who know how to 'manage the system' in the present arrangement, offer more options to the buyers/consumers and easy transferability, and by introducing predictability/reducing delays in project deliverables minimise the gap between demand and supply.

The next section will discuss the competition and regulatory lacunae in the proposed draft Real Estate Bill (the November 2011 version), in an attempt to identify how successful the draft Bill might be in addressing the regulation-induced distortions discussed above.

Analysis of the Real Estate (Regulation & Development) Bill, 2011

At a first glance, it appears that Indian real estate as a sector has sufficient competition and a surfeit of regulations to ensure a free and fair operating system for all stakeholders. However, when one gets deeper into the policies/laws/regulations that govern the real estate sector, one realises that the present system favours the big players with huge entrenched entry and exit barriers.

A separate study commissioned by the Committee on National Competition Policy, Ministry of Corporate Affairs has evaluated the statutes, rules, regulations, policies and practices in the real estate sector and found that there exist specific provisions in the present laws which curb competition or have the potential to curb competition. While these distortionary statutory provisions needs to be amended, the study also identified provisions in the draft Real Estate (Regulation & Development) Bill (henceforth the draft RE Bill) with potential anti-competitive implications, which needs to be revised.

It is common knowledge that builders blatantly engage in various malpractices, be it delay in construction, use of substandard materials, deviation from sanctioned plans, failure to obtain the occupation certificate, avoiding the formation of a co-operative society, illegal sale of parking and other open areas, misappropriation of advance monies taken for maintenance etc. Apartment purchasers in India are almost always at the receiving end, with the only viable, time-tested and effective remedy available being through the redressal mechanism provided under the Consumer Protection Act or the judicial system.[18]

It is in this light that the introduction of the draft Real Estate Bill by the ministry of housing and urban development is also being evaluated here, as some analysts contend that this new legislation may in reality be beneficial to builders at the cost of the flat purchasers.[19]

The preamble clearly states that the draft RE Bill aims:

> *to establish the Real Estate Regulatory Authority for regulation and planned development in the real estate sector and to ensure sale of immovable properties in an efficient and transparent manner and to protect the interest of consumers in the real estate sector and establish an Appellate Tribunal to adjudicate disputes and hear appeals from the decisions or orders of the Authority and for matters connected therewith or incidental thereto.*

The Real Estate Bill, envisaged as a national legislation,[20] proposes creation of an Ombudsman for all residential buyers, by creating checks on developers/ promoters and ensuring that consumer rights are enforced more stringently. Furthermore, this Act seeks to set up a Regulatory Authority and an Appellate Tribunal which will create an alternate redressal mechanism for residential buyers. Also, it provides for enhanced transparency through a host of checks on promoters to ensure that not only are the current information asymmetries in the development sphere removed but also that the promoter adheres to his timelines and delivery specifications and his accountability is ensured through monetary and even civil penalties.

The entire focus of this Bill has been to create an efficient regulation mechanism for the residential housing sector and provide consumers with a tool for efficacious implementation of their rights. The status of the Real Estate Bill is that tabling the draft Bill has been approved for Legislation under Entries 6&7 of the Concurrent List by the Legal Division of the Ministry of Law & Justice, and the Legislative division has made some suggestions on the language which will be shortly incorporated in the form of a final draft.

This rest of this section attempts to demystify the proposed Bill and evaluate the above claims, also outlining some important regulatory lacunae in the present draft.

The draft Real Estate Bill is clearly a huge positive step towards creating and bringing about the much needed transparency by seeking to regulate the hitherto largely unregulated housing sector in India. When the Bill gets enacted, it will provide considerable relief and succor to the ordinary real estate buyer and investor who at the moment go through innumerable obstacles when buying a property and at times is duped by small developers, builders and even brokers. By imposing strict regulations on the Promoter, the Bill looks to ensure that construction is not only completed in a timely manner but that on completion the buyer gets the property as per the specifications that he had been promised.

Further, by seeking to establish the Regulatory Authority and the Appellate Tribunal, the Bill aims to create a dispute resolution mechanism and provide a specialised forum for hearing disputes related to property matters and expeditiously address the grievances of the consumer who otherwise had recourse to either a prolonged litigation process in a court of law or consumer courts.

The Bill aims to be balanced. While it holds the developers accountable, it also looks to ensure that the allottees do not default in making payments. Thus, by providing penalties for both the promoters and the allottees, the Bill seeks to minimise non-compliance by all parties. However, a concern has been raised that certain provisions of the Bill may end up taking away some of the current rights of the Indian consumer that is conferred under the Consumer Protection Act.

Section 60 states that "no civil court shall have jurisdiction in respect to any matter… no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act". The new Bill while providing for a pro-consumer dispute settlement and appeal mechanisms, also seems to take away the alternative, efficacious remedy which was hitherto available to a real estate purchaser. However, at a recent national consultation on the draft Bill, the Secretary of HUPA clarified that the Real Estate Bill does not propose to replace/eliminate the role of consumer courts. It has been envisaged that the dispute settlement and appeal mechanisms under the Bill would look address/redress the larger transaction related and systemic issues of consumer grievance, while the consumer courts will continue to have jurisdiction over the basic and local real estate consumer concerns.

But a more serious limitation of the Real Estate Bill, despite the clear outlining of its objectives in favour of the real estate consumer (buyer), is that it is a partial legislation which fails to address the key concerns of a key section of stakeholders, namely the builders/promoters, and in doing so also ill serves the consumers it seeks to protect. The draft Real Estate Bill clearly focuses on the consumer concerns, and the developers/promoters are concerned that the RE Bill will just add another layer of time consuming compliance requirements. A single window clearance system to cut through the red tape and enable fast tracking of real estate projects has been a long standing demand of the developer community in India.

While it can be argued that even other federal countries like the US do not follow such a practice (Annexure 7.3 lists the cross-country experiences on Approvals), in the Indian context it is pertinent to note that the project delays are more often than not attributable to the inordinate time lag between the application and approval for a particular project, and that delays are often compounded by the multiplicity of government agencies from which such approvals must be taken. Without ensuring time-bound approvals, penalising the developers for delays is not only unjust but also counterproductive, and will only end up reducing the supply of residential properties.

Representatives of the real estate industry, such as CREDAI and NAREDCO, said that constitution of the Real Estate Authority should be broad-based to take care of interests of all stakeholders. A two stage single window clearance at the Central and state levels could therefore be considered as a means to redress this important procedural drawback. In the absence of such consolidation/ harmonisation of the process for approvals, the builders/ promoters are right to complain that the Bill will add to the regulatory cost and compliance delay. They further argue that the requirement of registration with the Real Estate Authority (regulator), and the complicated permissions/ approval process and additional requirements like submission of bank guarantees and financial statements will in turn add to the financial burden of the final consumers onto whom the additional costs is sure to be passed on.

Thus, in the interest of the consumers it seeks to protect, the Bill needs to be inclusive towards developers. Furthermore, affordable housing projects in particular may need different financing and price control regulations, lest the developers pass on the higher cost of financing/transparency requirements to be met under the new registration provisions of the Bill to the budget consumer.

In addition, there are other internal inconsistencies which demand ironing out before the Bill is tabled/passed. First, Section 3 of the bill provides that a builder must be compulsorily registered with the real estate regulatory authority for plots measuring 4000 sq. meters or more. Most of the buildings are constructed on smaller plots. Hence this provision will not be applicable to most builders, and a large section of the Indian real estate purchasers will remain outside the ambit of the consumer grievance redressal mechanism that this Bill proposes to provide.

Secondly, the Bill is limited in that its provisions do not encompass all entities/aspects of the project development process where consumer concerns may arise, and focuses only on the construction and marketing phases.

Third, the Real Estate Bill addresses concerns of the primary market, totally overlooking the consumer/developer concerns of the secondary real estate market.

Fourth, though the list of disclosures required to be furnished by the Promoter is fairly exhaustive, it could further be benchmarked against the best practices of the developed markets so as to bring India's real estate markets more in conformity with such markets where regulations have existed for some time and relevant lessons can be learnt from their experiences.

Last, the Bill does not bring into the ambit of registration/regulation either: (a) the government agencies at different levels that are in charge of the regulation/approval processes and malpractices and implementation irregularities (mostly at the city-municipal levels) which are often at the root of many consumer woes, or (b) the property agents/architects/building contractor who might be equally complicit in the malpractices that the property developer/promoter indulges in.

On the other hand, and as discussed earlier, from the developer's perspective the major flaws of the present draft Bill are:

1. The sector badly needs a single window clearance mechanism to remove the administrative delays and running around various departments for the plethora of approvals required. This will help reduce the project delays, and check price escalation.
2. Strict penalties have been imposed for non-delivery by developers. But what happens in case of delays experienced from the state/city development departments and other ministries? Will the developers be made to pay penalties for government procedural delays? With delays in the approvals and clearances stage being quite lengthy in character, local authorities must also be made accountable.
3. Similarly, in case of non-provisioning of basic amenities in the project, the developer will be criminally prosecuted, but what in case the local authorities delay on their part in providing these amenities in the project?
4. All government agencies/local authorities/statutory bodies engaged in the business of development of land or housing have been kept out of the ambit of the regulator. How does the Union government hope to create monitoring mechanisms for state level regulatory bodies?

There also exist inconsistencies in the provisions of the Bill *vis-à-vis* the other regulations applicable in the sector which need to be eliminated. To cite one example, the Bill makes registration compulsory of an Agreement to Sell. The Indian Registration Act, 1908 however, does not provide for compulsory registration of an Agreement for Sale since such an agreement by itself does not create any interest in immoveable property but merely gives the right to obtain another document, which when executed would create right, title, and interest in immoveable property. Through various amendments in local state laws, a few states in India have provided for compulsory registration of the Agreement to Sale.

However, as and when the draft Real Estate Act is enacted by the states, all Agreements to Sale would require mandatory registration, so far as purchase of properties under the new law are concerned. This requires that the states modify/harmonise their local registration requirements in line with the Central Real Estate Act, which will go a long way in further protecting the rights of the property purchasers, but which are completely under state jurisdiction and the Central Real Estate law will have no authority upon.

The main concerns are (a) how will the disputes/implementation irregularities from such inconsistent provisions be resolved, (b) which law will have primacy in case of a difference of opinion/dispute, and (c) whether a consolidation/harmonisation of such legal overlaps be possible at any point in future? Such inconsistencies in other legal provisions and statues therefore need to be ironed out for the proposed Bill to be effective in helping the sector develop in an efficient and sustainable manner.

Dissecting the Role of the Regulator

Land and urban planning including housing is a State subject. In a quasi-federal state like India, states act as independent, autonomous agents in regard to subjects which are under their purview. This is quite similar to the US, where local city laws hold primacy over the county and the national laws in matters relating to real estate.

In such a scenario, when the US also does not have a single window approval system and a single regulator in place, it is quite a pertinent question to discuss whether in India with a similar constitutional framework, a regulator will actually be the panacea for the ills that plague the real estate sector. Overarching, all-encompassing regulators (Real Estate Authority) at the state level is a distinct possibility in the not so very distant future as the government enacts the Real Estate (Regulation & Development) Bill, 2011.

However, and notwithstanding the concerns of the developer/promoters, perusal of the draft Bill seems to suggest that the real estate regulator in India has been envisaged more on the lines of a consumer vigilance forum than a licensing authority, despite the Authority being projected as a nodal body for registration of real estate projects. Such mandatory registration and public disclosure requirements will bring in much-needed transparency and accountability in the sector.

Enhanced transparency will not only benefit the consumers, but also benefit the honest developers by augmenting credibility and making bank financing available at lower interest rates, the latter being a function the sectoral risk perception which is expected to go down with the enhanced disclosure norms and registration processes, thereby facilitating larger investments in the sector in the long run.

Banks and fund managers seem encouraged that the presence of the regulator will lead to an increase in vigilance of the deployment and use of financing by the developers, the latter in the past having often used funds for acquisitions which were actually demarcated for construction.

The US has multiple regulators at the central, state and city levels. However, stringent implementation of rules and procedures ensures consumer protection. The US has laid down certain rules and regulations governing the working of brokers. It has also provided minimum educational and professional qualification criteria and a code of ethics for the real estate dealers/brokers and state development agencies, in addition to requirements for contractors, architects and developers.

The regulator should therefore ensure that all stakeholders are held variously accountable to ensure that the rights of the buyers are well defined and adequately protected, which requires a well-defined code of conduct/ethics is laid down for all the stakeholders in the real estate industry.

China has also recently brought in regulation to control price rise in cities. Local governments have been made accountable for stabilising local real estate prices. China further provides for a grading system for developers based on their capital, technical employees etc. The crafters of the Real Estate Authority need to learn from these experiences to serve their purported mandate better (see Annexure 7.3 for detailed comparison).

Finally, ICT should be used intensively and extensively by the regulator to enhance transparency and reduce the paperwork, as well as for efficient management of records and documents. Online registration processes and filing of project approval documentation is both necessary and cost-and time-efficient.

Competition Analysis

This section will provide a brief analysis of competition assessment of the current regulations. The objective of competition assessment is to examine the impact of the rules and regulations laid down by regulatory agencies related to the sector. Effective regulatory arrangements are necessary to ensure fair competition in markets. This is very important for the proper development of the sector. It is also necessary to check anti-competitive practices in the sector.

Table 7.2: Competition Assessment of the Real Estate Sector in India

Factors Impeding Effective Competition	Present Status
1. Entry and exit barriers	Legal procedural complexities, small and individual holdings, untraceable records and unavailability of organised finance are major entry barriers to FDI in real estate. Taking an example of legal problems, for instance, The Haryana Development and Regulation of Urban Areas Act, 1975 provides for clauses which create entry barriers by mandating the requirement of 25 percent bank guarantee in the case of residential/commercial projects and 37.5 percent in case of cyber city or cyber parks. It raises cost of entry for the prospective developers. Such onerous requirements act as an obstacle for smaller and medium sized developers. Further, the requirement of maintenance of the development for the period of 5 years after the date of issue of completion certificate creates exit barriers, thereby again preventing many prospective developers. These barriers make the incumbent players status quo oriented which go against the principle of increasing competitiveness in the sector. It also acts as disincentive for prospective players.
2. Differential treatment to market players	It has been seen that some policy measures provide unequal treatment to different market players in the sector. There are provisions in the National Urban Housing & Habitat Policy 2007 (NUHHP) which indicate that there is unequal treatment in support and concession to different players. Projects undertaken by developers under a scheme of the government for Affordable Housing receives support from the Central Government to the extent of ₹50,000 per dwelling unit or 25 percent of the cost of all civic services (external and internal) proposed in the project. However, if the same developer on his own accord takes up an affordable housing project, he is not entitled to the said support from the Central government. For instance a developer in Gujarat, who has undertaken Affordable Housing project on his own accord, is not entitled to the benefits provided in the Affordable Housing Scheme in Partnership as it currently stands,

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Factors Impeding Effective Competition	Present Status
	as the benefit is only when development is carried out under a scheme of the government. It clearly shows that there exists a situation of unequal provisioning of policy concessions, available to one class of developers as against the other, and absence of competition neutrality. Such instances can be found at State level also. For example, the above provisions of Punjab Housing & Habitat Policy, 2008 provides for unequal application of law and preferential treatment to government undertaking. The Policy provides for the setting up of a state-based real estate regulator for the private developers and does not provide for regulation of public agencies involved in construction/ real estate, namely housing boards or development agencies of the government.
3. Barriers to raising finances	Though, FDI up to 100 percent under the automatic route is allowed in townships, housing, built-up infrastructure and construction development projects, yet there are certain conditions in the policy which are onerous. In case of development of serviced housing plots, a minimum land area of 10 hectares is required and in case of construction-development projects, a minimum built-up area of 50,000 square meters, is required. The current FDI policy which provides for a minimum area (538,195.5 square feet/50,000 square meter) and minimum capitalisation (US$10mn / US$5mn) is not in compliance to standards of competitive regulations for affordable housing projects, where to match such sizes and investments would keep the segment, which requires maximum units, out of FDI. These threshold limits have kept investors at bay, and has impacted investment in the Affordable Housing segment, which is in dire-straits for want of investment. These restrictions greatly affect investment opportunities, especially for medium and smaller developers, which may not be able to attract such large investments.
4. Lack of uniformity of laws at State level	Real estate sector is mainly governed by State legislation. The multiplicity and complexity of the regulation and procedures cause confusion and act as a strong

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Factors Impeding Effective Competition	Present Status
	disincentive. Further, land use restrictions like Urban Land Ceiling Regulations Act (ULCRA) have sky rocketed the real estate value and has also created entry barriers.
5. Taxation Structure	High stamp duty has always been a major deterrent for people to declare actual value in the sale deeds and consequently the involvement of black money in property transactions. Further there are instances of unequal treatment to the market players. For instance, Section 35AD of the Income Tax Act, 1961 provides deductions to housing projects under a scheme for affordable housing framed by the government and notified by the Board; however Affordable Housing projects undertaken by the developers 'voluntarily' are not eligible, nor are those carried out under the reservation policy of the government.
6. Complex procedures leading to delays	As already mentioned, every real estate project prior to launch has to seek almost 52 approvals, and the time lag in anything between two-three years, differing from state to state. There is no single window clearance system, the approval system is not time bound and could take up to two years, and there is no provision for online submission. These circumstances together make the entire business proposition onerous and time-consuming for any prospective developer.

But, for infusing competition in the sector, it is very important to have a conducive policy framework. It has been seen that there are government policies, rules and regulations which often pose a threat to fair competition. The need is to identify such inconsistencies through competition assessment so that a comprehensive policy response can be generated to rectify the situation. Table 7.2 summarises the competition assessment of the real estate sector in India.

The above analysis points that the sector is fraught with high entry barriers such as regulatory barriers, financial risk, high capital cost of entry and economies of scale. The Competition Commission of India (CCI) has also observed[21] that 'Real Estate is a high cost sector with natural entry barriers due to high cost of land and brand value of incumbent market leaders…". Further, such a market structure may lead to the incumbent players behaving in an anticompetitive and collusive manner which further effects the competition in the sector and ultimately the consumer.

The results from the perception survey carried out under this project also paint a similar picture of the sector. About 52 percent agreed that existing regulations are not effective; 63.2 percent refer to multiplicity of regulation and lack of consistency as the main obstacles in the sector. It is important to take steps for an overhaul of the legislations and policies that inhibit this sector, mainly at the state level.

The Real Estate Bill seems to be an important step in this direction. This will help infuse competition, mainly by allowing more players, more options to the buyers/consumers, easy transferability, business regulations by reducing delays in projects deliverables, and by creating a stock to cater to the imbalance between demand and supply. Effective regulation is key to generate competition in the market.

There is need of effective regulation which will promote a competitive and predictable environment in the sector. This will create an enabling environment for the prospective entrants and thus will attract competition in the sector. Infusing competition also helps in addressing the concerns of the consumers as the increase in number of market players implies better choice to consumers. 54.9 percent of the respondents of the survey mentioned above also feel that a strong regulation policy and its proper implementation will help to improve the quality of governance and reduce corruption in the sector.

Conclusion and the Way Forward

It is argued that in a federally governed sector like real estate, a single unifying regulatory body may not serve the purpose. However, given the persistent problems consumers have been facing, it is necessary to create a focal point of governance. In the corporate sector in India, tried and tested best practices in governance are already being applied. It is perhaps time to bring Indian real estate up to those standards as well.

Can they achieve a sufficient level of self-governance to clamp down on the questionable practices? The draft Real Estate Bill has proposed the creation of overarching state level regulators in the form of an independent Real Estate Authority, with mandates of promoting transparency and offering expeditious consumer grievance redressal. With such refined and focused regulations brought into play by the government, it is to be hoped that the real estate community clearly will see the benefits of self-regulation to government mandated compliance to ethical norms/dispute arbitration.

A growing economy and favourable demographics, including a large young population, are the two strongest growth drivers of the Indian real estate market. The efficiency of businesses and quality of life for human resources are also determined by the quality of real estate. For India to stay ahead in the race for economic growth there has to be greater emphasis towards improving the regulatory framework to create an ecosystem which is conducive to real estate development.

Without significant multi-dimensional reforms, however, the sector will witness increasing levels of consumer dissatisfaction, below-trend levels of investment in the industry, little redevelopment of uneconomic areas of housing, and a lower quality of urban management than could otherwise be the case; the enactment of the Real Estate Bill is not sufficient. Some measures, especially lessons from East Asia, adapted to India's setting, could be useful:

- *Urban Land Value Capture:* Public land sales by transparent auctions are essential for ensuring a fair land market. In China, while traditionally unregulated and non-transparent, a constitutional change in 1988 mandated all public land transactions (land use rights) to be auctioned under open, competitive bidding, similar to Singapore and Hong Kong, with proceeds flowing to the municipalities. Between 1990 and 2002, the speedy implementation of such transactions is what enabled emergence of much of new urban landscape (from Guangdong to Shanghai) in China.

- *Enforcement and Dispute Settlement:* Improving land administration and courts are important. Specialised courts to handle contract disputes are needed to restrain opportunistic behaviour by developers or local authorities.

- *Public Redistributive Uses:* Some part of the new land value has to be transparently provided to the community, especially for low-cost public housing, which has long dominated successful East Asian urbanisation. This added to improved connectivity in rural areas and communities, including rehabilitation and resettlement will immensely transform the Indian urbanisation trajectory.

- *Public Land, Densification, Land Taxes, and User Charges:* Publicly owned land has to be fully listed, encroachments removed, and managed transparently including regular sales to manage land markets. Similarly, eased floor-area ratios can expand the supply of buildable space (density). Land taxes and user charges need to be brought to economic levels.

- *State Governments Must Improve Area Planning and Wider Connectivity:* Local municipalities should handle local needs. But larger urbanisation strategy will need state government master plans for overlapping jurisdictions and area-wide planning, including new cities and transport corridors.

- *Increased Central Government Funding:* JNNURM will need redesign, expansion and deepening, addressing much larger funding needs for critical public requirements, such as low-cost housing, urban transport, slum redevelopment, and water and sanitation. A programmatic transfer, rather than project-by-project sanctions, may be needed, benchmarked against front-loaded reforms and results.

Some other recommendations and suggestions are listed to enable India to fulfill the housing deficit and take concrete steps to ensure a viable long term solution for the real estate sector's problems. The aim is to look at regulations and market practices which can be introduced, implemented or overhauled towards a more inclusive growth to fulfill the "Housing for All" objective. Based on industry interactions and the brain storming exercise undertaken for this paper, suggestions to address the key concerns and the regulatory gaps impacting the housing sector are enumerated below:

- *Infrastructure Status to Housing:* As a policy initiative and to reflect the changing landscape of housing requirements in the country, granting infrastructure status to large scale township projects or affordable housing projects may be considered. This will enable the sector to not only access low-cost institutional funds but also leverage long term funds.[22] The Insurance Regulatory and Development Authority's (IRDA) regulations mandate insurance companies to invest upto 15 percent in the social and infrastructure sector. If the housing sector is granted infrastructure status, it could benefit from greater access to long-term finance like these.

- *Overhaul Old, Archaic Laws:* JNNURM has mandated the abolition of archaic laws such as the ULCRA and the Rent Control Act if states wanted to tap into Central government funds for city-development projects. The states which still follow these rules should be encouraged to abolish them to avail of the mission benefits.

- *Streamlined Approval Process:* In India, more than 52 approvals are required for housing and real estate projects, which can take up to two years, as several agencies are involved in providing clearances. With land and housing being a state subject, and every state being unique in its clearance procedures, there should be a movement towards merging the cumbersome procedural process into a single window clearance mechanism which will enable time-bound and a streamlined approach to clearances. Administrative delays in project sanctioning also adversely impacts consumer confidence.

- *Reforms for Encouraging Affordable Housing Projects:* The government should actively consider modifications to the existing FDI norms for development of affordable housing. The current limits of minimum area (538,195.5 square feet/50,000 square meter) and minimum capitalisation (US$10mn /US$5mn) are unlikely to be satisfied by any affordable housing project. Further the FSI norms need to be changed to allow for denser urban developments.

- *Floor Space Index (FSI) Issues:* As per the current regulations, the FSI is near-uniform 1 to 1.5 in most Indian cities. Though it tends to control unplanned development in the city centres, overall a low, uniform FSI will tend to increase its cost without realising any corresponding augmentation in the productivity of land. One suggestion is to vary the FSI within a city keeping in mind the current demographic statistics and based on land use. The FSI could differ between the city centres and the suburbs depending on parameters such as population density, basic infrastructure availability and business potential. This will be keeping in line with other world cities where the city centers have a FSI much higher in comparison to the suburbs.

- *Calculating the Area of Sale:* Presently, there is no standard method of calculating built-up area in India. The definition of built-up area should be clearly laid down, stating whether the term refers to super built-up area, carpet area or any other accepted definition. As the calculation of built-up area is currently not standardised, the same unit can be sold with different area calculations and, thus, lead to different FSI values across the country. The adoption of standard area-measuring techniques, such as those prescribed by the Building Owners and Managers Association (BOMA) International and the Royal Institute of Chartered Surveyors (RICS), which creates the Code of Measuring Practice, may be considered.

- *Stamp Duty Rates:* Stamp duty rates vary from 5 to 15 percent in different states. This could be reduced to arrive at uniformly applicable rate across states. Under JNNURM, nearly 35 percent of the states had already rationalised stamp duty rates to 5 percent by mid-2010. Since, this is an additional cost in the transaction process, respective state governments should expedite its reform and levy a uniform stamp duty rate of five percent across the country.

- *Service Tax and Value-Added Tax (VAT):* The Central government proposes to impose service tax on real estate, whereas some state governments are imposing VAT. This will create a double taxation regime, and in all cases the extra burden will be passed on to the consumer. The government should consider clearly defining "real estate property" as either a product or service and determine tax accordingly. This issue merits attention in view of the impending introduction of goods and service tax (GST).

- *Streamline Provisions of REMFs and REITs:* Real Estate Mutual Funds (REMFs) and Real Estate Investment Trusts (REITs) can be excellent funding opportunities for real estate development. However, due to lack of clarity on taxation and levy of additional transaction costs such as stamp duty, they have failed to gain momentum. The government should streamline and relax the issues related to the enactment of legislations, which enables the creation of a viable REIT and REMF market in India.

- *Remove Anomalies of Property Tax Distortions:* Property taxes are an important element of the current distortions in the residential property market. Property taxes are collected by the Urban Local Bodies (ULBs) to finance local government expenditures. However, as most ULBs use a notional property rental value which is far removed from the market value of the property, the taxation mechanism ends up being skewed. This increases the overall price of the property for such a real estate developer, and a project which may have been affordable tends to be relatively expensive.

- *Use of ICT for Land governance:* Technology will be the chief instrument of reform as unintended consequence. The computerisation of railway bookings two decades ago dramatically reduced the corruption, delays and harassment routinely visited upon the average traveller. Similarly, mobile and internet technologies open up possibilities for e-governance that cannot be anticipated in advance. Being able to create an electronic registry for land records might do more for urban governance than any direct attempts to improve it.

Effective legislation, judicial activism and an appropriate regulatory mechanism will together help create a vibrant industry with greater emphasis on protecting consumer interests, which inevitably get trampled during the profit maximisation exercise of the private developers and brokers. The real estate sector thus desperately needs both a rationalisation of the existing plethora of laws as also creation of new regulations to govern the now largely unregulated private sector and its operations. To serve the latter purpose, the draft Real Estate Bill is a good initiative and its speedy enactment is encouraged.

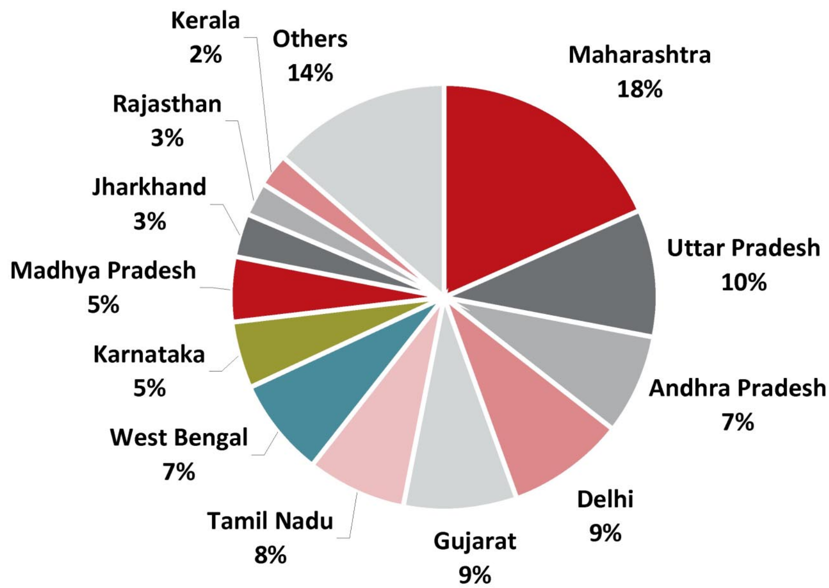
However, the current lacunae in the Bill need to be plugged to do justice to the spirit of the proposed law. It is clear that the need for a regulator for the sector has been recognised by all stakeholders. However, the draft Bill should aim to meet the challenge of satisfying the concerns of all stakeholders. To meet that end, like all other legislations, a consensus with state governments has to be evolved. Further, given the state autonomy in matters of land and for creating an effective regulator, the modalities of implementation of the regulation and the functioning of the regulator need to be clearly defined.

Annexure 7.1: Status of Key Reforms under JNNURM (as of June 2010)

	% of States/ Cities Achieved	Overall Status of Reform
State Level Reforms		
74th Constitutional Amendment Act (Transfer of 12 scheduled functions)	35	Medium
74th Constitutional Amendment Act (Constitution of District Planning Committee)	65	Medium
74th Constitutional Amendment Act (Constitution of Metropolitan Planning Committee)	19	Low
Transfer of City Planning Functions	42	Medium
Transfer of Water Supply & Sanitation	55	Medium
Reform in Rent Control	29	Low
Stamp duty rationalisation to 5%	35	Medium
Repeal of ULCRA	94	High
Enactment of Community Participation Law	39	Medium
Enactment of Public Disclosure Law	61	Medium
Urban Local Bodies (ULBs) Level Reforms (At city Level)		
E- Governance Set-Up	34	Medium
Shift to Accrual Based Double Entry Accounting	57	Medium
Property Tax (85% Coverage)	32	Low
Property Tax (90% Collection Efficiency)	23	Low
100% Cost Recovery (Water Supply)	11	Low
100% Cost Recovery (Solid waste)	9	Low
Internal Earmarking of Funds for Services to Urban Poor	77	High
Optional Reforms (At a City Level)		
Introduction of Property Title Certification System	0	Low
Revision of Building Bye Laws - Streamlining the Approval Process	48	Medium
Revision of Building Bye laws - Mandatory Rainwater Harvesting in all Buildings	77	High
Earmarking 25% Developed Land in all Housing Projects for EWS/LIG	40	Medium
Simplification of Legal and Procedural Framework for Conversion of Agricultural Land for Non-Agricultural Purposes	60	Medium
Introduction of computerised process of Registration of land and property	58	Medium
Byelaws on Reuse of Recycled Water	45	Medium
Administrative Reforms	26	Low
Structural Reforms	34	Medium
Encouraging Public Private Partnership	71	High

Source: Jawaharlal Nehru National Urban Renewal Mission, June 2010; complied by JLL Research team.
Note: States leading the reforms under JNNURM are Andhra Pradesh, Gujarat, Kerala, Karnataka, Madhya Pradesh, Tamil Nadu, Uttar Pradesh and West Bengal.

Annexure 7.2: State-wise Commitment of Approved Costs under JNNURM - Urban Infrastructure & Governance



State	Commitment of Approved Costs (in INR Cr)
Maharashtra	5,138.27
Uttar Pradesh	2,707.05
Andhra Pradesh	2,054.28
Delhi	2,518.97
Gujarat	2,386.52
Tamil Nadu	2,126.76
West Bengal	2,052.89
Karnataka	1,460.26
Madhya Pradesh	1,328.50
Jharkhand	941.20
Rajasthan	748.69
Kerala	645.55
Others	3,831.92
Total	**27,940.86**

Source: Jawaharlal Nehru National Urban Renewal Mission, February 2011

Annexure 7.3: A cross country comparative on state of regulations basis various stakeholders and their interests

Parameters[23]	US	China	India
Approvals	No formalised "single-window" approval process Regulatory approvals are currently being provided based on a multi-jurisdictional basis (national level, state, county and local level) Regulatory guidance is frequently issued at several levels, with the local level superseding the others (example, the city building code supersedes that of the county or state) There is no set number of approvals required for a project. It varies widely based on the location, type of property and type of use	The Chinese government has put into place regulations to prevent developers from over-leveraging themselves. One such example is the regulatory control it has placed on the purchase of land by restricting the installment payment period to 1 year and requiring at least a 50 percent of the total price as the down payment. Thus, developers need to completely pay off land purchases from the government within one year of the sale agreement. Only in certain special projects is a one year extension granted. Local governments are also regulated as they are required to fully reflect the proceeds of land sales in their budgets. They are also not allowed to give any discounts to developers or give any allowances to delay payments Developers are not allowed to buy new land if they fail to pay off a land purchase in time	Regulations governing housing and urban development are the responsibility of individual states in India and vary substantially Most approvals are provided by the respective urban planning or municipal departments at the city level There is no single window clearance system. In addition, the approval system is not time bound and could take up to two years There is no provision for online submission

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Parameters	US	China	India
Land titles/ records	Any encumbrance on a property's title to be recorded at the county where the property is located in order to be enforceable The process of verifying a property's title and any existing liens is quite easy and straightforward and is undertaken by companies specialising in performing title searches for a fee and they provide limited guarantees on the accuracy of their reports A computerised land record system is not available to the public at large Some counties have made records or portions of their records available online, but these systems are limited and do not interface with other counties Title insurance also ensures that the rights of the buyer are protected in case of a defect in title during a sale	The Ministry of Land and Resources has a system where land records may be accessed online Since all land in China is owned by the government, title insurance is not required	The Government of India has introduced the National Land Records Modernisation Programme (NLRMP). The NLRMP oversees the computerisation, updating and maintenance of land records and the validation of titles. This programme is expected to provide a comprehensive database for development planning, regulatory procedures and disaster management activities by providing location-specific information and also providing citizen services based on land record data Indian has no mechanism of title insurance and the opaque functioning of the land records offices is a deterrent in ensuring a clear title check. With land acquisition a concurrent list subject, land records and title insurance need an active central government role to ensure clear titles

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Parameters	US	China	India
Presence of a regulatory body for the real estate industry	Since, real estate in the US is regulated at various levels, there is no single regulator, but rather a number of bodies that regulate the different usage and ownership aspects The Dodd–Frank financial regulatory reform has been signed recently, with 2,300 pages of guidance. The rules are still to be written	In order to regulate the market, the Central Government has introduced a more stringent and specific real estate regulation in the first half of 2010. "New State 10", by the State Department of Real Estate is a new regulation which enforces an accountability system for the local government to stabilise local real estate prices. This is aimed at promoting the construction of affordable housing to promote social development and enforce stability and accountability On this basis, local governments have introduced their own control rules in Beijing, Shanghai, Guangzhou and Shenzhen Beginning in April 2010, a series of measures have been introduced to curb the fast rising real estate prices in the country	Real estate and urban development are state subjects. There are a number of agencies involved in granting approvals for real estate projects in India. The Ministry of Housing, Government of India, through its notification No. 0-17034/18/2009 dated 23 September 2009, has issued a draft Model Real Estate (Regulation of Development) Act. The objective of the Act is to establish a regulatory authority to regulate the development of colonies, residential buildings, apartments and other similar properties. Considering that land, housing, the registration of chartered engineers and matters related to building bylaws fall under the jurisdiction of states, the ministry of urban development is presently framing a legislation only for Delhi. The Act is a model act, proposed to be individually adopted by different states of India (with modifications where required).

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Parameters	US	China	India
Licencing and regulatory authority for developers/ brokers/ salespersons	Laws and real estate licence requirements for real estate developers, salespersons and brokers in each state of the US are different Every state has a specific requirement for level of education, real estate educational courses and examination type States' recognition of each other's licences is known as reciprocity. However, the extent of licence reciprocity differs from state to state There is a facility to search and verify licenced players online on the websites of real estate licence boards	The Ministry of Construction implements stringent control developers through a system of grading and dividing developers into classes The grading criteria are set out in Article 5 of the Measures for Administration of Qualifications of Real Property Development Enterprises Basic criteria for each class of developers include the minimum amount of registered capital, number of professional technical officers and past experience Each property development enterprise has to possess a qualification certificate	There is no regulation National Association of Realtors has been recently set up in India. It lists amongst its aims to provide access to skills, education and best practices, act as a common voice for the brokerage community and to ensure its members adhere to a Code of Ethics. This has been done on the lines of similar associations in the US
Standard way of measuring area that you sell (carpet area/built-up area/super built-up area)	There is no single standard applied to all properties across locations However, the methods used by the Building Owners and Managers Association (BOMA) International are being embraced as the standard method, with office property type	A standard definition is not applicable across China In Hong Kong, a standard definition of "saleable area" came into force on 10 October 2008 and is now a requirement under the Land Department's Consent Scheme	There is no standard method prevalent in India Due to non-standardisation of the calculation of the built-up area, the same unit can currently be sold with different area calculations in different parts of the country, thereby also

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Parameters	US	China	India
	being, the most standardised. Other property types are moving along with their respective industry boards to evolve and move closer to a set of standards applicable for their type The extent to which standards are used also varies by specific location		possessing a different floor space index (FSI) value in different parts of the country
Presence of regulation to safeguard the interest of the end user	The US Department of Housing and Urban Development (HUD) has rules under the Real Estate Settlement Procedures Act to protect consumer interests pertaining to residential properties Issues related to end users are not a matter of federal regulation. These are dealt with in a legal contract. If a purchaser enters a contract with the developer, and the developer does not deliver on the terms agreed upon in the contract, the developer can be taken to court for breach of contract In the US, there are state real estate licencing laws and a code of ethics in place	The sales agreement contract specifies the area of the property being sold. In case of the sale of residential property, a minor differential (generally in the range of 2-3 percent) in the area is permissible. In case this is not followed, the buyer can legally get a refund from the developer The mortgage contract is a legal document and provides legal protection to the bank (lender) and the buyer (borrower) The sales agreement specifies the terms and conditions for sale and determines the legal rights of both the buyer and the seller Apart from conditions in the sales agreement, there are no other provisions to safeguard end-user interest	The conditions for the sale of a property are spelled out in the sale purchase agreement In case of a violation, the buyer can resort to legal action, which can be a rather lengthy and time-consuming process

Endnotes

1 Economic Survey 2010-11, Chapter 10, pg 251.

2 World Urbanisation Prospects: The 2009 Revision, United Nations, Department of Economic and Social Affairs.

3 Economic Survey 2010-11, Chapter 11, pg 283.

4 Census of India, 1991

5 As per revised estimates by Ministry of Housing and Urban Poverty Alleviation (MoHUPA), Government of India.

6 Report of the Technical Group, MoHUPA (11th Five Year Plan: 2007-12) on estimation of urban housing shortage.

7 A brief description of the above legislative inventory of the real estate sector in India can be found in the *Real Estate Sector Study* of the Committee on National Competition Policy, Ministry of Corporate Affairs, October, 2011.

8 Realty Decoded, FICCI-Ernst & Young – Indian Real Estate Report 2010

9 Economic Survey 2010-11, Chapter 11, pp 281-82.

10 For example, on the one hand, developers and private corporations are lobbying national and state governments to ease restrictions on transfer, sale, use and development of land. On the other, farmers, landowners and other marginalised groups that depend on land have begun forming alliances to protest against multiple urban planning and development agenda.

11 Sarkar, R. (2009). 'Overview of the report', in Mohanty, N., Sarkar, R. & Pandey, A. (Eds.) India Infrastructure Report, IDBI & 3iNetwork, New Delhi, India.

12 Morris, S. & Pandey, A. (2007). 'Towards reform of land acquisition framework in India', Economic and Political Weekly, Vol 42.

13 Morris, S. & Pandey, A. (2007), *op. cit.*

14 Dupont, V. (2007). Conflicting stakes and governance in the peripheries of large Indian metropolises – An introduction, *Cities*, Vol. 24, pp 89-94.

15 It has, however, been argued that in view of the high land prices and the huge real estate taxation burden (estimated at a consolidated 36 percent), the 'affordable housing for all' scheme has become a breeding ground for corruption and loot, as builders and government officials connive to tweak the requirements to construct high-priced studio apartments for the affluent.

16 Sriniwasan, S. (2011). 'Reforms, better town planning, quicker approval needed in real estate sector for betterment of economy', The Economic Times, 26 December, op-ed.

17 Both the US and China do not have a standard carpet/super area definition. However, certain standards have been implemented in China to have a standardised 'saleable area' definition. India definitely needs some kind of standard in providing area measurements which will protect the rights of buyers and customers and

provide exact information on how a developer is advertising 'efficiency' of usable area in his project.

18 Very recently, the Competition Commission of India or CCI has delivered a landmark judgment against DLF, which brought out the supernormal clout of builders/ promoters exert in the present system, in which the 'locked in' consumers suffer from 'after market abuse' because of 'information asymmetry' [Para 1 & 6 - Supplementary Order - DLF Park Place Residents v. DLF Limited, Case No. 18 of 2010, Competition Commission of India]. This strengthens the case for regulatory intervention to counter such abuse, and which calls for an alternative forum other than the existing ones for speedier grievance redressal.

19 Gai, Jehangir B. (2011). Real estate bill is against consumer interest, The Economic Times, 26 December, op-ed.

20 It needs to be clarified that the new draft Real estate Bill is a Central law, and not a Model RE Act, as was proposed earlier.

21 Para 12.74 – Main Order - Belaire Owner's Association v. DLF Limited and HUDA - Case No. 19 of 2010, Competition Commission of India

22 Realty Decoded by E&Y and FICCI, Sept 2010

23 Realty Decoded – E&Y and FICCI, Sept 2010 and country level data from State Department websites

CHAPTER 8

Regulating Retail Distribution in India: Remove Impediments to Competition and Growth*

Introduction

Retailing is one of the fastest growing economic activity clusters in India, registering consistent 20 percent plus growth rates for nearly a decade that is dovetailing the rising per capita income and dual-income consumerist tendencies of a growing middle class in the country. The sector's economic significance in India is enormous. The retail sector directly contributes around 11 percent to Indian GDP; it is also the second-largest employer (after agriculture) having had a share of roughly 7.2 percent of total employment in 2007-08[1, 2] and over 15 million traditional retailers.[3]

The sector is dominated by the unorganised sector, the latter accounting for over 95 percent of the total sales revenue. Consequently, retailing and its associated (back-end distribution) activities are also an important source of self-employment in the country. On the other hand, organised retail (comprising of incorporated businesses),[4] which has accounted for a stable nearly five percent of the market share in the past decade or so, is expected to grow at a CAGR of over 40+ percent in years to come.

It has been forecast that total retail sales in India will grow from an estimated US$395.96bn in 2011 to US$785.12bn by 2015,[5] with an anticipated US$30bn in fresh investments in the next five years and, though the absolute market size of the traditional segment will remain larger, organised retail sales (growing at rates four-fold faster than the traditional retail segment) will reach US$450bn by 2015, accounting for an estimated 14-18 percent of the total retail sales.[6]

Another interesting feature of modern organised retailing in India has been its wider spread and rapid outreach. No other country has seen the organised sector move to the non-metro and small town-semi rural localities at such

* This chapter is based on research by Suparna Karmakar, New Delhi; NCAER Studies on Facilitating Efficient Agricultural Markets in India; and the chapter on Agricultural Market Reforms in ICRR 2, 2009.

an early stage of its development.[7] Not surprisingly, therefore, India has emerged as the fifth-largest retail destination globally and the third most attractive emerging market destinations for retailing investment[8] and India's trade partners are aggressively negotiating for market access in the sector in both the bilateral/regional and the WTO trade negotiations.

Organised retailing in India has a few large sellers, the latter accounting for around three percent of the total retail distribution businesses contribution to GDP,[9] and their market penetration so far has not gone beyond the urban buyers in any significant manner; the organised sector businesses are also highly concentrated, with the top 10 retailers in the country accounting for nearly 2/3rds of the organised retail market. It has also been observed that much of the sales growth in organised retail chains in India is a result of new store openings.

However, in addition to the increasing overall demand, it is the convenience of shopping in the organised stores, viz., temperature-controlled atmosphere, easy and convenient display/layouts of products in store, longer shop opening hours and increasing preference for one-stop shopping from the new-age middle income both-busy-professional couple/family units that has been leading the change in consumer expectations/preferences from in-store retailing formats.

Both the developments, i.e., the increasing importance of one-stop shopping consumer behaviour as well as the ongoing concentration process in the retail industry, will, over time, make the suppliers more and more dependent on fewer and larger retailers, thus consolidating the trends in and prospects of the organised retail segment. This is even more so because the buying decision of one-stop shoppers has been found to depend more on overall expenses rather than on individual product prices.[10]

Retail distribution (terminology used here to encompass the back-end distribution and logistics aspects in addition to the front-end retailing services) is an industry with a generally competitive structure that typically has a large number of firms and relatively high entry and exit rates globally.[11]

This is particularly true in India because of the high share of unorganised sector stakeholders in the sector; unorganised retailing has low entry barriers, which is why they are widespread in India and provides an easy source of livelihood. Furthermore, the industry is highly dynamic and market structures differ widely across segments. The retail literature does not have 'hard and fast' rules on the definition of 'modern retail', but the literature suggests a broad definition that includes:

(1) use of 'self-service',
(2) use of IT (including use of electronic billing systems and ICT in inventory management);

(3) a certain scale of operation: this can either be of the store itself (such as a hypermarket or supermarket) or the size of the chain (which could be of small outlets such as convenience stores or neighbourhood stores), or both (such as a chain of large stores);
(4) the assortment of products can be narrow (such as a focus on dairy) or wide;
(5) the procurement system can be traditional or modern;
(6) the retail environment can be fancy and air-conditioned, or 'bare-bones' and austere;
(7) the outlet or chain can be a mix of retail and wholesale (such as most cash & carry stores); and
(8) the owner can be any entity – foreign or domestic, state, cooperative, or private.[12]

As a result, retail services are understood to encompass a wide variety of forms (shops, electronic commerce, open markets, etc.), formats (from small shops to hypermarkets), product ranges, business structures (independent stores, franchises, integrated groups, etc.), locations and sales channels. Retail has many connections with other markets both upstream (e.g., suppliers, logistics providers etc.) and downstream (e.g. consumers). Any development in the retail sector thus automatically has knock-on effects in other economic sectors and on their respective actors and vice versa. Therefore, any policy/regulatory response seeking to resolve an identified problem should take into consideration the horizontal nature of retailing services by giving due consideration to potential impacts along the supply chain.

This chapter analyses the impact of select sectoral regulations on retail distribution in India, with special focus on if/how new regulations/regulatory bodies can boost growth prospects and competitiveness-led efficiency-gains for key stakeholders. It may be recalled that, in 2009, a Parliamentary Committee headed by Murli Manohar Joshi had also called for creation of a regulatory authority, but one that would focus on unfair practices of big retailers. Subsequently, the Centre has floated a proposal that the problems faced by unorganised retail traders may be redressed by a national model law for organised retail trade. It is in this context that the chapter tries to evaluate the need, viability and contours of a national level legislation for organised retail trade and a regulatory authority for the retail distribution sector.

Also, since the complexity of the sector should not be reduced to a simple dichotomous analysis, the recommendations in the chapter emanate from our review and analysis of the role of regulation on segment growth and competition across store formats in a few selected product groups, namely, food and grocery (which accounts for over 60 percent of the retail sales in

India and 99 percent of which is in the unorganised sector), personal care (FMCG and apparel), consumer durables and electronics; together these account for nearly 85 percent of the total retail market in the country today.[13]

However, given that reform requirements and their impacts are most critical in the food and grocery segment (and its upstream sectors/activities), the discussions in this chapter focus more on the concerns of this sector. Given the vastness of the scope of analysis in a subject such as this, this paper will thus limit its discussion on some of the key regulations that does affect this sector and look at the anticompetitive elements therein which restrict growth and efficiency.

Further, the discussion will assume that both from the perspective of the regulatory impediments affecting the sector and threats and opportunities to the different stakeholders, the big domestic organised sector and the foreign retailers are the same, as opposed to the organised SME and traditional sector players.

The chapter gives an overview and the rationale of regulation in retail distribution and the evolution of retail regulation over time and in different countries. To derive some future guidelines, we also look at the international experience on retail regulation to evaluate the impact of select regulatory interventions and try to identify the relevance/applicability of global regulatory best practices in India. It also analyses in detail some of the current policy and regulatory regimes (including the proposed regulations) under which the retail sector sub-segments (and in particular the food and grocery sector) operates in India, with a view to understanding the limitations that have constrained their development. The paper concludes, with some insights and recommendations for policymakers to facilitate handling of emerging concerns.

Table 8.1: Laws and Regulations Governing Retail Sector

S. No.	Laws and Regulations Governing Retail Sector	Overview	Impact
1.	Shops and Establishments Acts	These legislations are in state's domain, there is no unified legislation on this area, as per distribution of power mandate of the Constitution of India. It regulates conditions of work and employment in shops,	These state laws have different provisions on opening and closing hours and on the working hours for women. All of them require the shops and offices to be closed for at least one day a week on a mandatory

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S. No.	Laws and Regulations Governing Retail Sector	Overview	Impact
		commercial establishments, residential hotels, restaurants, eating houses, theatres, other places of public entertainment, and other establishments. Owners of these establishments are required to file returns to designated authority under the Act and registration of establishment needs to be renewed	basis. Constraints on opening and closing hours limit the operations of retail outlets and inconvenience the clientele. Compulsory closure of stores and offices for a day in the week is also not warranted because, if worker's welfare is the aim, it can be accomplished by requiring that employees should be given weekly off day on any fixed day by rotation
2.	The Legal Metrology Act, 2009	The Legal Metrology Act, 2009, replaced the Standards of Weights and Measures Act, 1976. The Legal Metrology Act and the Rules made thereunder have come into force with effect from 1st April 2011. But, in the states, the Act and the Rules as well as the State Enforcement Rules will come into force from the date of their notification in the official gazette of the State. This is an improvement over the Standards of Weights and Measures Act, 1976	The practice at present is that the inspecting authorities hold the retailers also liable for any violations in compliance with the standards of Weights and Measures Act. Since retailers purchase products from large numbers of suppliers, it is not practical for them to verify whether the manufacturers have complied with the provisions of the Act. The Act needs to be amended to make only the manufacturers and packers responsible for non-compliance and not the retailers
3.	The APMC Act, 1954, and State Agricultural Produce Marketing (Development and Regulation) Act, 2003 (Model Act)	Market committees are constituted under the State APMC acts. These market Committees are empowered to regulate market of agricultural produces. A number of states in India have attempted to amend their laws and bring them in line with model Act. If streamlined, this will facilitate not only contract farming but	The APMC system has abetted monopolistic behaviour and reduced the choices available to small farmers. Unwittingly, the well-intentioned APMC law has contributed to helping cartelisation and collusion amongst incumbent traders. The need, therefore, is to re-visit the APMC Act. Worse

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S. No.	Laws and Regulations Governing Retail Sector	Overview	Impact
		also movement of agricultural produces and may result in promotion of retail sector. A little tweaking in the APMC Act would allow the retailers directly procure vegetables and fruits from the farmers, invest in them to help drive yields, quality of yield, storage and processing capacities.	is the impact of the APMC Act in disallowing private processors and retailers to integrate their enterprises directly with farmers or other sellers, eliminating middlemen in the process. As per the APMC Act, farmers cannot enter into contracts with buyers. This leaves no incentives for farmers to upgrade and inhibits private and foreign investments in the food processing sector
4.	The Drugs and Cosmetics Act, 1940 and The Drugs and Cosmetics (Amendment) Act, 2008	This Act regulates the import, manufacture, distribution and sale of drugs in India. The Act has a number of schedules which carry names and conditions with respect to medicines. The Act gives separate treatment to Ayurvedic and other indigenous medicines. With respect to retail sector, the overall regulatory framework of the Act is not very supportive to retails, as they may prefer buying bulk drugs and make it available at competitive costs	
5.	The Contract Labour (Regulations and Abolition) Act, 1970	The Act provides a framework for regulation of contract labour. It would be a point for consideration that it puts curb on hire and fire system, which might be required for a growing retail sector coupled with some measures of social security. In the present format, the Act provides a strict system of registration of firms, establishment using	

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S. No.	Laws and Regulations Governing Retail Sector	Overview	Impact
		contract labour and after expiry of the validity of the registration certificate, the establishment ceases to employ in the establishment contract labour in respect of which the certificate was given. The rules made under the Act mandate a number of measures to be fulfilled by the Contractor with respect to contract labour	
6.	The Income Tax Act, 1961	Income Tax Act may be used as a catalyst for the retail sector. In order to enable mergers and amalgamations in loss-making retail companies, so that the amalgamated entity is able to carry forward the predecessor losses, section 72A of the Income Tax Act, 1961, may be considered to be extended to retail companies, as currently the retail companies do not come under the definition of industrial undertaking, which is one of the mandatory conditions for carrying forward of losses under section 72A for any M&A	
7.	The Customs Act, 1962	The Act may provide relaxation to a number of items from duty, which are core for development of the retail sector, for example, exemption for capital imports of supply chain equipment, etc.	
8.	The Essential Commodities Act, 1955 and The Essential Commodities (Amendment and Validation) Act, 2009	The Essential Commodities Act, 1955, and a number of control orders issued under it were designed to put up against blackmarketeers in an economy struggling with production enhancement and meeting the needs of people. In today's	

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S. No.	Laws and Regulations Governing Retail Sector	Overview	Impact
		circumstances, when India is getting gelled with global economy, it may be suggested that stock limits under the Essential Commodities Act may be reviewed	
9.	Warehousing (Development and Regulation) Act, 2007	The Act must be amended to provide for special provision for development of retail sector. Such as special tariff loans for warehousing and back-end processing	

State of Play and Rationale for Retail Sector Regulations in India

Regulation is, by definition, rules enforced by a government agency to control economic activity. Economic regulation consists of rules governing price, output and industry structure. It is used generally in cases where the free working of market forces leads to sub-optimal outcomes due to the presence of natural monopolies, information asymmetries between consumers and producers or the imposition of costs by producers on others without any penalties. The resultant institutional environment, in general, and regulatory governance (defined as the framework for regulation), in particular, is increasingly viewed as important factors to promote competitiveness, by improving rule-making by establishing or reforming regulatory appraisal of regulations and keeping regulatory regime up to date.[14]

The rationale for regulation in retail sector primarily emanates from the need for addressing the effect of corporate retail on: (a) Efficiency concerns (impact on competition and collusion), (b) Distribution concerns (impact on traditional retailers/small shopkeepers and employment), and (c) Managing urban planning and optimal density of retailers (entry regulations).

It is often said that free competition (a key determinant being freedom of entry and exit), where feasible, is superior to regulation. Extensive involvement of government in economic activities (and more so in state controlled economies/sectors) often leads to entrenched business laws, regulations and pronouncements that foreclose entry and/or restrict competition.

Thus, the rationale for economic regulation is clearly to prevent the incumbents from distorting the playing field for the entrants in sectors where competition is in prospect, but not yet present, regulation is adopted on a transitional basis until competition is effective. It is in this context that we evaluate the retail sector regulations in India, where we find that, despite operating as a largely unregulated sector with free competition (entry and exit), retail sub-sectors where the government has intervened to facilitate marketing reforms, notably agriculture, it has failed to deliver a level playing field, largely because of policy-induced protection of vested interests, conflict of interest between the regulator and other stakeholders, as well as regulatory capture. Also, selective liberalisation distorts markets and allows opportunities for arbitrage.

The retail distribution sector in India so far is *not* governed by any exclusive and comprehensive Central legislative framework and is yet to be conferred industry status. However, the sector is governed and regulated by a multitude of statutes and regulatory policies/licencing requirements, supervised and enforced by an equally large number of departments, ministries and organisations at Central, state and municipal levels.

Key applicable regulations are: the Shops and Establishments Act, the Standards of Weights and Measures Act, the Essential Commodities Act, the Drugs and Cosmetics (Amendment) Act, provisions of the Contract Labour (Regulations and Abolition) Act, various applicable Labour Laws, the Warehousing (Development and Regulation) Act, the APMC Model Act and its state-level adaptations, the Food Safety and Standards Act and even many of the logistics sector regulations that affect retail distribution, such as the Multimodal Transportation of Goods Act and the Carriage by Road Act; many are rightly of the view that the sector is overregulated.

In addition, a multitude of licences and clearances need to be obtained (and renewed at regular intervals) before operations can commence;[15] Annex 8.1 provides a non-exhaustive list of applicable statutes and the licences/regulatory clearances required by a representative firm to operate in the sector. Unsurprisingly, the traditional units often manage to bribe/slip through the cracks of the monitoring and enforcement/compliance requirements.

Given the recent favourable experience of regulatory reforms in the media (film) sector, lately there has been a growing demand from business houses for creation of a national retail legislation and an independent regulator for the retail sector. *Prima facie*, an open sector which retail distribution is in India should not require economic regulations (in the sense discussed at the beginning of this section). But, if it does, what kind of regulatory/policy regime is most appropriate? But, a more important concern is, can and will this sector benefit from centralised regulatory governance, especially an independent national regulator, given that a large number of regulations affecting the sector are on areas under state jurisdiction? This chapter addresses these issues.

Past studies by CUTS of the legal, policy and institutional frameworks in India reveal a somewhat haphazard and uneven approach to the evolution of regulation within different sectors, resulting in inadequate, inappropriate and expensive reforms. This study hopes to ensure that a similar fate is not inflicted on this very important economic sector that provides for the livelihood of many, since the political economy of retail sector regulation in India is more complex than in other sectors, as has been amply proved by the ongoing brouhaha on the proposed liberalisation of the FDI regime in multi-brand retail (Annexure 9.2 gives details of the Retail FDI policy proposal and its status as on January 15, 2012).

A quick detour to survey the history and evolution of retail regulation globally reveals some interesting features, which are important insofar as they help us understand the natural evolution path of the sector and identify the regulations that India should incorporate to minimise the negative effects of the inevitable advent of organised retailing.[16]

First, the 'supermarket revolution' has occurred in developing countries only in the past 2 decades. The record of this revolution, particularly in Asia, shows that the sector's opening up and rapid growth observed in the early 2000s in China, Indonesia, Malaysia and Thailand has continued and the 'newcomers' – India and Vietnam – have grown even faster.[17] Although FDI has been important, the roles of domestic conglomerates and even state investment have been significant and unique.

Second, Asia's supermarket revolution has exhibited unique pathways of retail diffusion and procurement system change. There has been 'precocious' penetration in rural towns by rural supermarkets and rural business hubs, emergence of penetration of fresh produce retail that took much longer to initiate in other countries/regions, provision of credit (through use of credit cards), use of loyalty cards and banking facilities to mimic the traditional retailer niche, and emergence of developing-Asian retail multinational chains. In procurement, a symbiosis between modern retail and the emerging and consolidating modern food processing and logistics sectors has already arisen, a mere five years into the entry of organised retail.[18]

Third, several approaches are being tried to link small farmers to supermarkets, which can be replicated for the small manufacturers/suppliers. Some are unique to Asia, for example assembling into a 'hub' or 'platform' or 'park' the various companies and services that link farmers to modern markets. Other approaches relatively new to Asia, but found elsewhere, especially in Latin America, include 'bringing modern markets to farmers' by establishing collection centres and multipronged collection-cum-service provision arrangements and forming market cooperatives and farmer companies to help small farmers access supermarkets.

Further, productivity and employment in retail services around the world are found to vary widely and largely due to the prevailing regulations. A recent MGI research shows that regulation that allows expansion of modern retail formats raise productivity and the impact of policy changes on performance is usually visible within 2-3 years. After opening the sector to foreign investors, Russian retail productivity has more than doubled in the past ten years from 15 percent of the US level to 31 percent, simply on the back of gaining share of modern retailers.

In Sweden, liberalisation of opening hours and zoning regulations unleashed competition and productivity increased at an average of 4.6 percent for ten years after the laws were changed. Flexible hiring laws, lower minimum wages and part-time employment arrangements tend to boost retail employment and service levels, as has been observed in the US and the UK.[19]

Coming back to the regulations in the retail sector, regulation literature indicates two main types of non-FDI retail regulations: (a) entry barriers through real estate use and zoning, especially restrictions on large outlets; and (b) operational barriers on opening hours, price-setting abilities, procurement requirements, etc. Variations of these regulations have been proposed in a recent policy in India, but are yet to be implemented. It may be noticed that India is the 5th largest retail market in the world. The market size in 2010 was estimated at US$353bn (Source: IBEF) and is expected to reach US$543bn by 2014.

On parameters of the Competition Act, 2002, entry barriers in this sector may be analysed. As far as real estate use is concerned, it falls mostly within the domain of state governments, which is a crucial feature having retrograde impact on retail development. Different states may adopt different parameters with respect to real estate use and zoning. This calls for a uniform approach on this subject across India. If this is considered as entry barrier, then, more importantly, predatory pricing can be a concern in markets with high barriers to entry, which the Indian retail market is not as of now.

Given that unorganised retailing has low entry barriers, pricing below cost may succeed temporarily in driving out unorganised retailers from a market, but once prices return to normal levels, the same or other nimble-footed unorganised retailers can reappear. Thus, it is not impossible to point that, given entry barriers in organised retail, the aspect of competition may remain abysmal in this sector, resulting into rent-seeking anticompetitive behaviour. Thus, entry barriers may be considered for remedy more at the Central government level for providing equal platform to all the players.

As far as operational barriers are concerned, it comes through local laws such as the Shops and Establishment Act and General Administrations executive powers. Retails are treated no different than a shop. As it may seem restrictions under the local laws are mostly for the purpose of security and to avoid labour exploitation, but in reality these general provisions applied to big retails does not serve the purpose, rather it is regressive on retail sector overall. It necessitates some kind of a guideline from the Central to state governments.

However, international experience on these has been a mixed bag. Entry regulations against big retailers are a very popular measure and have been introduced in many countries to protect smaller independent stores. However, in the longer term, as studies in several countries in Europe, Latin America and the US show, these have not been successful in preventing the reorganisation of the sector and restructuring of the traditional entities and their business practices, and have in fact had a sizable negative impact on employment growth, especially in the traditional/small retail stores.[20]

Using a new dataset from the UK, Sadun (2008)[21] also shows that in fact the entry regulations have been associated with greater employment declines in the independent stores they were meant to protect. The reason is that when large retail chains are prevented from entering a new area with a big store, they typically enter instead using a smaller in-town store format, as seen in the western European and Japanese cities. These smaller format stores then compete more directly with independent stores.

Sadun estimated that 15 percent of the employment decline experienced by independent retailers between 1998 and 2004 in the UK can be attributed to the perverse effect of such planning regulation. Furthermore, entry regulations also hinder the reallocation of resources and employment between and within firms, which appear to be a major driver of productivity growth in the retail sector. Stringent regulations depress incentives to use ICT and undertake process innovation, and increases labour costs in large stores, leading to higher social costs for consumers; winners are usually the incumbents, enjoying higher profits and having no incentive to improve productivity/economic efficiency.

It is, thus, possible that policy safeguards in the form of entry regulations (proposed in the new FDI policy on retail that the Indian cabinet passed in November 2011, and with widespread acceptance) will on the one hand be perceived as being protectionist while being not really effective in stopping the inevitable reorgnisation/restructuring of the sector in the medium term nor prevent crowding out and unemployment of some stakeholders in the supply chain. Hence, while adopting stringent entry barriers through zoning regulations or caps, policymakers need to evaluate the inadvertent harm that such policies may cause to the intended beneficiaries in the longer term.

Evaluation of the Extant Retail Distribution Regulatory Regime and Contour of Reform

The popular debate on new regulatory interventions/reforms in the retail sector in India has focused mainly on the impact that unfettered introduction of corporate/organised modern retail would have on the traditional retailers/small shopkeepers and employment/livelihood therefrom, that is the distribution concerns discussed earlier. In fact, opponents of the new liberalised FDI policy have raised their reservations[22] on a few issues, namely: (1) small retailers/kirana stores will be crowded out; (2) crowding out of the 'middlemen' will take away an important source of self-employment in the country; (3) the domestic manufacturing sector and even the small farmer will be adversely affected; (4) consumers will be harmed due to potential anticompetitive practices of large supermarket chains.

Furthermore, most academic discussions focus on regulatory reforms necessary for levelling the sectoral playing field, or the efficiency concerns, undermining the important associated consumer welfare issues, the third rationale for retail regulation. The optimal density and urban planning concerns (incl. safety, noise pollution, and traffic congestion), need for/analysis of regulations that promote public health, hygiene and safety standards are also largely missing from these discussions. The growth of large format retailing raises serious issues for the urban environment and town planning in dense and rapidly urbanising countries like India. The need for intelligent regulation, therefore, cannot be overemphasised.[23] These however call for reforms in a diverse set of real estate regulations implemented usually in a haphazard manner by the states, being in the State List.

From a competition regulation perspective, the fear of larger firms resorting to anticompetitive pricing practices (viz. efficiency concerns and abuse of dominance in form of price gouging from consumers) after gaining market dominance through the strategy of price undercutting (predatory pricing) seems to loom large in the popular discussions, calling for regulatory intervention. Predatory pricing can be a concern in markets with high barriers to entry, so that a firm can raise the lowered prices and earn excess profits once its competitors have exited the market.

But as discussed earlier, the retail distribution sector in India does not only have a very large number of players in a free market system, it is also overwhelmingly dominated by the unorganised sector. Unorganised retailing has low entry barriers, which is why they are widespread in India and are able to provide an easy source of livelihood (and thus heightening the political costs of reform).

In such a situation, however, pricing below cost may succeed temporarily in driving out unorganised retailers from a market, but once prices return to normal levels, the same or other unorganised retailers can reappear. Thus, it is difficult, if not impossible, to point to sustainable benefits that can be obtained by an organised retailer using predatory pricing. A related argument is that organised retailers might collude to carve up parts of a larger market into sub-markets, in which they can operate as virtual monopolies. This, too, is improbable in the absence of high entry barriers. If there are monopoly profits to be made, there will surely be an incentive for other, unorganised and organised, retailers to enter the market.[24]

The upshot of the above is that though the sector is not unregulated, since most of the (domestic) players find it rather easy to enter and exit the market, fears of predatory pricing and potential abuse of dominance is overblown. Despite the fact that more than 30 licences and regulatory clearances are needed on an average to operate a multi-product retail store in India (which even if justifiable and necessary, is bothersome and time consuming), the sector is open to free entry and competition, both from domestic as well as foreign companies, though in some segments there are investment-related and other regulatory limitations to foreign participation, imposed largely for protection of the traditional mom-n-pop stores.

Hence, issues that economic regulations primarily try to redress, namely concerns of predatory pricing and abuse of dominance should not be of any real concern in India. This was also a near universal reaction from business groups to our poser during the stakeholder consultation aimed at gauging evidence of competition concerns in the sector, especially on predatory pricing.

In addition, to understand the key regulatory impediments that affect the sector, we conducted a semi-structured questionnaire-based survey of key stakeholders/experts in the sector, selected from the industry, academics/ consultants and policy practitioners, and conducted through in-person interviews/meetings and telephonic consultations. The interviewees were asked to rank, among other things, the regulatory impediments to competition and growth in the sector (including whether entry/operating regulations a barrier to growth/ efficiency/ productivity, esp. in organised retail); effect of intermediaries in the supply chain on business models and profitability and productivity; implementation problems; evidence/ concerns of cartelisation and/or dominance in the sector; and on how to improve state of play in the Indian retail regulatory regime.

The outcome of these consultations was the following understanding of the major impediments/growth challenges for the sector:

- Poor physical infrastructure (roads, storage and processing) which adds to the distribution challenge, and urban planning and land acquisition laws that has inflated the real estate costs are the primary impediments growth.
- Miscellaneous inter-state border barriers deny scale-efficiency of organised retail, and consumers suffer having to pay higher prices.
- Skill and manpower availability is a key constraint for organised retail.
- Uniform rules across states governing working hours and employment contracts are needed to promote labour welfare and support organised retail.
- Taxation issues – implementation of GST[25] and elimination of state border levies (and a single point collection of these taxes, say through a prepaid card and use of ICT) to facilitate efficient sourcing will go a long way to promote growth, profitability and efficiency in the sector.
- Food and grocery is and will continue as the driver of Indian retail growth story, so agriculture supply chain (logistics and warehousing-cold storage infrastructure) reforms, including removal of state controls on storage and distribution, are critical.
- Simultaneously, APMC Act reform/implementation is necessary in order to make it small agri-producer/farmer friendly – not all states that have adopted it enforce this Act in the right spirit, and some have only partially amended/introduced amendment bills.[26]
- Feet dragging on policy and implementation - quick decision making is needed, esp. in the interest of protecting consumer welfare.
- Managing competition from new retail/store formats like e-retail,[27] direct selling, organised specialty retail, members-only sites for branded products/food items, etc. is becoming more critical to survival of both traditional and in-store format organised retail.
- Adoption of the environmental and other health/hygiene standards add to cost of operations, so there has to be some mitigating (state) support for the SME and traditional retail segments.

From our discussions and survey, it was clear that the regulations affecting the distribution channel are among the most important operational regulations that the Indian retail sector is concerned about, though store opening hours and labour regulations are also areas of concern. The former include the logistics and warehousing related regulations, streamlining of which is important, as also is their proper implementation and enforcement. The large geographical area of India and its relatively weak physical infrastructure are the most important constraints on distribution of all products, though affecting the food and grocery segment more than the FMCG and consumer goods/electronics products, given the higher frequency of transactions/ movement necessary for maintaining an efficiently functioning just-in-time supply chain. The problem in large part emanates from the constitutional provision in the Seventh Schedule which puts production, supply and distribution of goods as Entry 27 in the State List. It gets worse in Sixth Schedule, since no person, 'who is not a member of the Scheduled Tribes resident in the district shall carry on wholesale or retail business in any commodity except under a licence issued in that behalf by the District Council'.

Combined with the multiple tax jurisdictions and various inter-state border barriers erected for fiscal and rent seeking purposes, this has resulted in fragmentation of the market, both from the procurement and retailing perspectives. While the administration of maximum retail price (MRP)[28] has helped to create a nation-wide uniform point of sale price regime, the market fragmentation reduces/eliminates any procurement efficiency that a large retailer may offer.

This latter has in fact resulted in levelling the sourcing field, in particular in the fresh and semi-processed segment, food insofar as all retailers (large and small, including the hand-cart retailers) all necessarily have to make procurements from the local wholesale markets (established FMCG/ manufacturing distribution supply chains and APMC *mandis* in case of the food segment*)*.

Agricultural markets in India, characterised by fragmentation and the presence of long chains of intermediaries linking the farmer to the ultimate consumer, are examples for market failure calling for regulatory intervention.[29] Fragmentation provides a bargaining advantage to buyers/ traders of produce who extract surpluses from sellers/producers because of their advantageous positions. The actual producer, the farmer thus gets only a small proportion of the expenditure incurred by the consumer.

Given the significance of a farm constituency that demanded support in the form of output and input subsidies, the government tried to build up its support among farmers by ensuring fair and remunerative prices through the Agricultural Produce Marketing Committee (APMC) Act, 1954. The basic objective of these acts was to provide fair competition through mandatory auctions of produce in regulated markets; often the entire state would be designated under the ambit of the regulated market area. This was meant to generate fair and remunerative prices and to ensure full accrual of payments to the grower without their being whittled down by leakages to intermediaries.

However, implementation left a lot to be desired. Traders had to buy licences in order to trade, a fact which limited their number and therefore competition for the produce. Producers were also required to sell their produce only to licenced traders in the regulated market area. As noted in a report by the Inter-Ministerial Group (2011), the State APMC acts has had the unintended consequence of allowing buyers to set up cartels. The APMC Act was amended and a model law – State Agricultural Produce Marketing (Development and Regulation) Act, 2003 – was made.

With respect to the food and grocery retailing in particular, our discussions with the large corporate retailers (purely domestic and the JV units) and the cash-and-carry wholesalers reveal that even with the investments made in the backend infrastructure and tying up direct sourcing, around 60-70 percent of the total procurements are still from the *mandis* and the consolidators (importers/trading houses). The APMC licence raj ensures that these *mandis* are usually managed/controlled by a few traders who often collude and form cartels; not only trading licences are given according to the norms set by the market governing councils, but also these entrenched interests do not allow private *mandis* (the Model APMC Act provided for the setting up of private markets, direct purchases by consumers from farmers and contract farming) to operate that would allow for free competition in the market.

In a rare example, Delhi has 6 *mandis* and seemingly enough competition, but the muddled nature of the operating laws and their irregular and opaque implementation make them into *de facto* oligopolies. The outcome: on the one hand, farmers are denied the right to sell their produce outside *mandis* and directly to consumers, retailers or food processors, while on the other, the retailer pays the inflated prices when procuring from the intermediaries.

A key reform requirement is therefore proper implementation of the APMC Act, as there are problems in the content and implementation of the acts in different states which create market distortions. Also as noted earlier, despite the existence of the model APMC Act since 2003, only 19 states and UTs allow competition in the market. The APMC laws where they exist have not always been helpful instruments of market regulation, and many of the altered statutes do not conform to the spirit of the model APMC Act.

Also, implementation of the law often changes with the change in officers-in-charge. Enhancing competition in agricultural markets also calls for removal of the restriction on mandatory selling and buying in regulated markets. Instead regulated and unregulated markets should be allowed to co-exist. Such co-existence would increase competition for the farmer's produce. These regulatory changes should further be accompanied by competition-enhancing infrastructure creation, including transparent and timely information to farmers about alternative options to sell.

Apart from the APMC Act, other outmoded laws and rules, including the retrograde Essential Commodities Act, allow various kinds of controls on storage and movement restrictions, stock limits and bans or caps on the export and import of agro-products. Many of these interventions lead to market distortions if not failure, and have a direct impact on the final product price at the retail outlets. The beneficiary is the intermediary, as in the present distribution system about 75 percent of the final product price is due to the margins of the multiple intermediaries that the local *mandis* support, and the fees and miscellaneous costs incurred for trading in the market.

The importance of appropriate regulations for creating the right set of market incentives for farmers cannot be overemphasised. Regulatory reforms should stimulate competition by dismantling barriers to entry to agricultural markets as well as enable a reduction in the length of the chain of intermediaries separating the final consumer from the farmer. The latter should also be given the option of postponement of sales after harvest through provision of adequate and appropriate kind of warehouse facilities.

Recent regulatory reforms in storage and agro-processing have taken place under the Warehousing (Development and Regulation) Act, 2007 (which also allows for trade in Certified Warehouse Receipts or CWRs) and the Food Safety and Standards Act, 2006, modified in 2011. The integrated food law finally came into place in 2008 with the health ministry forming the long-pending Food Safety & Standards Authority of India (FSSA). The concern of stakeholders consulted on these laws however is *vis-à-vis* the implementation glitches that are feared and enforcement irregularities (respondents said it was too early to make any judgement on the performance), rather than the intent/quality of the law.

In fact most of the regulatory failures/barriers in the sector today are seen to emanate from the enforcement problems and rampant corruption, though most interviewees and survey respondents agreed that these regulations are necessary, and are in the interest of the consumers as well as businesses.

This takes us to the second set of concerns that were highlighted by most of our interviewees/respondents and which pertain to the continued 'inspector raj' in the country that also adversely impacts the retail distribution sector. Since the formal retail sector has to comply with multiple regulations and often must obtain as many as 30 different approvals and permits to be able to do business, they are seriously affected by the corruption and rent-seeking that prevails in the system in the name of inspection and compliance monitoring.

Examples abound of fraudulent cases being prosecuted until a pay-off is received by the enforcement officers, with most organised sector players having had harrowing experiences. This affects the competitiveness of the organised SME retailers the most, both in terms of extra expenses and time lost to renew/complete the licensing processes.

Labour and skill issues are the third important bone of contention for the sector. While the organised retail segment complains of lack of skilled retail shop-floor manpower in the country (most retail school graduates are taught management aspects and not the operational issues of retail businesses, nor are the latter jobs considered respectable enough), the labour that is available pose other kinds of problems. The following problems have been identified as affecting working conditions, labour productivity, employment levels and competiveness in the retail sector:

- differences in working conditions caused by differences in labour laws in different states and collective agreements applicable to retail services (each state has its own shops and establishments law, which defines the rights and obligations of employees and employers);
- the negative impact of the informal economy on working conditions;
- the irregularities in rules governing working hours and the opening hours, and lack of laws supportive of retail requirements (24x7x365);
- a lack of consumer information on the social responsibility of retail service companies; and
- a mismatch between the skills needs of companies and those of staff in the retail sector.

Finally, we return to the issue of unintended consequences of entry regulations. In the new retail FDI policy, the government has proposed allowing 51 percent FDI in multi-brand retailing, which, however, has come with several proposals for restrictive sourcing and investment requirements and entry regulations. Two such requirements are: 30 percent procurement from local SME suppliers and about 50 percent of the investment to be made in the backend infrastructure.

Ostensibly, this move is aimed at protecting the small traders and manufacturers and the liberalisation framework has packaged in conditions to ensure that organised storage and transport chains will be built. However, it is debatable if the proposed sourcing regulations will be able to keep the playing field levelled for the small suppliers and farmers and save them from being abused by the large buyers.

Furthermore, it has been argued that, in the absence of a single market within India (as discussed earlier, even the introduction of GST will not remove all the inter-state border barriers that fragment markets and prevents efficient sourcing by retailers), the controls on storage and distribution under the Essential Commodities Act and non-conformity with the 2003 Model Act that seeks to amend the archaic state APMC laws,[30] markets will remain oligopolistic, leading to higher prices than is economically justifiable. The sourcing conditions of at least 30 percent procurement (including in food items) from SMEs may in fact help push up the prices further that will then be passed on to the consumers. Thus, the proposed procurement requirements will not be able to serve the cause of consumers nor effectively protect the small retailer/supplier from dominant behaviour of the larger peers.

Similarly contentious is the proposed cap on number of outlets in big cities, which will restrict the number of outlets and put limits to access in cities with designated population sizes (zoning regulations), done ostensibly to protect the traditional retailers in places with low population density. While the exact impact of this policy in the Indian market is yet to be established, as we discussed in the earlier section, international experience of this rather popular entry regulation has been disappointing.

Econometric research on employment effects of such planning regulations show that these regulations have not prevented competition from larger players, who then enter the market through other store formats, and compete more directly with the traditional retailers. On the other hand, most successful South-east Asian governments (and also China) helped their traditional retailers to compete by helping them to upgrade their facilities/business environment and offered financial support to revamp, retrain and restructure.

The main threat to traditional retailer in the country is likely to come from the alternative retailing formats, like direct selling, speciality stores and e-retailing, which are heretofore unregulated, and most probably would benefit from regulatory interventions. The online retail market, though small, is a more serious threat to some small retailers in certain markets than the large store operators.

Technology is bringing radical changes in how people shop, with smartphones emerging as the most dominant consumer technology platform, the physical store, however, is no longer the final shopping destination. The online world (e-retailing) has, in fact, opened up sales opportunities that stores can't match, with possibilities of easier customisation through IT-applications to match the customer preferences. The internet lends itself to specialty retailing because it allows companies to offer huge product portfolios without having to stock inventory in bricks-and-mortar shops. This requires that retailers innovate and rethink their operating models in ways many could never imagine even five years ago.

Today, shoppers can find low prices and infinite choices online, so once the initial novelty-factor wears off, few bother to drive to an out-of-town super/hyper-markets. Even in semi-urban and rural India, the new wave of online retailing or e-tailing indicates that traditional retailers are, in any case, facing competition from the direct selling companies/online retailers who have started to use the cash-on-delivery model for branded products in several FMCG, consumer durables and lifestyle categories. Even globally, in the post-crisis years, online sales have continued to outpace overall retail spending growth.

Also, the sector seems to still lack proper formulation and enforcement of key environmental and health/hygiene standards that are the hallmark of any evolved retail distribution system worldwide. For example, the open/wet markets for fresh produce in the country need serious regulatory interventions for their modernisation and for ensuring public health and hygiene. In most East Asian countries, the wet markets (consumers still prefer to buy from the open markets) have either been shifted by law into the closed supermarket premises and/or designated market areas have been modernised at government expense to upgrade facilities free of cost/made available at very subsidised rental rates.

For example, in Singapore, Hong Kong and China, the government first enacted a health and safety regulation that made it illegal for vendors to sell in open markets in the metros; their trading zones were restricted and minimum market infrastructure requirements were imposed for retailers. That essentially ensured that temporary open markets (for both food products and non-food items) couldn't be set up at will. However, mere drafting of laws and their enforcement is not sufficient. The governments also created the necessary infrastructure/encouraged or coerced the local municipalities/market associations to invest in upgrading the market infrastructure, which the individual vendors were allowed to use.

Conclusion and Recommendations

The discussion so far has highlighted that the progress and prospects of entry of organised retail into India is following the general global trends, only at a much rapid rate. Thus, it is fair to expect that much of the experience in the rest of the world, in particular *vis-à-vis* consolidation of the market in favour of formal retail market shares will be observed. The international experience is also heartening.

In densely populated countries (with consequent higher real estate prices) of Europe and Japan, small-store formats thrive and flourished even in the face of competition from big-box retail. However, introduction of foreign competition forced manufacturers to cut costs in their supply chains and small stores become more efficient. Because of entrenched consumer habits, preferences and allegiance, the likely adverse effect gets further mitigated. This has been seen in Indonesia and Brazil, where even after opening the retail sector to FDI, 50-70 percent of the trade in groceries, fruits and vegetables takes place through the traditional small stores.

In Germany, one of the large supermarket chains is actually a cooperative of small stores. By coming together under a large cooperative, the small retailers retained a large level of ownership and independence while gaining the cost, marketing and process-capability advantages of modern retail. Hence, it is possible for small stores owners to respond and acquire many of the key advantages of large stores while building on their own areas of strength.

What is clear is that, in India, and notwithstanding the political dogma and fears of the trading community, the prognosis of the traditional (and the innovative modern independent) retail sector's demonstrated ability to hold its own against corporate players in the organised sector has so far been good. Experience also shows that rather than decimating the traditional retail shops, competition from the organised sector in the past few years has in fact spurred the traditional retailers into upgrading to modern formats with convenient and better organised displays, ICT-enabled storage and procurement management and electronic billing counters etc on the one hand, and on the other to improve their services and customer-interfaces by making home deliveries and customising the offerings to specific consumer preferences.

Another unique experiment to address the high real estate expenses is seen in Kolkata. Realising that format innovation to leverage cost efficiency was the key to survive, Kolkata-based Baid Group has come up with the innovative idea of a dual functionality retail space to ensure maximum efficiency of retail spaces.[31]

The result has been that in the past decade or so of its entry in to the market, organised retail in India has not managed to increase its share from the less than five percent estimated in 2005. This is unlikely to change even with the advent of the foreign retailers, as Indian consumer tastes and shopping preferences continue to remain old school for the most part; hence, the foreign players will need to meet this need should they wish to succeed in this market.

A case in point is that the local online book stores like Flipkart are out-competing the global giant Amazon, simply by virtue to tweaking the online advance-payment-by-creditcards to the more acceptable cash-on-delivery mode. Similar customisation to meet Indian consumer's idiosyncrasies are being noticed in every retail product segment, and it is the local firms that are always first to adopt while the MNCs are trying to implement their global practices.

Forecasters are also unanimous in their assessment that even if the share of modern retail grows from the present less than five percent to the estimated 16 percent by 2016, the absolute market size of traditional retail will be larger than that of the organised retail. Analysis of available data on the impact of big players on small retailers in Brazil indicates that the India projection is not a one-off case. Even after opening up to foreign investment in 1994, traditional small retailers in Brazil managed to increase their market share by 27 percent.

With the introduction of FDI and efficiencies of organised retail, it is to be hoped that the pro-active traditional retailers in India will also adopt some of the best practices by consolidation and collectivisation of purchases and integrating with logistics operators for addressing the price and quality concerns of consumers.[32]

In the case of China, since liberalisation of retail sector in 1992, the number of small outlets equivalent to *kiranas* have increased from 1.9 million to over 2.5 million and employment has in both wholesale and retail sectors nearly doubled from 28 to 54 million in less than a decade. In Malaysia, some small retail establishments, which do complementary business other than those covered by supermarkets, were found to benefit from the presence of supermarkets in their vicinity.

Another notable fact is that the share of food and grocery in total retail sales have been declining in the past two decades, and the trend is expected to continue.[33] Organised retailers should benefit from this trend because many non-food products require investments at scales infeasible for most unorganised retailers. Durable goods, in particular, have high growth rates and low levels of household penetration, and represent a significant, long-term, opportunity for organised retailers. On the other hand, unorganised retailers should also be able to reorient and provide necessary maintenance and repair services,[34] and compete in second-hand markets for durable goods, which have long replacement cycles in India.

The former, however, faces competition from e-commerce sites that offer significant discounts on foreign labels – premium fashion and lifestyle brands and electronic goods with aspirational value – the penchant for which is growing among the younger Indians. The potential threat from e-tailing is thus not far-fetched. Experience from around the globe suggests that the small trader needs to worry more about the spread of e-commerce/home shopping, than the presence of foreign corporate retail.

When it comes to the regulatory impediments, however, the findings of this study indicate that while the sector suffers from over-regulation (or rather *over-inspection*) in some aspects, there remain some other key areas in urgent need of regulation that are yet missing/needs updating. Having set industry performance and health/quality standards that are benchmarked with the global best practices will be in the interest of the consumers and help drive in a proper manner organised retailing business practices. The view from the experts is also that consolidating the regulatory requirements and harmonising the laws in different states will help in easing doing business conditions in the retail distribution sector; this exercise, if undertaken, however will benefit all the economic sectors, and not only retail.

Also, the paper finds that given the present regulatory circumstances (esp. physical infrastructure and taxation regimes), current practice of using multiple intermediaries in different jurisdictions is an efficient model of distribution, as despite higher prices the retailers are able to reach out to most consumers in the country. However, should the organised retailers improve supply chain, government policy and regulation induced inter-state barriers are reduced and geographical integration, storage and credit infrastructures improve, the number of intermediaries will automatically reduce by the natural process of consolidation, thus improving the efficiency and profitability for the remaining members in the supply chain.

Simultaneously, the large organised retailers will aggressively cut costs, with improved sourcing methods that reach out to many more suppliers, which will also benefit the small and medium suppliers from interiors. Thus it is those intermediaries which are not adding any value but exist merely due to the regulatory structure/faulty implementation and the present manufacturers with established SCM mechanisms that are threatened by the prospects of future competition that any such regulatory consolidation and improved enforcement modalities will induce.

In fact, it can be argued that the viability of the traditional/small retail can be improved if licence/inspector raj is abolished (SMEs relative cost of handling the requirements is much higher than that of the large organised retailers); this move will in fact encourage many of them to become formal retailers and comply with the regulatory requirements.

The Case for an Independent Retail Regulator

Last, but not the least, is the question of the independent regulator for the retail sector in India. We mentioned earlier, that given the experiences of formalisation and better business prospects in the traditionally informal sectors such as films after a similar move, industry stakeholders are making strident demands that (1) the retail sector be granted industry status, and (2) an independent regulator is set up for the sector.

But, do we really need a retail regulator? Efficacy concerns of a central regulator in a sector with largely state jurisdiction are but natural, especially in a country like India where often the letter and spirit of the law remain vastly different, and interpretations of a requirement tend to vary widely. Our discussions with the consumers as well as the sector experts and industry stakeholders indicate that the demand for a central regulator in retail has primarily emanated due to the distribution concerns (market fragmentation and regressive APMC implementation) discussed earlier.

Most are of the view that it is better to consolidate, rationalise and harmonise existing regulations rather than create new regulations/regulators. They are also of the view that while the sector is largely open and there exist no major competition concern that needs new regulatory intervention, the existing market distortion/ competition concerns should ideally be dealt with by the CCI under Competition Act, and the extant distribution and other socio-economic concerns of the small mom-n-pop retailers are best handled through appropriate zoning policies, and social policies, viz. retraining and general support to help businesses' structural transformation.

That said, majority of the respondents also agreed that an independent regulatory commission will be helpful, insofar as it is able to reduce malpractices and bureaucratic red-tapism, and provides a single window for information, approvals, licences and the clearances required, and for trouble shooting and conformity, just like a business facilitation centre for industry. The onerous licencing requirements stemming mainly from red-tapism, and multiplicity/duplicity of approvals and implementation gap in regulations in addition to the infamous inspector raj is something that should be the first task of regulatory/administrative reforms.

Given the federal nature of the sector, and the multiplicity of the regulatory bodies/agencies involved in its governance, it is believed that proper implementation and enforcement of regulations will require the business facilitation and single window clearance systems set up under state regulatory bodies rather than a national level regulator, which in order to ensure buy-in of policies and regulatory reforms needs to be constituted in a manner that fairly represents the interests of all the stakeholders under the supervision of the state administration.

Annexure 8.1

Relevant Statutes

A non-exhaustive list of the relevant statutes applicable/governing this sector is as follows:

1. The Shops and Establishments Acts – these legislations are in state's domain, there is no unified legislation on this area, as per distribution of power mandate of the Constitution of India. It regulates conditions of work and employment in shops, commercial establishments, residential hotels, restaurants, eating houses, theatres, other places of public entertainment, and other establishments. Owners of these establishments are required to file returns to designated authority under the Act and registration of establishment needs to be renewed. As of now the processes given under the Act are flowing from the side of government department, if made more participatory, it would be better for owners of establishments. It may be suggested that a Uniform legislation allowing shops to operate 365 days and extended hours may be considered for providing a framework for retail sector.
2. The Standards of Weights and Measures Act, 1976 – The Legal Metrology Act, 2009 replaced the Standards of Weights and Measures Act, 1976. The Legal Metrology Act and the Rules made thereunder have come into force with effect from April 01, 2011. But, in the states the Act and the Rules as well as the State Enforcement Rules will come into force from the date of their notification in the official gazette of the state. This is an improvement over the Standards of Weights and Measures Act, 1976.
3. The APMC Act, 1954, and State Agricultural Produce Marketing (Development and Regulation) Act, 2003 (Model Act) – Market Committees are constituted under the State APMC acts. These market committees are empowered to regulate market of agricultural produces. A number of states in India have attempted to amend their laws and bring it in line with model Act. If streamlined this will facilitate not only contract farming but also movement of agricultural produces and may result in promotion of retail sector. A little tweaking in the APMC Act would allow the retailers directly procure vegetables and fruits from the farmers, invest in them to help drive yields, quality of yield, storage and processing capacities.
4. The Drugs and Cosmetics Act, 1940, and The Drugs and Cosmetics (Amendment) Act, 2008 – This Act regulates the import, manufacture, distribution, and sale of drugs in India. The Act has a number of schedules which carry names and conditions with respect to medicines. The Act gives separate treatment to Ayurvedic and other indigenous medicines. With respect to retail sector, the overall regulatory framework of the Act is not very supportive to retails, as they may prefer buying bulk drugs and make it available at competitive costs.

5. The Contract Labor (Regulations and Abolition) Act, 1970 – this Act provides a framework for regulation of contract labour. It would be point for consideration that it puts curb on hire and fire system, which might be required for a growing retail sector coupled with some measures of social security. In the present format, the Act provides a strict system of registration of firms, establishment using contract labour and after expiry of the validity of the registration certificate the establishment, the establishment ceases to employ in the establishment contract labour in respect of which the certificate was given. The rules made under the Act mandate a number of measures to be fulfilled by the Contractor with respect to contract labour such as; if the contractor fails to provide the canteen within the time laid down the same shall be provided by the principal employer within sixty days of the expiry of the timer allowed to the contractor.
6. Various applicable Labour Laws (details http://labour.nic.in/act/welcome.html)
7. The Income Tax Act, 1961 – Income Tax Act may be used a catalyst for the retail sector. In order to enable mergers and amalgamations in loss making retail companies, so that the amalgamated entity is able to carry forward the predecessor losses, section 72A of the Income Tax Act 1961, may be considered to be extended to retail companies, as currently the retail companies do not come under the definition of industrial undertaking, which is one of the mandatory conditions for carrying forward of losses under section 72A for any M&A.
8. The Customs Act, 1962 – the Act may provide relaxation to a number of items from duty, which are core for development of retail sector. For example, Exemption for capital imports of supply chain equipment etc.
9. The Companies Act, 1956 -
10. The Essential Commodities Act, 1955, and The Essential Commodities (Amendment and Validation) Act, 2009 – the Essential Commodities Act, 1955 and a number of control orders issued under it were designed to put up against blackmarketeers in an economy struggling with production enhancement and meeting needs of people. In today's circumstances when India is getting gelled with global economy it may be suggested that stock limits under Essential Commodities Act may be reviewed.
11. Warehousing (Development and Regulation) Act, 2007 – the Act must be amended to provide for special provision for development of retail sector. Such as Special tariff loans for warehousing and back-end processing.
12. The Food Safety and Standards Act, 2006
13. The Multimodal Transportation of Goods Act, 1993 (amended in 2005)
14. The Carriage by Road Act, 2007

Typical clearances required for retail stores[35]

A. General
1. Trade Licence
2. NOC for Fire Licence from Municipal Corporation
3. Health and Sanitary Licence
4. Registration under Weights and Measures Act
5. Forecourt Licence (for sale outside the shop area) (if required)
6. Signboard Licence (Within & Outside the Store)
7. Approval from the State Pollution Control Board (water disposal/solid waste disposal) (if required)

B. Operations Related
1. APMC Licences (F&V and Staple – Procurement and Sale)
2. Eating House/Food Licence (Food & Beverages)
3. FSSA clearances – under the integrated food law, which covers over 16 laws
4. PFA Licence required for the different categories of products stored/ sold in the distribution centres (DCs) under the Prevention of Food Adulteration Act (PFA)
5. Cold Storage Licence – under the Factories Act, but now also under the Warehousing (Development and Regulation) Act
6. Sweets Shop (Shop-in-Shop) Licence (if required)
7. Licences under the Drugs and Cosmetics Act, 1940 and the Drugs and Cosmetics Rules
8. Household Pesticides and Insecticides Licence (if required)
9. Registration of manufacturers, packers, and importers under Rule 35 of the Standards of Weights and Measures (WM) (Packaged Commodities) Rules
10. Essential Commodities Act – Storage Control Order
11. Manufacturer's Warranty to Consumer under the PFA Act

C. Infrastructure Related
1. Power Connection
2. DG Set Approval as required from the Local Electricity Board
3. Licence if the Facade of the Store faces a Road (if required)
4. Licence for Ground Water Storage and Usage

D. Labour Related
1. Shops and Establishment Act
2. Employees PF Act - Apply for PF Code
3. Employees State Insurance Corporation (ESIC) Act regarding Medical Benefit/Sickness Benefit and Employment Injury
4. The Contract Labour Act
5. The Payment of Gratuity Act
6. The Factories Act

E. ***Taxation Related***

1. Professional Tax (if applicable).
2. Octroi/Cess in lieu of Octroi (if applicable)
3. Entry Tax (if applicable)
4. Service Tax Registration
5. Permanent Account Number (Income Tax
6. Sales Tax Registration (State-wise) VAT & CST

Annexure 8.2

On November 24, 2011, vide a Cabinet decision, the Union government liberalised domestic FDI Policy in the retail trading sector, allowing majority foreign participation in the multi-brand sector (under government approval mode of entry) and opening the single-brand sector completely, subject to foreign firms conforming to stipulated conditions. The proposed **FDI Policy in retail trading sector** is as follows:

(1) FDI in Multi Brand Retail Trade (MBRT) in all products is permitted, in a calibrated manner, subject to the following conditions:

a. FDI in MBRT may be permitted upto 51 percent, with government approval.

b. Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, to be sold unbranded.

c. Minimum amount to be brought in, as FDI, by the foreign investor, is US$100mn.

d. At least 50 percent of total FDI brought in shall be invested in 'backend infrastructure', where back-end infrastructure includes capital expenditure on all activities, excluding that on front-end units; for instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehousing, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted as back-end infrastructure.

e. At least 30 percent of the procurement of manufactured/ processed products shall be sourced from 'small industries' which have a total investment in plant and machinery not exceeding US$1mn. This valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose.

f. Self-certification by the company, to ensure compliance of the condition as above, which could be cross-checked as and when required. Accordingly, the investors are required to maintain accounts, duly certified by statutory auditors.

g. Retail sales locations may be set up only in cities with a population of more than 10 lakh. As per 2011 Census only 53 cities qualify for FDI in multi-brand retail out of the nearly 8000 towns and cities, and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking.

h. The FDI in multi-brand retail is being opened in 53 cities only with population of 10 lakh and for the rest of the country, current policy regime will apply. In the current regime, upto 100 percent FDI is allowed in wholesale cash and carry, from which franchise/small retailers are able to source quality products for sale to the public at large.

i. Government will have the first right to procurement of agricultural products.

(2) FDI, upto 100 percent, in the Single Brand Retail Trade (SBRT) sector, is permitted with government approval, subject to the following conditions:

a. Products to be sold should be of a 'Single Brand' only.
b. Products should be sold under the same brand internationally, i.e. products should be sold under the same brand in one or more countries other than India.
c. 'Single Brand' product-retailing would cover only products which are branded during manufacturing.
d. The foreign investor should be the owner of the brand.
e. In respect of proposals involving FDI beyond 51 percent, 30 percent sourcing would mandatorily have to be done from SMEs/ village and cottage industries artisans and craftsmen. 'Small industries' would be defined as industries which have a total investment in plant and machinery not exceeding US$ 1 million. This valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose. The compliance of this condition will be ensured through self-certification by the company, which could be subsequently checked, by statutory auditors, from the duly certified accounts, which the investors will be required to maintain.

It is to be noted that for the above Cabinet Decision to take effect, the Government of India (GoI) has to notify it, which is yet to be done given the fierce opposition from several political opponents in an election year, especially *vis-à-vis* the multi-brand retail liberalisation. However, in recent statements, senior government functionaries have indicated that once the Assembly elections scheduled to be held in five states — Uttar Pradesh, Punjab, Uttarakhand, Goa and Manipur — between January 30 and March 3 are over, the present proposal on MRBT will be 'tweaked' to make it acceptable to all sections and implemented.

Separately, the Commerce Ministry has by a formal government order recently notified the opening of the domestic single-brand retail market to 100 percent FDI (51 percent FDI in SRBT was allowed since 2006). The notification has clarified that any foreign retailer setting up shop in the single-brand category **must** source at least 30 percent from Indian small and medium enterprises (SMEs).

Endnotes

1 Department of Industrial Policy and Promotion, 2010: According to the National Survey Sample Organisation (64th Round), retail businesses employed 33.1 million people, largely in the unorganised retailing segment. Employment in organised retailing is still very low, employing only about 500,000 people and almost all in urban areas, though KSA Technopak has estimated that modern retail/retail services sector has the potential of creating over 2 million new (direct) jobs within the next 6 years in the country (assuming only 8-10 percent share of organised retailing). In years to come, it has been projected, organised retail services can create as many new jobs in India as the BPO/ITeS services.

2 In fact, retail employment grew at a slower rate than overall employment in India in 2005-06. More recently, however, the two have grown at about the same rate because retail employment rates have risen and overall employment rates have fallen. This acceleration of retail employment has been predominantly in the rural areas. Between 1999-2000 and 2004-05, employment in retailing had grown by more than 30 percent in rural areas but by less than 3 percent in urban areas. Source: Kohli, R. and Bhagwati, J. (2011). 'Organised Retailing in India: Issues and Outlook', Columbia Programme on Indian Economic Policies, Working Paper No. 2011-1.

3 Data sourced from Investment Commission of India, 2009. Of these around 97 percent are very small mom and pop operators.

4 Defined as a network of similarly branded stores with an element of self-service. However, partnerships, private and limited companies, and businesses run by cooperative societies and trusts are not considered to be organised businesses in India. Instead, they are classified as part of the unorganised sector, which also includes all businesses in the informal sector.

5 Business Monitor International (BMI) India Retail Report for the second-quarter of 2011.

6 McKinsey & Company, 2008. *The Great Indian Bazaar: Organised Retail Comes of Age in India*, August.

7 Reardon, T. and Gulati A. (2008). 'The Rise of Supermarkets and their Development Implications: International Experience Relevant for India', IFPRI Discussion Paper 00752, New Delhi, India. Given the market size in India, even small pockets of consumers in the non-metro and small town-semi rural localities constitute as significant markets in certain formats of organised retailing, which has contributed to its unusual diffusion pattern in India when compared with the experience in rest of the world.

8 A.T. Kearney's 9th annual Global Retail Development Index (GRDI), 2010. The annual A.T. Kearney Global Retail Development Index ranks 30 emerging countries (selected from a list of 185) on a 100- point scale—the higher the ranking, the more urgency there is to enter a country.

9 Data sourced from India Brand Equity Foundation, Confederation of Indian Industries.

10 This follows the global trends in the sector; a survey conducted for the UK Competition Commission in 2000 found that "[t]he main factor and most likely

influential determinant of store choice is the ability to one-stop shop", which sometimes leads the popular super-/hyper-market stores to charge higher prices than competitors. The influence of shopping costs on multiproduct retailers' pricing decisions was analysed first in: Klemperer, P. (1992). 'Equilibrium Product Lines: Competing Head-to-Head May be Less Competitive', *American Economic Review*, 82: 740-755; and Beggs, A.W. (1994). 'Mergers and Malls', *Journal of Industrial Economics*, 42: 419-428.

11 According to firm-level data collected in the context of the OECD growth project in 2001, entry rates (*i.e.,* the share of new firms in the total number) and exit rates (percentage of firms that went out of business) in the distribution sector (including both retail and wholesale trade) ranged from 7 to over 13 percent in European countries and were around 10 percent in the United States over the 1988-1995 period. Source: OECD (2002). *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance.*

12 Reardon, T. and Minten B. (2011). 'Surprised by Supermarkets: Diffusion of Modern Food Retail in India', Journal of Agribusiness in Developing and Emerging Economies,1(2).

13 Technopak Retail Outlook (2007). *Top Trends in Indian Retail Sector*, October, projections.

14 Parker, D. (2002). 'Economic Regulation: a Review of Issues', *Annals of Public and Cooperative Economics*, 73(4): 493-519; and OECD (2002). *Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance.*

15 Multi-product retailing operations require adherence to almost all of the above laws and regulations, the number varying according to the nature of business. On an average, more than 30 licences and regulatory clearances needed to operate a store, depending on products being sold. For example, even a fresh food retailer in Karnataka needs 7-8 trade licences, from multiple agencies.

16 The following discussion is based on: Reardon and Gulati, 2008, *op. cit.*, and Reardon, T., Timmer, C. P. and Minten, B. (2010). 'Supermarket Revolution in Asia and Emerging Development Strategies to include small farmers', PNAS Early Edition, October 12.

17 In western countries like the US, on the other hand, modernisation of retail has taken much longer, about 130 years. Supermarkets in the sense we understand now started in the US in the 1920s and 1930s and became dominant in the late 1950s. The advent of modern retail (viz. chain stores) however had started in the late 1870s, long before the supermarket format emerged as large self-service stores in the 1930s. In every recent 'wave' of supermarket spread in developing countries, however, this evolution time span is becoming shorter and shorter.

18 Several trends characterised the development of chain stores over the past century in the US, with similar trends seen in the UK and France, are outlined here: (1) The trend was from non-food chains to dry-food chains to full-line chains offering fresh foods. Supermarkets did not sell much fresh produce until the 1960s because it was considered impossible to move beyond the American tradition of buying in wet-markets and tiny fruit shops. (2) The trend was from clerk service to self-service. (3) The format trend was from the traditional system described earlier to chain non-food shops, to chain grocery shops, to small supermarkets and food sections in department stores, to medium and large supermarkets in towns, to hypermarkets in the suburbs, to convenience stores and neighborhood stores in dense inner-city areas and small towns. (4) The trend was from large cities and

economic boom areas to second- and third-tier cities and second-tier areas and to suburban areas when those developed in the 1950s. Wal-Mart's development in the opposite direction was a clear exception. (5) Individual chains and the overall supermarket sector underwent massive growth over seven decades, and that growth cycle eclipsed an earlier cycle of growth in self-service chain grocery stores. (6) Chain stores mimicking and then improving on the credit system that the small traditional shops had used for customers by developing credit cards, loyalty cards, and banking services. They also took on other services, such as health clinics and banks for poor consumers. (7) Chain stores modernised their procurement systems. Woolworths and A&P had historically focused on cutting costs through bulk buying, self-service, and efficiencies in inventory handling. As competition increased, the importance of modern logistics and cost cutting intensified, and from the 1990s on, those strategies took center stage.

19 McKinsey Global Institute (2010). *How to Compete and Grow: A Sector Guide to Policy*, March.

20 Boylaud, O. and Nicoletti, G. (2001). 'Regulatory Reform in Retail Distribution', OECD Economic Studies No. 32, 2001/I. Also: Kirkpatrick, C. (2006), 'Regulatory Impact Assessment', in M. Crew and D. Parker (ed.), International Handbook on Economic Regulation, Cheltenham, UK and Northampton, MA, USA: Edward Elgar.

21 Sadun, R. (2008). 'Does Planning Regulation Protect Independent Retailers?', CEP-LSE Discussion Paper No 888, August.

22 However, one of the main reasons for the present standoff in this policy appears to be that of political opportunism and playing to the gallery of vested interests in an election cycle. A detailed discussion on these fears and concerns is available in the CUTS issue paper on 'FDI in Multi-brand Retailing – Adequate Safeguards is Key to Success', PARFORE, 1/2012.

23 Kalhan, A. and Franz, M. (2009), 'Regulation of Retail: Comparative Experience', *Economic & Political Weekly*, XLIV(32), August.

24 Kohli, R. and Bhagwati, J. (2011), *op. cit.*

25 On January 9, 2012, the Empowered Committee of State Finance Ministers gave an 'in-principle' nod to the Union government's proposal to re-orient taxation of services from a formally listed set of services to a comprehensive coverage limited by a negative list. This negative list would need to evolve with decisions on GST. But this move constitutes one important step in the attempts to introduce GST in the country, though important issues need resolution for the introduction of a comprehensive GST with reasonable costs of compliance and administration.

26 According to the agriculture ministry data, out of 35 states and Union Territories (UTs) as on December 23, 2011, only 19 states/ UTs have made such amendments in their APMC Act for direct marketing, contract farming and markets in private and cooperative sectors. Key grain producing states, such as Haryana, Punjab and Madhya Pradesh, have initiated only partial reforms. Also 7 states and UTs do not have any APMC Act to govern agricultural trade.

27 While online sales make up a small portion of overall retail spending in India (one estimate pegs it at a mere US$10bn), at 32 percent annually they are growing fast. In select product segments (usually non-food), JuxtConsult, a New Delhi-based research firm, estimates that 17 million people bought something online in

2011, up from 10 million last year. The cash-on-delivery model adopted by the Indian online retailers has aided this rapid growth in sales and outreach.

28 The MRP requirement on all the retail products aids the consumer and prevents overcharging/malpractice by the retailer. While some retailers do sell below the MRP, this cannot be seen as a violation of the law and neither does it count at predatory pricing as the (dealer) margin shared is usually less than 5 percent and the products are never sold at less than cost price.

29 For a detailed exposition, see ACIAR-NCAER project ADP/2002/089 entitled 'Agricultural Trade Liberalisation and Domestic Market Reforms in Indian Agriculture', Final Report, August 2009.

30 Recently, a committee headed by Harshvardhan Patil and comprising 11 state agriculture marketing ministers has recommended states to carry out reforms for creating a barrier-free national market. The committee also sought a cap on the market or development fee imposed by APMC markets on grain, fruit and vegetables, to curb the rise in food prices. Although a large number of states have carried out reforms in their respective APMC Acts, these laws lack teeth in creating alternative wholesale markets in the private sector.

31 The dual utility concept gave birth to Amoda, which serves as a spa during the day and converts itself into a bar at night. As this spa bar took off successfully, the company went on to experiment with Zevar – the 'Z' lounge and Amarna – 'the gold bar'; Amarna is an exclusive gold jewellery shop that serves as a lounge bar in the evening.

32 Earlier research by OECD (1997) and by Reardon *et al* (1996) suggests that large firms, or firms which have co-operative arrangements tend to innovate more than small independent firms. But with India's head-start in the cooperatisation experiment since 1980s, it is possible that even the smaller independent firms might quickly group together and try to benefit from collective/large scale sourcing to compete against the large corporate retailers.

33 Technopak Retail Outlook (2007), *op. cit*. Driven by the growth of organised retail coupled with changing consumer habits, food retail sector in India is set to be more than double to US$150bn by 2025, according to a report by KPMG. However, as a proportion of total consumer spending, its share is expected to progressively decline to around 50 percent by 2016.

34 A similar trend has begun even in the apparel segment. With changing preferences for shopping in organised stores, the business of the neighbourhood tailors is increasingly trending on custom-resizing of readymade clothing.

35 Source: Retailers Association of India.

CHAPTER 9

Public Road (Passenger) Transport Regulation in India*

Introduction

While the railways historically played a dominant role in the overall transport system in India, road transport has now come to occupy a pivotal role.[1] According to Government of India estimates,[2] in 2004-05, road transport had a share of 4.5 percent in India's GDP as compared to the railways share of 1 percent. Most recent estimates give the road modal share at nearly 63 percent in freight movement compared to 10 percent in the early 50s.[3] In case of passenger movement, the road mode is estimated to cater to about 85 percent of the demand with the private sector involved in a significant manner.

Over the past five decades, the growth of vehicular traffic on Indian roads has been far greater than the growth of the road network, as a result of which the main arterial roads have been working at more than capacity. Between 1951 and 2007, the vehicular population grew at a compound annual growth rate (CAGR) close to 11 percent compared to 4 percent in the case of the entire road network and just about 2.1 percent in the case of the National Highway segment (the latter however has improved to 4 percent in the past decade). The composition of the vehicular population in the year 2008 reveals a preponderance of two-wheelers with a share of nearly 72 percent, followed by cars with a share of 14 percent.

Notably, the share of buses was at 1 percent compared to more than 11 percent in 1951. According to PRTC[4] (as quoted by NCAER), in recent years, the bus mode dominates the public road transport scene in India with a share of nearly 55 percent. While this may be true at an all-India level, at the level of the cities (urban areas), bus transport varies from 5 percent for the smaller urban conglomerations to nearly 44 percent in larger urban areas that do not have the services of railways.[5]

1 This chapter is based on a paper contributed by S. Sriraman, Walchand Hirachand Professor of Transport Economics, Department of Economics, University of Mumbai.

Passenger movement by road is expected to rapidly expand in the years to come in view of a number of factors, including among others rapid motorisation (especially car ownership) resulting from rising income levels, demand for quality services, and provision of upgraded road networks. The public passenger transport system consists of a wide variety of modes which includes mass transit/metros, contract carriages (buses, taxi-cabs, and auto-rickshaws), stage carriages (high capacity buses, mini-buses). Each of these has distinctive characteristic features.

From a social perspective, bus transport is considered to be the most optimal road mode since it involves less fuel consumption, congestion (use of road space) and pollution per unit of transport output, namely, passenger kilometer. Despite its importance, particularly in an increasingly carbon-footprint conscious world, it is however observed that the bus mode is beset with many problems arising out of faulty policy and regulatory regimes (such as inefficient fare and permit policies, ineffective implementation of safety measures, etc.) which have implications on usage, efficiency of operations, technological development etc.

It is felt that in order to meet the emerging requirements in the public road (passenger) transport services, or Bus transport, instituting an enabling policy environment and a complementary regulatory regime is necessary.

It is against this background that this chapter examines the elements of the existing policy and a corresponding regulatory framework that ought to be in place to enable the sector to play its rightful role in the Indian economy. It gives an overview of the existing Bus Transport regulatory structure in India, especially in regard to the market characteristics. We then examine the policy and regulatory environment under which it operated with a view to understanding the limitations that have constrained its development. The chapter outlines the international experience of regulation and deregulation in recent years, in order to derive some guidelines for the future. Drawing from this analysis, it concludes, with an outline of a regulatory policy framework that can better suit the sector to handle emerging requirements.

Bus Transport Laws and Regulatory Structure

Bus Transport: Its Evolution and Recent Market Characteristics

Bus transport services began in India nearly a hundred years ago. By the early 1920s, a large number of vehicles were already operating in several parts of the country. For nearly three decades from its inception, the service was almost exclusively provided by the private sector. Its growth was unprecedented, which led to unhealthy competition among the operators who were plying these vehicles for hire and reward and also proved to be a threat to the railways.

In the Mitchell-Kirkness Report,[6] it was thus recommended that the number of licences for buses on any route ought to be restricted and that conditions such as scheduling, publication of fares and compulsory insurance of motor vehicles should be prescribed. During pre-independence years, efforts were made to control and regulate the industry, both to avoid unhealthy competition and also to allegedly protect the railways revenues in which the Government had considerable financial stake. This control came in the form of the Motor Vehicles (MV) Act of 1939.

According to Padam,[7] every expert opinion at the time suggested controlled monopoly as an answer to the evils of the system. Attempts to bring the operators into groups of operators however proved futile due to conflicting objectives of the parties concerned.

Soon after independence, it was accepted that the means of production must be closely controlled, if not owned by the State. This was also reflected in the case of road transport, which was listed in the Schedule B of the Industrial Policy Resolution which called for progressive nationalisation. This arose in the form of legislation, namely, the Road Transport Corporations (RTC) Act of 1950. This legislation was meant to enable the state governments to form transport corporations within their jurisdictions. Accordingly, many states completely nationalised public bus operation while some others provided for a limited role for the private sector. The passage of this legislation seemed to indicate the government's desire for increasing state control, with the MV Act, 1939 continuing to be the ruling legislation.

However, the RTC Act provided for monopoly and government ownership wherein the government would not only be the regulator but also be an operator. Consequently, special provisions were added to the MV Act in 1950s for publication of nationalisation of bus route schemes and for approval of these schemes by the government. This was reinforced further in the context of the Five Year Plans when the Planning Commission emphasised the importance of bus transport in the fulfillment of Plan objectives.

The bus mode of public transport has been generally provided by the respective State Road Transport Corporations (SRTCs) with the private sector playing a limited role. The growth and performance of State Road Transport Undertakings (SRTUs) during the past five decades have been no mean achievement, although there was considerable variation in the performance of these Undertakings in different states; following liberalisation in the early 1990s, the share of the SRTUs in terms of vehicle numbers has however been declining. The share of the private sector in the total number of buses increased from 57 percent in 1980-81 to about 85 percent in 2007-08. Thus, a rapid decline of the share of SRTUs buses from about 45 percent in the mid-70s to around 15 percent in 2007 was observed. At present, there are 63 SRTUs having a total number of around a lakh of buses of varying fleet size.

In terms of passenger movement, since the 90s, the SRTUs have not been able to cater to the increasing demand, especially in urban areas, as reflected by the occupation ratio (number of Passenger kms per Seat kms) in the cities. Therefore, it became essential to re-allow private sector participation in areas where only public operators were allowed till the early 90s, and to enlarge private participation where it already existed to fill the gap between demand and supply.

But given the lack of effective implementation of the regulatory framework, across states many instances were noted of clandestine operations carried out by the private sector. This was more prevalent in mofussil (rural) operations, one motivation being the associated profitability of specified routes and the other being the indifference of the monopoly operator, namely, the SRTU, in meeting the genuine demands of the concerned areas, which has often resulted in the low load factors of many SRTUs thereby affecting their financial performance very adversely.[8]

Coming to the issue of market share, NCAER examined the market structure relating to bus transport in seven states in the country. Table 9.1 shows the market share of the private and public operators in these states, with the former often dominating the less developed states.

Table 9.1: Market share of Private buses: State Wise Trend over 2001-05 (percent)

Sr. No.	Name of State	2001	2002	2003	2004	2005
1	Himachal Pradesh	36	40	46.1	49.2	49.6
2	Tamil Nadu	25.4	21.3	21.3	21.1	20.9
3	Orissa	93.8	94.8	95.2	95.7	96.8
4	Rajasthan	85.3	82	81.2	81.9	82.4
5	Maharashtra	10.7	10.1	9.4	8.8	7
6	West Bengal	85	85	84.6	85	85
7	Kerala	85.4	85.4	86.5	82.6	82.6

Source: NCAER, 2007

The above dynamics of the market structure must be viewed against the background of the overall transport policy of the Central government as well as the enabling policies of the different states which has in fact contributed to the lack of uniformity in patterns and concerns across states. Following the liberalisation of the economy in the early 90s, the Planning Commission issued guidelines on the means by which additional demand for bus transport was to be met.

In 1993-94, the Planning Commission laid down that all additional demand for bus services has to be met by the private sector. Accordingly, privatisation schemes for provision of bus transport were initiated in many states, especially those in which all routes had been nationalised earlier. While this encouraged private participation, they were also at the root of the many distortions which created more problems than they solved in the years to come. A few cases can be examined.[9]

In 1993-94, permits were issued to co-operatives of unemployed youth in Haryana with a view to generate employment opportunities in the State. These operators could provide bus services only on intra-district routes, which were essentially 'link' roads. To ensure monopoly of the Haryana Roadways in the profitable inter-state routes, these link roads could include National and State Highways, only upto a maximum length of 15 kilometers, leading to fragmentation and anticompetitive practices.

A peculiar feature of the bus transport sector in Rajasthan was that the route network was demarcated across the public sector and the private sector. The share of Rajasthan State Road Transport Corporation (RSRTC) in the total route-kilometerage went down progressively over a period of time. The trends indicated that any new expansion in route kilometerage had been in favour of the private sector. The load factors for the Corporation went down steadily during the late 90s with reports indicating that the tremendous growth of 'clandestine' operations on nationalised routes was at the root of the decline.

In Himachal Pradesh, service provision has been distinctly categorised in terms of three regions: (i) upper region or high-hills (ii) middle-region or mid-Himalayan regions and (iii) lower region or foot-hills. About 60 percent of HRTC's services were being provided in the middle and the upper regions. The upper region roughly corresponds to the tribal belt of Himachal Pradesh which accounts for 42 percent of the area of the state but only three percent of the total population.

The HRTC has a total monopoly in this region. Most of the HRTC's routes were concentrated in the middle-region. Here, the HRTC faced competition from private operators mostly on remunerative routes. While, in the lower region, the HRTC faced competition from other inter-state operators such as the 'Delhi Transport Corporation', the 'State Transport Haryana', 'Punjab Roadways' as well as the 'RSRTC'. The load factor was lowest in the middle region due to progressive influx of private operators in this region. In comparison, the load factor was higher in the upper region because of the total monopoly of HRTC operations.

The World Bank in 2005 examined private bus operations in three states, namely, Karnataka, Maharashtra and Uttar Pradesh. In both rural and inter-city segments of the passenger transport market, stage carriage operations were found to be still predominant. Restrictions were reported with respect to grant of permits, both in nationalised and non-nationalised areas. To bridge the gap between demand and supply, clandestine operations seemed to be the rule with markets becoming ruthlessly competitive and most of the private buses having contract carriage permits violating the permit conditions and operating as 'stage carriages'.

They also had to compete with the multitude of smaller vehicles such as maxi cabs, jeeps, vans and LCVs and tourist cabs, all of which operated without any regard to the permits they hold and did not follow any regulations either in fares, on routing matters or in timings of operation with their operations being fully flexible and varying with traffic demand. In situations where SRTUs had not met market demand, the market was working around the failures of the government instruments – the SRTUs and the restrictive policies designed to protect them – to meet societal needs. The cases referred to above clearly reflected ineffective regulation while at the same time bringing into question the relevance and need for such restrictive regulation.

Contemporary Indian Regulatory Framework in regard to Bus Transport: The MV Act and State-Specific Regulations

The current MV Act, 1988 came into force on July 01, 1989 after very comprehensive amendments to-date and is applicable throughout the country. It defines the powers of Central and state governments with regard to the regulations for road transport industry. We discuss in brief below the significant provisions relevant to our purpose. While some of these are valid across all states, some of them provide for additional regulations.

(i) *Selection of Drivers:* It is mandatory for drivers of stage carriages to hold a valid driver's licence as per the Act of 1988. The prescribed age limit for acquiring such a licence is minimum 18 years, which is valid across the country and the required educational qualifications may vary across states.

(ii) *Selection of Conductors:* It is mandatory for the conductors of stage carriages to hold a valid conductor's licence as per the Act of 1988. The prescribed age limit for acquiring such a licence is minimum 18 years which applicable within the state boundary and the required educational qualifications may vary across states.

(iii) *Registration of Motor Vehicles:* A certificate of registration issued by the state government is a basic necessity for operating the vehicle across the country. The validity of the certificate is 15 years for vehicles not used for public purposes. In Rajasthan, the same holds good for transport vehicles (which includes stage carriages as well as contract carriages) as well. However, in the case of change of ownership or place of residence, a new certificate specifying the same is required from the concerned authority. To obtain a valid registration certificate it is essential across all the states for the vehicle to carry a fitness certificate. This certificate is valid throughout the country but it cannot exceed the age limit of the vehicle. The age limit of vehicles may vary from state to state.

(iv) *Control of Transport Vehicles:* For the use of a vehicle as a transport vehicle a valid permit issued by the State Transport Authority (STA) or Regional Transport Authority (RTA) is required. Accordingly, there are *no entry barriers for operations* in a State. The permit prescribes the place and manner in which the vehicle (as a stage or contract carriage) is to be used. These relate to route or routes required the type and seating capacity of vehicle, number of trips to be provided, etc. Any individual or company may apply for a permit.

(v) *Fixation of Fares:* Under this provision, the state can set maximum and minimum fares. In the case of stage carriages, the proposed fare to be charged is also to be submitted along with the application.

(vi) *Exit Barriers:* There are also *no exit barriers*. As per the Act, an operator may curtail operations at any time by informing the concerned authority. The state also has the right to cancel or suspend the permit on certain grounds such as breach of conditions, loss of ownership of vehicle, etc.

(vii) *Special Provisions Relating to State Transport Undertakings:* If the state government feels that for the purpose of providing an efficient, adequate economical and properly co-ordinated road transport services it may be necessary in the public interest to reserve certain routes or areas for operations, it may do so under the provision of this Act. On such routes only temporary permits with one-year validity can be issued to the private sector. Under these provisions, some of the states have imposed their own restrictions such as complete nationalisation (Maharashtra), some routes reserved for the public operator (as in West Bengal and Orissa, Kerala, Rajasthan), confinement to rural areas or link roads (Himachal Pradesh, Haryana) and permits for operators who ran buses prior to nationalisation (Tamil Nadu).

(viii) *Control of Traffic:* It is mandatory for all vehicles to follow the maximum and minimum speed fixed under this Act. The state government may, however, vary the same in the interest of public safety or convenience either in the entire state or in a particular area or road. No vehicle which is not fitted with pneumatic tyres is allowed to be driven in any public place.

(ix) *Provision of Bus-Shelters:* The state government or any concerned authority also determines places at which motor vehicles may stand either indefinitely or for a specified period of time and also the places at which public service vehicles may stop for a longer time than is necessary for boarding or dropping passengers. While in Tamilnadu, Kerala, Orissa, Himachal, West Bengal and Orissa, private operators are allowed to park in public terminals while in Maharashtra, they park their vehicles outside the bus terminals.

Analysis of the Current Regulatory Regime - Provisions, State of Implementation and Limitations

Regarding entry controls in terms of issues of permits, it is widely recognised that while some degree of control is necessary so as to avoid excessive competition, the basis which should normally have been a comprehensive planning exercise has always been missing. Moreover, the issue of getting permits is by itself such a long-winded exercise that involves considerable delays which in turn constitutes a set of barriers to entry into the sector. NCAER (2007) has documented this aspect with regard some of the major States in the country. The exercise that was undertaken related to factors such a time taken for issue of permits, nature of permits (temporary or permanent), registration fees charged, maximum number of vehicles allowed, issue of permit for a single routs or for a network of routes, resulting in a with a competition index (see Table 9.2).

Table 9.2: Competition Index for Passenger Transport in Seven States

Sr. No.	States	Competition Index
1	Rajasthan	0.838
2	Orissa	0.764
3	Kerala	0.721
4	Tamil Nadu	0.622
5	West Bengal	0.602
6	Himachal Pradesh	0.595
7	Maharashtra	0.569

Source: NCAER (2007)

As is clear from Table 9.2, Rajasthan is at the top of the ranking of the competitive index. On the other hand, Maharashtra is at the bottom of the ranking. Amongst the six indicators analysed Maharashtra is at the bottom for all indicators. Himachal Pradesh is just above Maharashtra, i.e. at the sixth position in the ranking.

Road transport regulations in India as discussed earlier, have allegedly arisen from the need and desire to protect the railways. The permits confined road transport activities initially to a certain defined local area which was then extended to a region, then to the province and then finally to nation as a whole when the need arose for greater capacity over longer distances and especially when the railways were unable to lift the required tonnage at the right time and at the right place. In fact, the road mode is most optimal over short or medium distances, with the railways scoring over road only in longer distances. Optimality is defined in terms of minimum resource cost to society including energy and environmental considerations.

RITES (2009) has shown that the misallocation of resources due to non-optimal modal mix amounted to nearly ₹40000 crores in 2006-07. This problem could perhaps be reduced to an extent by an appropriate combination of pricing and investment policies which takes into account the multi-modal nature of movements especially long-distance ones.

Section 67 of the MV Act 1988 empowers the state government to issue directives to the State Transport Authority regarding the fixing of fares and freights (including maximum and minimum) for stage carriages, contract carriages and goods carriages. It is, however, unclear to what extent the fare regulations are observed. The true situation is probably a mixed pattern, with the degree of adherence to statutory fares depending on how closely those fares happen to match the market prices at a specific time and place. But it is recognised that the regulation of fares has almost always been done in an inefficient manner which reflects two particular features.

One relates to excessive constraint of general fare levels which often affects the revenue required to fund expenditure on vehicular maintenance and replacement. Another issue relates to approvals for fare rise often taking a long time by which time the purpose of the exercise is lost. In a developing country like India, fare control would be required for a public service but the governance of such a provision needs to be improved significantly.

To a limited extent, there must be provisions for automatic fare increase based on market considerations such as fuel prices and consumer price index which indicates the general level of inflation for the common man. It must be remembered that all these features emerge out of the policy decision making framework some of which need to get formal approval from the regulatory authority.

The introduction of special provisions for SRTUs in the MV Act 1939 in 1950 (Chapter 6) has had, it appears, varying impacts. The nationalisation process that followed was reasonably successful especially in the first three decades but the inability of the public sector to successfully meet the additional demand was due to financial constraints on fleet expansion and political interference; the emergence of the private operator in a formal manner and more significantly in a clandestine way (mostly due to local political support) also affected its role. In both rural and inter-city segments of the bus passenger transport market, restrictions have been reported with respect to grant of permits, both in nationalised and non-nationalised areas.

And yet the SRTUs have neither expanded their fleet nor (generally) officially allowed private operators in the nationalised areas, although recently, in some cases, private buses have been recruited under SRTU management under the 'km-scheme'. It must also be noted by many of the SRTUs (under the guise of special provisions) have become insensitive to the needs of users' – their primary clients – as result of which any private sector provision despite all its weaknesses has been accepted as a reasonable alternative to the SRTU.

Policy Initiatives in Recent Decades and their Implications

Intercity Movement since the 90s

As suggested earlier, a reversal in the policy direction since the 90s encouraged greater reliance on private sector provision by liberalising market entry in all market segments, except for certain 'nationalised' stage routes where the SRTUs still retained some legal monopoly rights. The role of the SRTUs in inter-city transport has now considerably reduced through most of India, and several states (mostly in eastern India) now rely exclusively on private provision.

Only Andhra Pradesh reportedly has as yet no substantial private bus competition to the SRTU. Private bus operators have also established a new standard of service in long-distance inter-city services (particularly in states like Tamilnadu), while the market for shorter-distance transport is being transformed by the introduction of small to medium buses, which operate more efficiently on the rural routes.

In many states, a policy of hiring private buses by SRTUs to supplement their fleet strength and to operate under SRTU management on still-nationalised routes has also been introduced. In cases where the SRTUs have not met market demands, private operators have overlooked restrictive regulatory policies to operate clandestine services. Those operators having contract carriage permits violated permit conditions to operate as stage carriages. They competed with the multitude of smaller vehicles such as maxi cabs, jeeps, vans and LCVs and tourist cabs, all of which operated freely without any regard to the permits they held and did not adhere to any regulations concerning fares, routings or schedules, since their operations are fully flexible and can vary instantly with traffic demand.

From a user perspective it is fortunate that the market has managed to circumvent these restrictive regulatory policies resulting in a more flexible transport system, very responsive to the specific needs of the passengers. But this has been achieved at the expense of 'so-called' public regulation, and also to some extent at the cost of meeting minimum international service quality (safety and environment) standards.

Public-Private Partnerships (PPPs) in Urban Bus Transport in Recent Years

The promotion of such partnerships has been an underlying objective of policy statements related to the transport sector that the Central and state governments in India have been putting forward since the late nineties. In recent years, serious efforts have been made to operationalise the concept in the context of bus transport as part of the implementation of the National Urban Transport Policy,[10] which has incorporated it, in some cases, as part of the Central government funded Jawaharlal Nehru National Urban Mission (JNNURM) that has prescribed model guidelines to the state and local governments. The emphasis has been on the need to promote public transport systems with a more directed initiative to promote the bus mode in the different cities for which funds for bus procurement are being liberally given even within the framework of PPPs.

The JNNURM proposed to provide 50 percent of the funds required to buy the buses for city transport to 63 cities if they adhere to certain defined guidelines. Of the balance fund required, the state government would have to put in 20 percent of the amount and balance 30 percent would have to come from City municipal corporations or City transport corporations or a private party by way of a PPP. Some notable experiences of different PPP models are discussed.

The Indore Experience

Indore City Transport Services (ICTS) Limited was incorporated on December 01, 2005 with an objective to operate and manage the public transport system of Indore. IMC (Indore Municipal Corporation) and IDA (Indore Development Authority) took 50:50 stakes in a special purpose vehicle which has been run on a public-private partnership basis, while providing the policy and regulatory framework for private operators that provide services on different routes.

Initially, the company identified and took permission for 18 high travel demand routes from the Transport Authority of state government and started operation with 37 ultra-modern low floor buses with 2 broad doors which allowed passengers to board and alight quickly and easily, saving time and fuel, and giving better run-times and improved economy to the bus operators. Real time vehicle tracking and fully computerised ticket vending system were some innovations tried first time in the country. Operation and maintenance (O&M) and other regulatory measures were being exercised by the company.

The city bus route network system was scientifically planned and designed. Direction oriented 'hub and spoke model' of routing has been adopted and the model was designed keeping in mind the motto of 'Minimum Investment with Maximum Returns' for all parties involved in the business. A few years later, Indore has a fleet of modern, low-floor buses with computerised ticket vending. Electronic signboards at bus stops announce when the next bus is due based on satellite data. Investment in the system has risen to Rs 40 crore, all done privately. ICTS has made a profit since inception and so have its six private partners who run the buses. It has clearly displayed revenue generating ability and financial sustainability of the PPP structure.

The Vadodara (Baroda) Experience

Vadodara Municipal Corporation (VMSS) took up the initiative of organising a city bus service on the basis of a public private partnership. As the lead implementing agency, it defined the bus routes, bus stops and fare structure and also the quality of service in terms of frequency. It had to follow guidelines for city bus services as per urban development and urban housing development department, was responsible to get NOC (No Objection Certificate) from the Gujarat SRTC (GSRTC) for stoppage of current services, given that the RTA was responsible for sanction of stage carriage permits under the MV Act. The bus stops were made by VMSS on a build-operate-transfer (BOT) basis. In lieu of the rights given to the operators for collecting fare, VMSS got a premium on a yearly basis from the operators.

On the other hand the private partner procured, owned and maintained buses; took care of expenditure on rolling stock and O&M (including cost of driver and conductor, supervision, fuel). It also provided uniforms to drivers and conductors. Another private party built and operated 124 pickup stands to give support to the bus services on basis of advertisements.

To begin with, 41 routes were operated with 100 buses. VMSS income increased from bus operations as also from bus stands. This income has been used for the infrastructure development of the city. VMSS has encountered several challenges in terms of the phenomenal growth of 3-wheelers and personalised vehicles (two wheelers and cars) which have created difficulties in bus movement. A move towards heavy occupancy vehicle lanes and then towards bus rapid transit system could pave the way for a vastly improved system to emerge.

The Jalgaon Experience

The motivation behind the application of the PPP model in Jalgaon was provided by the poor services that the then existing public operator, MSRTC, was providing. MSRTC sustained continued losses from the business and its demand for compensation from the Jalgaon Municipal Corporation did not receive any response. As a result, operations were discontinued in August 2009. The Municipal Corporation wanted to provide bus services but had neither the resources nor the requisite expertise to do so and hence there was no option but to go in for the PPP model.

A Special Purpose Vehicle (SPV) - JNTU was formed for this purpose. The SPV floated the tender for bus services which then received one response 'ECOBUS' that subsequently began operations with the fleet of buses fitted with EURO III diesel engines with rates being ₹3 for the first two kilometers and ₹0.60 per km thereafter. This system adopted e-enabled measured such as GPRS fleet tracking system, electronic ticketing system, LED and LCD displays in buses and stops, and smart card passes. The frequency on all routes was 15 minutes. As a result, the carrying capacity increased by 400 percent while average occupancy rose to 55 percent leading to a revenue increase of 500 percent. All these were achieved due to sustained marketing efforts, more revenue from advertising, motivation of man power thereby providing high-quality services, and above all achieving high level of operational efficiency.

However, a little more than a year later, the services have been withdrawn due to a number of reasons significant among them being the lack of infrastructure provision as provided in the agreement between the public and private partners. Non co-operation on the part of MSRTC did not permit use of a terminal that has been lying unused ever since MSRTC stopped city operations. The absence of a bus terminus and depot space resulted in significant additional expenditure on diesel for bus turn-around on every trip and empty movement at the start and close of the day. While the tendering process had specified 15 routes to be bid for, only 5 were offered and the remaining not being offered at the instance of the MSRTC. It is our understanding that even the routes proposed were never planned, which meant there is need for rationalisation of routes based on a comprehensive study that needs to be undertaken to examine origin-destination movements and also to categorise routes as trunks and feeder routes. This is a vital part of the urban planning and development department which is currently not being given adequate attention.

An analysis of the different case projects in Indore and Vadodara reveals that a proper PPP framework was one of the factors responsible for making a project successful. The regulatory body (the local agency or SPV) analyses demand, plans routes, fixes fares, gives out tenders, and monitors performance regularly. Success has resulted from proper identification of risks and rewards and their allocation to the party which was best able to manage it, quick decisions made regarding tariffs, routes, frequency, etc., transparent selection of the operator, continuous consultation with stakeholders and provision of space for facilities. In Jalgaon, failure resulted as many of these basic governance elements especially on the part of the public authorities were missing, including even proper planning and simple monitoring practices.

International Experience in Road Transport Regulation & Lessons for India

Transport Regulations – An Overview

A broad definition of regulation is: any measure or intervention which seeks to change the behaviour of individuals or groups. The purpose of regulation is to achieve better outcomes compared to the situation if regulation were not present. Historically, governments intervened to regulate transport for reasons of equity and later to lay down acceptable safety and environmental standards. It has equally been evident that governments tend to intervene when market forces do not produce either the desired efficiency or the type and kinds of services a society desire.

It is thus incumbent on the part of the government to ensure that the business of transport is reasonably profitable so that new technologies are introduced and the quality of service is enhanced. If there are too many restrictions affecting economic viability the result will be low technology, poor service and consequent immobility. Regulation must have a positive impact, i.e. to encourage rather than to discourage provision of better quality of service. The public, strategic and business interests may often conflict with one another, which is why the overall purpose of regulation is to balance and prioritise conflicting interests in such a way that the entire society benefits.

Essentially, economic regulation is about protecting the weak and restraining the powerful, so as to achieve economically and politically sustainable outcomes. It is about promoting and protecting investment on the one hand, while protecting the consumer and public interests on the other. Both need to be achieved.

Transport regulation – like infrastructure regulation – is necessary when the state determines that the provision of transport services cannot be left entirely to the private sector. This is because transport infrastructure – in most cases – will be a monopoly, and the holder of that monopoly will have an incentive and usually a tendency to abuse that position through charging excessive prices, demanding other unreasonable terms for access to the infrastructure, and providing a poor or declining quality of service, to the detriment of the users of the system and the public interest.

In the past two decades, almost all developed and developing countries have experimented with different forms of ownership and regulation of bus transport. Two basic considerations have driven this widespread experimentation: (a) bus services are important and (b) they are almost universally subject to a degenerative regulatory or managerial cycle that periodically endangers their availability.

Accordingly, in such situations, many countries across the world have experienced a fairly similar cycle of private and public investment in bus services.[11] The recent experience in some countries can be exmained in this regard.

UK

Private bus companies were common in Great Britain in the first half of the 20th century. As incomes and auto ownership began to grow and bus ridership fell, subsidisation of bus services began and most companies became publically owned. Public ownership and growing public subsidies were not very successful in arresting the decline in bus ridership. Efforts at privatisation were usually limited to contracting out operating functions such as maintenance, etc.

In one of the most dramatic and ambitious efforts ever undertaken to privatise public services, the British Transport Act of 1985 ordered the de-regulation and privatisation of bus services throughout Great Britain exempting only the Greater London metropolitan area (which followed a different model). The 1985 Act had three features:

a) Controls on entry were relaxed so that public or private bus companies could offer bus services by giving 42 days' notice.
b) Publically owned bus companies were re-organised as separate for-profit corporations.
c) Local authorities put supplements on unprofitable or commercial routes by subsidising additional services (of social concern) but these supplements had to be secured through competitive bidding among the operators.

The Transport Act created a competitive free market in the United Kingdom for the local (outside London), suburban-country and long-distance bus services. The operators were free to develop their own routes and timetables without the need to acquire an operating licence. They were required to register new routes and the only restriction in the initiation of new routes could be made on the grounds of traffic conditions. The main administrative task, through the registration system, was to closely follow the development of the services and to ensure that socially necessary, but economically nonviable, routes are also provided. After the introduction of the system, heavy competition began in the market for local and suburban passengers (mainly in the running of more buses than the reduction of fares).

Competition in long-distance public transport sector also commenced after deregulation. This primarily took place on the popular and economically attractive routes with price competition as the device leading to a decrease in fares. Further, features included the use of innovative price formation, the introduction of rapid and express services, and an increase in the frequency of services, the utilisation of opportunities provided by the new motorway system.

In London, following the model of competition for the market, increased patronage growth at a very fast rate compared to other areas in the UK. London's success was due to three factors: strong regulatory powers, public subsidy and strong political commitment. However, improvements and the popular cheap fares policy would have been impossible without the subsidy paid for them. A strong political commitment has been essential in delivering a pro-bus and anti-congestion policy backed by adequate spending. It was observed that transport authorities outside London would have to have substantial funding in place before they could plan and specify networks, fares and other standards. Authorities would also need to consider the role of parking charges, the strategic allocation of road space, compliance, and possibly road space charging in order to improve services and encourage patronage growth.

But the results have also indicated limitations. The expectation that competition will improve the quality of services has not been realised though service innovations that have materialised. With the concentration in the marketplace, competition has virtually all but ended. Practical problems such as instability, lack of coordination, time tabling and information, bunching of buses at popular times, customer uncertainty, lack of information, different types of vehicles, difficulty in establishing demand patterns rose. Such difficulties could be significant but could possibly be minimised in other countries in similar situations with better planning procedures.

However, Gomez and Meyer[12] observed that the most distinctive lesson for developing countries from the British experience is the importance of innovations in service provision that was most likely stimulated by privatisation. Such cases of innovation practices have been reported in India in a response to user needs both from the private as well as public sector operators, though the regulatory framework has not necessarily been reformed to enable this.

Sri Lanka

Motorised road transport began in Sri Lanka at the turn of the 20th century with road transport becoming popular after the Second World War replacing railways as the primary mode of travel. Today, 68 percent of all motorised passenger trips in Sri Lanka are made by bus even though the share of private vehicles, which has been rapidly gaining ground over the last two decades, stands out at 24 percent. Sri Lanka saw four periods of distinctively different service provision in terms of ownership, management and regulatory structures during the past 100 years with the current one of regulated mixed competition beginning in 1979, the government providing encouragement for unrestricted entry for the private sector. The unplanned and rapid growth between 1979 and 1983 led to many owner driven buses entering the industry.

Instead of setting up a regulatory agency, district based operators' associations were given significant regulatory powers. With the ministry of transport not exercising any noteworthy control over district associations the general standard of passenger transport diminished very quickly. There were no entry qualifications for operators or bus crews. Generally, travel times increased and quality of service declined.

The enactment of National Transport Commission Act number 44 of 1991 saw the creation of a dedicated regulator for private bus transport. Even though the Act provided for specific regulatory instruments, the National Transport Commission did not develop all these regulatory measures and saw its role mostly as an issuing office for route permits. According to Kumarage and Jayaratne,[13] in this phase the private sector fleet increased rapidly but saw declining reliability and productivity. Moreover, private sector entry has fragmented the integration of the bus network because they operated only where and when it is profitable to do so.

In addition, a host of regulatory lapses was also been responsible for the situation. The lack of capacity of regulators as well as emphasis on revenue orientation instead of sector development has been identified as major concerns why regulators have not fulfilled their roles justifiably. This seems to be a problem of concern in the Indian context as well. Another source of concern has been the maintenance of service on unremunerative (mostly rural) routes. The essential cause of poor service accessibility was a combination of sole reliance on the public sector to provide subsidised services and the decline of its capability to perform that function. This could be overcome by moving to the competitive tendering of subsidised services which would allow the private sector to supplement the public sector supply.

US

Privately-owned unsubsidised firms provided almost all US transit services in the first half of the 20th century but most approached or actually entered into bankruptcy and were taken over by public authorities in the 1950s and the 1960s. A typical form of private involvement in bus transport in the US would be managing companies or contracting services for the company owned by public authorities. This gradual and piece-meal privatisation through contracting-out in the US contrasts sharply with the sudden and wholesale privatisation that occurred, for example, in Britain. The gradual approach has, according to some experts, avoided the transitional problems experienced in Britain and has allowed public authorities to experiment with different contracting procedures that encourage new entry and competition. Further, the presence of competition has been more important than wholesale privatisation in evoking cost savings.

The long-distance bus industry now faces a highly competitive transportation environment. Not only were companies engaged in price war over potentially profitable bus routes while abandoning marginal routes, but they also had to contest for passengers with the new low-cost deregulated airlines and for packaged freight with trucks. Companies made considerable efforts to adjust to the new conditions by lowering prices, improving facilities, especially terminals, investing in new coaches, making rural connections with independent feeder lines and in establishing computer systems to assist with ticketing and routing. A disadvantage in contracting is that the services provided are designed by the public rather than the private sector. While contracting may evoke cost savings and productivity increases, it is less likely to encourage service innovations.

The basic lesson for developing countries, such as India emerging from the US experience is that the private sector performs best when it is asked to do a relatively well defined task and with minimum interference from public authorities beyond that which is required to prevent fraud or prevent other abuses.

Chile

Intercity bus regulation in Chile took place in the late 1970s. This allowed higher fares and new companies to enter the business. Following years of control it was expected that fares would rise and this indeed happened at first. However, subsequently fares fell back as new competitors entered the business so that ultimately fares were only slightly above the levels set under regulation. In subsequent years, the number of operators increased substantially. A period of consolidation began which was characterised by a growth in size of large bus companies. Many of these companies developed their own bus stations.

Deregulation thus resulted in more services being offered especially in rural areas and improved the frequency and quality on existing routes especially where many operators competed. The main concern was the level of competition on rural routes, which was quite low on secondary routes. This could be a genuine problem in the Indian context. However, provided that the local governments continue to offer facilities to other operators, the threat of new competition should in itself help to limit the risk of excessive fares and poor services being provided.

Some Lessons for India

The need to regulate fares on urban routes based on a thorough but quick understanding of underlying cost profiles and associated efficiency norms can be assessed only by a specialised agency. In rural areas, optimal reforms would be to combine privatisation with deregulation of fares. Here, operators can experiment with various combinations of fares with services and even provide for cross-subsidisation. However, this is dependent on maintenance of effective competition. Estache[14] points out the limits to such competition as arising especially from market failures.

Government intervention may thus be needed, critically in developing countries like India where there is potential for anticompetitive behaviour in the form of practices and procedures of route associations. While these associations offer important benefits in co-coordinating schedules, reducing unsafe driving, etc., they can limit competition by restricting entry or encouraging higher fares. But the implications need to be understood as well especially when there are universal service obligations/unviable but socially required routes.

Role and Performance of Sectoral Regulators

According to Gwilliam,[15] regulatory failure is almost by definition institutional failure. Such a failure emerges when there is no appropriate focal institution to handle, say, in this case, bus regulation. Given the existing regulatory arrangements such as the ones we have at present, there could be an acute problem of overlapping of jurisdictions of national, state and municipal level of governments. Basically, this begins at the level of formulation of policies and in transport all the three levels of government have their own focus areas to contend with. In the absence of effective co-ordination between these tiers of government at the policy formulation and implementation level, it is not surprising that the accompanying regulatory framework faces similar problems in practice.

It is widely recognised that the implementation of the MV acts has focused excessively on the revenue generating provisions to be concerned with active implementation of many useful provisions which when considered very carefully require a far more sophisticated framework involving technical skills to perform the expected role adequately. Mention may be made of fare control, for example, which can be exercised only after a thorough examination of an entity's cost profile its capacity to serve the requirements *vis-à-vis* the market.

In addition, we have already mentioned the need for a comprehensive planning exercise which serves as some reasonable basis for provision of permits. Today, there is complete arbitrariness in issue of permits, especially in regard to the need for additional capacity. Even when it comes to competitive bid franchising, the concerned authorities have hardly any idea as to what the service needs are. Accordingly, the need arises for a planning and specialist regulatory agency that has the expertise and skills to examine these issues with the implementation being left to the administrative authorities.

Gwilliam observes that only the existence of an effective multi-modal transport agency can aid in the emergence of a stable regulatory regime. In the Indian context, there is an urgent need for a National Transport Commission which besides reviewing India's transport priorities and policies within an integrated framework on a continual basis, could also monitor economic regulation and thereby promote competition.[16] There is also a need for such regulatory mechanisms at the State and local levels.

Conclusion and Policy Recommendations

Two important issues commonly arise when seeking to introduce or improve economic regulation:

1. What should be the basis of competition, either free competition (or 'competition in the market') or some kind of contracting or franchising (or 'competition for the market') and how is this ensured?
2. How is a government to monitor services and control anticompetitive abuses?

Planning and Policy Issues

In the case of urban bus services, particular issues arise over planning and regulating services. For non-urban bus services there may not be a case for major intervention by government in planning and controlling services. Leaving operators free to plan services in accordance with the needs of the passenger encourages service innovation and frees government to concentrate on the important task of setting and enforcing safety standards and of ensuring that competitive conditions prevail.

There are many ways of introducing fair competition in service provision to the inter-city passenger transport markets in India. Route franchising is a means of maintaining some public control over the level of services and prices in the public passenger transport market, while using competitive forces to secure supply at the lowest cost. This can apply to non-remunerative bus services alone (as in most of the UK) or for all services (as in London) with the supplier either carrying only the cost risk (as in some cases in the UK) or carrying both the cost and revenue risk.

Competition between groups within a licenced franchise system can be promoted by ensuring that the routes for which monopoly franchises are granted overlap sufficiently to encourage competition for customers on common sections of route. This approach is practiced to secure competition between different bus operators' associations in Latin American cities and also between operators of different kinds of public transport vehicles in the context of some African countries. This form of competition makes it possible to some degree to organise supply, and limits anti-competitive operating practices, as long as there is a competent franchising authority to prevent the emergence of a single strong cartel.

It should be an accepted principle of good governance that any government that demands an operator meets unprofitable public service obligations should also be required to reimburse for those services given that the operator demonstrates efficient provision of services. Moreover, better accountability can be ensured when the government that demands the services is the one that meets the cost of such services, which is not the case if a different level of government (the central government) is expected to meet the obligations demanded by another level (often the local government). That the central government in India no longer financially supports the SRTUs but leaves this to state and local governments that demand reimbursement is therefore a step towards better governance.

Regulatory Issues

With a view to creating a market in which passenger services of various types and size compete with each other, unassisted, policymakers in India should be concerned with putting in place a proper regulatory environment. In particular: (i) regulations that internalise social costs, such as those related to the environment, safety and congestion, so that the market can allocate resources in a socially desirable way; and (ii) regulations that establish basic rules for fair competition should be developed and implemented.

There are two reasons why it may be necessary to retain some public regulation of the supply of bus transport in the inter-city bus markets. First, regulation may be desirable in some cases where an unregulated market process may result in: (i) mis-matching of schedules, (ii) increased pressure to engage in unhealthy operating practices, and (iii) perceptions relating to stability and reliability of service, with consequent reduction in vehicle utilisation.

Further, while cost reductions resulting from unfettered competition may allow previously unprofitable services to continue, and may even lead to more frequent services being provided on previously non-remunerative routes by certain service innovations using smaller vehicles that are better suited to low demand, social objectives may require direct financing of some services that might otherwise be lost through competition in the market as was the case of rural bus services in Sri Lanka. Enabling such markets to be 'contestable', could still allow non-remunerative services to be provided at the least cost. These failures of the market process may require qualitative controls, though not necessarily monopoly franchises, and never direct state involvement in service provision.

In an unregulated market, profit may be sought through the creation of an operators' cartel, as it happened in the bus industry in Chile, or by operators combining with suppliers of terminals or other infrastructure to exclude competitors from access to crucial facilities. The most efficient markets for road transport operations seem to normally comprise very large numbers of very small producers. However, if some firms or associations of firms, grow so large as to threaten the competitiveness of specific sub-markets, it is necessary for anti-monopoly authorities to intervene.

In the Indian context, it may be desirable to restructure SRTUs into a number of smaller firms to curtail their market power. The Tamil Nadu experience in the eighties and nineties revealed healthy competition between public sector units as well as between public and private sector entities. All these point to the removal of special provisions in regard to SRTUs in the MV Act as is being currently recommended by the Sundar Committee.[17]

The main focus of regulatory policies in the case of bus services should be qualitative standards related to ensuring the safety of the services and the minimisation of negative environmental impacts. Safety dimensions encompass vehicle road worthiness standards (brakes, steering, tires, visibility, lighting and signaling), driver qualifications and working hours, and avoidance of excessive overloading (riding on the outside or top of buses as happens from time to time in India is not conducive to safety).

Unfortunately, in India these beneficial regulatory dimensions are also not generally enforced for the same reasons that economic regulations are not generally enforced, i.e. transport operators generally find it more advantageous to make 'facilitation payments' to the transport authorities.[18] Qualitative regulations can contribute greatly to improved safety and environment. An MV Act containing only these aspects could continue to serve as a regulatory mechanism. The framework for economic regulation needs to be dealt with differently as suggested above.

Concluding Remarks

Having gone through a certain cycle of changes with respect to operator or supply response to emerging needs, the situation in developing countries like India is such that the emphasis is turning to the traditional bus transport mode, particularly in urban areas and for over short and medium distances, in part also due to concerns about road congestions and national carbon emissions. Public transport has a unique feature in that it is in competition with the private transport which is in the public interest to suppress. The emergence of public-private partnerships especially in public transport can be expected to mould the private sector entity in support of a publicly desired outcome.

The objective of the reforms agenda formulated for the urban areas, for example through JNNURM, to justify the bus component comprises of an elaborate set of guidelines for improving urban mobility and ensuring priority for public transport. These guidelines range from dedicated lanes for buses, special purpose financing and public private partnerships for setting up Bus Rapid Transit System (BRTS), dedicated transport funds to be set up though additional vehicle registration fees, congestion tax and green tax, urban bus specifications to be followed etc.

Preference for public transport is rightly stressed. In this context, the significant role of Unified Metropolitan Transport Authorities in matters relating to providing the elements of the economic regulatory framework for multi-modal integration, demand management, restraint on private automobile growth has been emphasised explicitly. Only such a specialised regulatory agency (currently handled by municipal agencies referred to in case studies of PPPs) can ensure the competitive position of public transport over personalised transport in the context of urban areas. This experiment could perhaps also provide the guidelines for a framework, which though qualitatively different, could apply in the other segments of bus transport.

In this manner the government could best ensure well-functioning markets that provide the array of services the various market segments demand and at least cost. But the concept needs to be taken forward further.

Endnotes

1 This is by virtue of certain inherent advantages over the railways, most important of which is its flexibility and ability to provide the last mile connection.

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CHAPTER 10

Telecom Regulations in India: Recent Lessons and the Way Forward*

Introduction

Indian telecom sector is more than 165 years old. Till mid-80s, the sector was entirely under government ownership while the private sector was allowed to manufacture telecommunication equipment only. The actual evolution of the industry started after setting up the Department of Posts (DoP) and the Department of Telecommunications (DoT) in 1985.

Prior to liberalisation, the public sector held a monopoly in provision of telecom services. Before the entry of the private players, the telecom services were provided by three public entities viz. DoT, Mahanagar Telephone Nigam Limited (MTNL) and Videsh Sanchar Nigam Limited (VSNL). While MTNL primarily looked after the operation of basic telephony services in Delhi and Mumbai, VSNL provided international telecom services in India. DoT looked after basic telephony operations in regions other than Delhi and Mumbai.

During phase II, private sector participation in the Indian telecom sector has been a gradual process, wherein the government initially permitted players from the private sector to provide Value Added Services (VAS) such as Paging Services and Cellular Mobile Telephone Services (CMTS), followed by the Fixed Telephony Services (FTS) or basic services. Liberalisation process in the telecom services market began in 1992. During this period, the government provided licences to private players according to the services that were to be provided in the specified areas of service provision. During 1994, through a competitive bidding process, licences were granted to 8 CMTS operators in four metros, 14 CMTS operators in 18 state circles and paging operators in 27 cities and 18 state circles.

The need for independent regulation arose with the entry of private players. Also, to fulfil the commitments made when India joined the World Trade

* This chapter is based on papers contributed by Tom-Reiel Heggedal, Espen R. Moen and Christian Riis of the Norwegian Business School, Oslo; and Devendra Kodwani, Open University Business School, Milton Keynes.

Organisation (WTO) in 1995, the Telecom Regulatory Authority of India (TRAI) was established in 1997 to regulate telecom services including fixation/revision of tariffs. The establishment of TRAI was a positive step in terms of separation of regulations from policy making and operations, which continued to be under the purview of the DoT.

The telecommunications sector in India has had one of the highest growth rates worldwide and come to be regarded as the world's most competitive telecom market. The industry has undergone significant structural transformation since its liberalisation in the 1990's. During the last decade, the Indian telecom industry has evolved into a multi-segment, competitive market from a small supplier-dominated market having public sector monopoly.

The industry is expected to reach a size of US$65.53bn by 2012 at a growth rate of over 26 percent. In 1999, there were approximately 1.2 million mobile subscribers; the number had increased to 57.4 million in 2005. As of October 2011, India has the world's second-largest mobile phone users with over 881 million; in October 2011 there were over 914.5 million telecom subscribers, of which the wireless segment accounted for more than 96 percent. As in most other countries, the wireless segment of the Indian market has grown exponentially, with a 0.9 percent month-on-month growth in H2 2011, while the wired network growth shows a downward trend. India's urban wireless teledensity is at 159.96; however, mobile phone subscription coverage is still low in rural areas (though the month-on-month growth is a healthier 1.15 percent, compared to 0.76 percent for the urban segment), with a teledensity of 35.82.[1]

Also, there is a large variation in teledensity across states, and many less developed states have teledensity well below 20 percent. India also ranked as the world's fourth-largest among internet users with over 100 million subscribers in December 2010. The discussion and analysis in this chapter is focused on the wireless market.

On an average, there are around 10 operators in a licence region (circle or LAS) competing for the same customers, though the majority of the market is split among the five/six largest among them. There are 10-13 GSM licencees in all 22 LAS. In addition there are 4-5 CDMA licencees in each area. Most of the licencees have been allocated spectrum and compete for the same customer base. In the densest circles, like Mumbai, there are up to 12 active operators with a substantial subscription base. In more sparsely populated circles like Assam or North East there are 7 active operators.[2] Private companies have almost 88 percent of the market share; the two state controlled companies, BSNL and MTNL, have a combined market share of only 12.19 percent for wireless. There are six companies with a wireless market share around 10 percent (see Table 10.1); Figure 10.1 gives the detailed breakup.

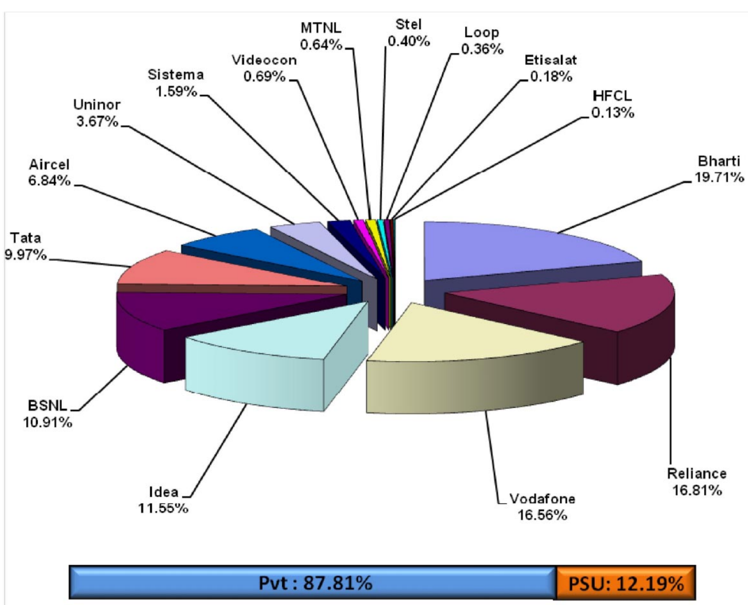
Table 10.1: Companies with a Nationwide Wireless Market Share of 10 Percent, October 2011

	Bharti	Reliance	Vodafone	Idea	BSNL	Tata
Market share	19.71	16.81	16.56	11.55	10.91	9.97
Share in net monthly additions	12.20	13.26	11.86	21.05	5.15	-12.04

Source: TRAI Press Release No. 57/2011

The distribution of market shares between the six companies has been stable over the last few years, though the performance and market share of Tata seems to have been affected in the past year because of the 2G scam. However, there is strong competition for market positions, both between established firms and from new entrants. The highest growth rate has been shown by Uninor, one of the newcomers in the market, with an October 2011 market share of 3.67 percent but with 34.22 percent of market growth (partly because of base effect).

Figure 10.1: Wireless Service Provider wise Market Share as on October 2011



Source: TRAI Press Release No. 57/2011

The Indian mobile telephony market is characterised by fierce retail price competition. The strong competition has contributed to a drastic decline in calling tariffs, and tariff levels are now among the lowest in the world.[3] Price levels have decreased significantly since market liberalisation took off in the late 1990s. A one minute call between Delhi and Mumbai that cost ₹37.50 before 1999 is now possible below ₹0.60. At their lowest, it is reported that average tariffs in India reached seven cents a minute, while for some limited plans it was even lower. The price for international calls has also dropped during the same period, e.g. calls to the US have dropped from ₹75 per minute to less than ₹7. The Herfindahl-Hirschman index,[4] measuring the level of competition, dropped in most circles between 2003 and 2007, to a rating of about 0.2.[5] This low rating is one of the lowest for telecom in the world.[6, 7]

The high growth rate in the telecom sector has boosted economic growth; the industry is expected to generate employment opportunities for about 10 million people by 2012. However, the fierce price competition in the market has driven down the revenue of participating companies. For the enterprises in the telecom sector, about 55 percent of revenues come from calls.[8] The average revenue per user (ARPU) has been declining in recent years; between 2008 and 2009 it fell by more than 12 percent. This seems to be a result of the fact that the share of prepaid phone subscriptions is highest in the country.[9]

In September 2010, more than 96 percent of the market was prepaid. This is a matter of concern since the ARPU for postpaid is ten times as high when compared to prepaid. Furthermore, the prepaid ARPU declined by more than 10 percent during the period June to September 2010.[10]

Further strain on revenues may come from mobile virtual network operators (MVNOs) that are yet to make their mark in the telecom market. However, several companies have plans to open MVNO enterprises in most LSAs. These will compete with the current licencees for existing subscribers, and for a share of the growth in the market. The market is expected to grow in the coming years, but for the most part in rural areas, where though the population density is low, inadequate wired services has led to a high unmet demand for telephony. However, rural growth is important, as more than 70 percent of the Indian population lives in rural/semi-urban areas.

3G service in the Indian telecom market has started to take off. The 2010 3G spectrum-licence auction brought private operators into the market to supplement two state-owned enterprises – BSNL and MTNL. There are three to five operators with 3G spectrum in each circle. This is less than the number of 2G operators, which might indicate that the competition on delivery of 3G services will be less fierce. However, calls using 3G will compete against calls using 2G, as consumers cannot distinguish between 2G and 3G calls. Hence, the voice market may become more competitive due to 3G entry.

A major potential growth area may come from wireless data traffic. India has poor broadband connectivity, with a subscriber base of only 12.98 million in October 2011, in particular outside densely populated areas. Thus, increased demand for data traffic may in large part be covered by wireless network operators, as has been experienced in the voice segment. This can cause further stress on an already packed spectrum. However, to keep costs low and incentivise spread of private sector, the DoT is looking to use a MVNO model to implement a rural wireless broadband scheme across the country. This will also help counter additional stress on scarce spectrum.

The focus of Indian telecom regulation is on ensuring efficient and adequate competition in the retail end of the market. Despite growth, mobile penetration remains moderate; as at the end September 2008, India had a mobile penetration of around 27 percent. However, the government's priority on competition may lead to an inefficient allocation of resources, as efficient spectrum usage is subject to increasing returns to scale. This chapter discusses some important market and regulatory inefficiencies in India, and addresses policies to remedy these inefficiencies.

The analysis focuses on three sources of inefficiency, related to:

i) allocation of licences, spectrum rights and scale economies;
ii) distortions associated with the fee and taxation system; and
iii) lack of transparency and credibility in telecommunications policy.

The chapter argues that the lack of market-based institutions and modalities for allocating spectrum rights (auctions) may give rise to a misallocation of resources. The current system (last used in the 2G licence distribution) does not ensure optimal spectrum allocation, i.e. the dominant firms, with the highest willingness to pay for licences, are awarded more licences than dominated or less efficient firms.

Furthermore, spectrum is a scarce resource, and hence it has a value which the government could realise through auctioning. Without up-front payment one risks that some or all of the rent is allocated to the telecommunication companies, leading to excessive entry into the market and consequent market fragmentation. Increasing returns to scale (up to a point) in spectrum use (trunking efficiency) leads to suboptimal spectrum use. In fact many argue that the industry is too fragmented and suffers from regulation-induced inefficiencies to survive in its current form.

It needs to be mentioned at the outset that the analysis in this chapter is based on economic efficiency concerns founded on the principles of economics. The policy recommendations are thus based on what arguably will lead to a more efficient allocation of resources in the Indian telecom market. However, the political difficulties of implementing good policies are outside the scope of this analysis, which does not consider problems related to the transition from the existing regulatory regime to the proposed policies, the details of the institutional reform that is needed *a priori*, or any other political economy aspect.

The chapter gives an overview of the existing regulatory regime, and the political economy motivations of telecom regulations in India. It briefly describes and discusses the auction mechanism for allocating spectrum on firms, the revenue taxation, regulatory truncation, and issues related to transparency and credibility and provides conclusion.

Telecom Sector Regulation in India – Overview and Political Economy thereof

There has been a rapid change in the Indian telecom regulatory environment over the past 20 years. The policy has evolved since mid-1980s, but the power to operate telecommunication networks remains an exclusive privilege of the Central government under the Indian Telegraph Act of 1885. However, the government may and does delegate such powers by issuing licences; in practice this power is exercised by the DoT, a department of the Ministry of Communications & Information Technology (MC&IT). The Telecom Commission is the highest decision-making body of MC&IT. Also, telecommunications is in the federal list, which means that the infrastructure was owned by the Central government.

TRAI was established in 1997 as a separate regulatory authority. TRAI's main functions are to make policy recommendations to DoT, levy fees and charges, and monitor prices in the market and on licencing matters. TRAI's autonomy was initially challenged by the DoT, which was then the service provider cum policymaker.[11]

The TRAI Amendment in 2000 reconstituted TRAI and made it mandatory for DoT to seek policy recommendations regarding new service providers and terms and conditions for new licences. Regulatory roles for the telecom regulator encompass tariff determination of landline phones, internet, internet telephony, cellular phones, cable and broadband connections, and interconnections for domestic and international services, in addition to promoting competition in the different services. TRAI is accountable to the Parliament, and its decisions can be appealed against by both companies and consumers.

In addition, Wireless Planning & Coordination (WCP) is the national radio regulatory authority responsible for frequency spectrum management, including licencing. WCP caters to the needs of all wireless users (government and private) in the country. It exercises the statutory functions of the Central government, and issues licences to establish, maintain and operate wireless stations. WPC is also a part of DoT.

Mentioned below are the nature and modalities of regulatory interventions in the Indian telecom sector.

Licence and spectrum allocation

The telecom market in India is in principle characterised by light-touch regulation. Liberalisation of the telecom sector started in the early 1990s when private participation in the market was first allowed. In 1990s, and before the establishment of the regulatory commission, the government allowed for private sector bids and an annual licence fee and contracts were used for service licences. The nationwide telecom market was divided into 23 (now 22) separate circles representing geographical areas (Licences Service Area or LSA), roughly corresponding to large states.

For each area, a Mobile Network Operator (MNO) needs a licence to establish an enterprise. The circles are divided into four categories: Metro circles and then A, B, and C circles. The Metro circles are densely populated cities such as Delhi and Mumbai. The other circles constitute geographical areas of varying population, where A has the largest population coverage and C the lowest.

Privatisation and liberalisation in telecom came to be viewed as necessary to overcome organisational inertia and attract new investment. Spectrum was made available to private companies first in 1995 and these were established thereafter. However, the extremely high entry costs and annual licence fee regime was a deterrent to the private sector who only bid for new licences. Subsequently, a one-time licence fee was introduced for the landline and wireless services, which was again changed to a model of smaller licence fees plus a revenue sharing mechanism.

The release of the New Telecommunication Policy in 1999 was a big step towards a competitive telecom market.[12] The policy put forth an ambitious plan to facilitate a modern and efficient telecommunications infrastructure taking into account the convergence of IT, media, telephony and consumer electronics. One of the main implications of the policy was that the licence regime shifted from an annual fixed licence to a revenue sharing system.

Under the revenue sharing system, firms pay an initial fixed fee and an annual share of revenue. The revenue sharing system facilitated more growth in the industry, as, apparently, companies suffered from financial constraints. Faced by credit constraints the firms were not able to pay the full value of licences up front. Revenue sharing gave firms an opportunity to enter the market at a reduced cost and invest, while the government could extract rents at a later stage when the firms' cash flows increased. Further, the public incumbent BNSL was separated from DoT and corporatised in 2000 to compete, in principle, on equal terms with private firms.

Licences and spectrum are allocated for 20 years. Companies need a separate licence for each circle. There are three types of licences: international long distance, national long distance and domestic services. In addition, there are three categories of domestic licences: fixed, cellular (CMTS), and Universal Access Service (UAS), which combines the first two. In total, there are 281 licences, out of which 240 are UAS. During 1995 to 2003, licences were auctioned in each circle. Initially, two operators were selected for each circle. The government made sure that at least one private operator was competing with a state-owned operator: BSNL and/or MTNL. In 2001, the fourth licence was given to the winner of a three-stage auction in each area. In addition to entry fees, spectrum charges were levied on licence holders as a percentage of adjusted gross revenue. Licences to operate were bundled with an initial allocation of start-up spectrum.

In 2003 additional mobile licences were made accessible to companies engaged in basic telecom services (i.e. fixed line licence holders) upon payment of the 2001 auction price in each circle. Start-up spectrum was not allocated directly with the licence. Spectrum was allocated to licence holders when available, on a first-come first-served basis.

Further, from 2003 there was a merger of licences, where existing cellular operators were allowed to exchange their licence for a UAS licence. From 2007, all companies could buy a licence at the 2001 auction price. The 2001 auction price can be perceived as relatively low since the market value of licences changes over time. Moreover, the licence price varies between the circles: from ₹11mn[13] in rural Himachal Pradesh to about ₹2bn for Mumbai. The total cost for licences in all circles is about ₹17bn.

As start-up spectrum is allocated to licence holders on a first-come first-served basis, licencees may face a long waiting periods before they are allocated spectrum. The initial allocation of start-up spectrum is small compared to other countries.[14] However, a licencee is allowed additional spectrum beyond the initial assignment as and when its subscriber base crosses certain thresholds. This is known as the Subscriber Linked Criterion (SLC) for spectrum assignment. Under the SLC, the ratio of subscriber thresholds to spectrum increases with the amount of spectrum already held by the licencee. Spectrum cannot be resold, traded or shared between operators under the current regulatory regime.[15]

However, mergers and acquisitions (M&A) of companies may be allowed by the discretion of regulation authorities under certain criteria, outlined in the draft of the National Telecom Policy 2011 (NTP 2011). If approved, the licencees under the new joint venture may share licences and spectrum. The main criteria for allowing M&A are: (i) there are at least four operators given service in the circle after M&A, (ii) the market share of the merged entity is less than 40 percent in the relevant service area, (iii) the involved parties comply with terms and conditions of the licence agreement. In addition to the above, TRAI's recent recommendations on spectrum management and licensing framework is expected to fuel consolidation in the industry. It has however been argued that higher spectrum charges can impede M&As and render many firms unviable.

Even if consolidations do not work out as envisaged, the directional draft of the NTP 2011 (which clearly states that the new policy will enable the operators to undertake spectrum sharing and even open the market to MVNOs) and recommendations by TRAI propagating a 'spectrum for anything' philosophy (or spectrum in any band being used for any service) would definitely lead to spectrum-sharing in the country in the future.[16] This will help generate additional revenues for the government through spectrum usage charges, and allow operators to achieve the much-needed spectral efficiency, by reducing the burden on the cramped network. Spectrum-sharing can potentially lead to a transformation of the industry, with new and improved business models.

Finally, in India, 3G is still treated as a separate service from 2G.[17] It is sufficient to hold a UAS licence to provide 3G, thus 2G licencees are allowed to deliver 3G services. However, spectrum in the appropriate bands is needed to provide 3G services. In 2010 3G UAS-licences were auctioned bundled with spectrum in all 22 circles. There was a high interest for these spectrum-licences and the winning bids were high. The total of the winning bids was about US$15bn. Three mobile operators, Bharti, Vodafone, and Reliance, paid US$737mn each for the Delhi and the Mumbai markets.

In addition to those three, six other operators got licences in other circles. No operator got licences for all 22 circles. The two state-owned enterprises, BSNL and MTNL, were given a head start by the government; they did not need to participate in the 2010 auction as they had already been allocated 3G spectrum in 2008. BSNL was allocated 3G spectrum in all the 20 circles it operates in,[18] and MTNL was allocated spectrum in the two other circles – Mumbai and Delhi. BSNL and MTNL paid the 2010 auction price for allocated spectrum in circles.

As a part of this project, a random sample survey of informed stakeholders was also conducted soliciting their views on the prevailing regulatory regime and status of competition enforcement in India in select sectors, including telecom. Despite the multiple problems with the spectrum sharing and distribution, 70 percent of the respondents seemed to either not have any concerns or do not agree that the prequalification processes and requirements for bidding for licences are in any way restrictive. Further, contrary to popular perception, approximately 37 percent of the stakeholders were of the view that the functional and financial performance of TRAI has not deteriorated over time. Surprisingly, 38 percent of the of the stakeholders did not consider the efficiency of regulatory bodies as a factor contributing to the growth of the sector.

The survey also tried to capture the views of the stakeholders on the slow pace of growth of the broadband services. There was no significant trend found, though around 39 percent of the respondents opined that both technology and regulations are equally important for growth of the sector. 47.4 percent of the respondents agreed that mandatory infrastructure sharing with private entities will facilitate competition as well as reduce costs for the telcos.

Taxes and fees

MNOs pay fees based on Adjusted Gross Revenue (AGR). The fees can be divided into three categories: licence fees, spectrum fees, and universal service levies. The licence fee as a percentage of AGR varies between the circles: 10 percent for metro and A circles, 8 percent for B circles, and 6 percent for C circles. The major part of the licence fee is the Universal Service Levy (USL) which constitutes 5 percent of AGR in all circles.

The spectrum fee is an annual charge based on the size of the spectrum held. The charges are based on a percentage rate of AGR where the rate increases depending on the spectrum held: 4.4 MHz carries a 3 percent charge, 4 percent for 6.2 MHz, 5 percent for 8 MHz, 6 percent for 10 MHz, 7 percent for 12.5 MHz, and 8 percent for 15 MHZ. The weighted average rate for GSM operators is about 3.75 percent. For 3G spectrum holders the charge is 3 percent of AGR or the 2G spectrum charge, whichever is greater, if a company also holds spectrum for GSM.

A universal service policy is in place to ensure that remote rural telephony is developed. Rural areas are largely serviced by BSNL, as the revenues are not large enough to cover the fixed costs in many of these areas. Previously, the rural fixed costs were cross-subsidised with revenue from other BSNL local and long distance calls.[19] However, due to increased price competition, cross-subsiding is not possible and consequently an Access Deficit Charge (ADC) was levied on the private players to fill the deficit.

ADC was paid on all incoming international calls and all outgoing calls from mobiles. These charges have been lowered over time on international calls, and were removed from domestic calls in 2008. The ADC is replaced by the USL part of the licence fee.

The money raised by USL is meant to be channeled back to the sector though the Universal Service Obligation Fund (USOF). Firms can apply to the fund to get support for rural telecom infrastructure projects. In the beginning, only basic telephony services provided through either wire line or fixed wireless were eligible. In December 2006 the Indian Telegraph Act was amended, enabling USO support to all types of telegraph services, including wireless, instead of just supporting fixed service roll out. Accordingly, wireless infrastructure is now eligible for support from the USOF. However, disbursement of funds has been slow. In fact the USOF has accumulated funds faster than it has disbursed them, raising questions about the size of the levy as well as the speed of use. The unutilised fund is estimated to be about ₹250bn in 2011, and expected to increase to ₹360bn over the next few years.[20]

Tariff Policies

A 'calling party pays' policy was introduced in 2003 to enhance price transparency and protect consumers against hikes in prices. In this policy the receiving party of phone traffic does not pay for the traffic. However, the operator who terminates the call has to pay a fee to the network receiving the call (see discussion on interconnection charges below), and this termination cost may be borne by the calling party. Forbearance of tariffs is the main policy; hence firms are free to set most prices on their services. However, there are some restrictions on tariffs. Existing tariff regulations can be divided into three categories: rural fixed line services, national roaming services, and leased circuits. TRAI offers a regulated tariff package for rural fixed lines. For the other two categories, TRAI sets maximum prices.

Under current rules for roaming tariffs, a Mobile Network Operator (MNO) can charge a maximum of ₹1.40 per minute for a local call for a mobile user traveling outside his home network, while for STD calls, the limit is ₹2.40 per minute for all outgoing, and ₹1.75 per minute for all incoming calls while on roaming, irrespective of the distance. However, existing rates are far lower than the caps imposed by TRAI. The tariff wars that gripped the sector in 2009 also resulted in some operators slashing their roaming tariffs.

In addition to end-user tariff regulations, TRAI regulates interconnect charges between MNOs. Before 2004 interconnection agreements were not regulated. From 2004 and onwards effective interconnection regulation was in place with a maximum price on interconnect usage. For local calls the charge is

20 paisa per minute, for long distance domestic and international the charge is 65 and 40 paisa, respectively. However, operators are free to set tariffs on termination to their own users, and the cost for users may be different than the interconnection charge.

Other Regulations

The implementation of number portability took place across India in the beginning of 2011. This will reduce switching costs for users and increase competition further. While the net impact of the policy is likely to be felt in a few years, the initial casualty has been the BSNL.

MVNOs are, in practice, allowed in the telecom sector. TRAI recommended MNVO entry in 2008, but its introduction was stalled by DoT. However, the case of Virgin Mobile forced DoT to speed this up. The Telecom Commission cleared the proposal to allow MVNOs in 2009. MVNOs need to pay a fixed fee to obtain an entry licence for each circle. MVNOs and MNOs are free to engage in any agreement regarding interconnect prices and traffic loads. MNOs are not required to let MVNOs use their spectrum. MVNOs are indirectly levied on the spectrum charge through the MNO used for traffic. The MNO either pays charges as given by the AGR of MVNO, or the MNO is taxed on payments from the MVNO.

Analysis of Telecom Regulations in India and Optimal Policy Choices

Spectrum is a natural resource needed for operators to transmit calls and other data traffic using wireless technology. The right to allocate spectrum is with the government. It is a given that wireless networks need spectrum, and since spectrum is a scarce resource it is imperative that its management and distribution should be predictable and transparent and should promote efficiency in usage. Spectrum is limited due to constraints on the bandwidths practical for usage in the telecom sector. A large part of this bandwidth is in use for other purposes than the telecom sector, such as military communication. A shortage of spectrum may raise operator costs and hurt expansion. It may also lead to higher user prices, and prevent the deployment of more powerful technologies.

Uncertainty with regard to how much spectrum capacity will be available for telecommunication in the future may reduce investors' confidence in a business where huge up front investments are required. For investors to make irreversible investment in the sector, their prospects with regard to the scale of business are essential. Therefore, it is potentially of great social value to increase the supply of spectrum available for mobile communication, by reallocating spectrum rights to the extent possible from non-commercial players, including the defense-sector, to commercial firms.

In an optimal allocation of resources the marginal return of a resource is equal across firms and regions. Historically, in India spectrum rights have been allocated using administrative procedures, viz. managed auctioning. Spectrum rights have been bundled with licences, and the telecommunication authorities have had considerable discretion in subsequent allotments, which created divergences in the marginal return of firms. As part of the new telecommunication policy, a decoupling of licences from spectrum allocation should take place.

Transparency and the market-based procedures were established in 3G spectrum auctions, but still there is a need to correct the legacy allocations in 2G. For almost all assignments of 2G spectrum, administrative procedures were followed that led to much avoidable controversy. Administrative assignment risks underestimating or overestimating price and is frequently controversial. At present, spectrum for telecom is managed under a quasi property rights regime in which the company that has been assigned the frequency does not have the right to alienate the frequency (except by selling itself along with the frequency, if approved), i.e. spectrum trading is not allowed. All these issues are addressed in TRAI's recommendations to DoT, but the recommendations have to be ratified before they translate into policy.

Inefficiencies caused by the 2G spectrum allocation mechanism

The administrative allocation of licences on firms rather than a market-based system, together with restrictions on second hand markets of licences as well as on M&As, is likely to lead to a sub-optimal allocation of resources. The main purpose of a market-based system like auctions for the allocation of licences on firms, are twofold. First, as firms compete for licences, the firms with the highest willingness to pay for the licences will get them. These are typically the most efficient firms. Hence, the auction ensures an efficient allocation of licences on firms.

Second, a market based system with auctions ensures that the rents associated with the scarce resource, viz. spectrum, are allocated to the government, which can use the revenues to reduce other taxes.[21] An open first-price auction with a given closing time is a typical auction form used by regulators across the world to extract surplus from spectrum allocation.[22] A market based system of allocating spectrum is also less vulnerable to corruption. The obligations are determined *ex ante*, compared to the present system, where authorities have discretion that may be used to extract surplus.

If, by contrast, the licences are allocated administratively on firms, there exists no mechanism that ensures that the most efficient firms get the licences. Hence, we may get into the unhappy situation where efficient and inefficient firms get the same amount of spectrum (for a given size), which leads to lower quality on the services than could otherwise have been obtained. In addition, if the cost of acquiring licences is low, the rent associated with the spectrum is allocated to the licencee. Hence there is a risk that too many firms may enter the market, thereby reducing the spectrum available for each firm. As there are economies of scale of using the spectrum up to a certain point, this may lead to severe inefficiencies (please see the discussion of truncation inefficiencies below). The inefficiencies thus created are further amplified by the fact that the licence (spectrum) fee that firms pay varies between users within the same area. If firms pay different fees for using the spectrum, the marginal value of spectrum is likely to be higher in firms that pay a high fee, than in firms that pay a low fee. Hence, the allocation of resources is distorted.

Box 10.1: 2G Spectrum Scam and Supreme Court Verdict

In 2007-08, the UPA government issued 122 new telecom licences. In the process, several rules were violated and bribes were paid to favour certain firms. According to the report of Comptroller and Auditor General, several licences were issued to firms with no prior experience in the telecom sector or were ineligible or supressed relevant facts. The violation cost the exchequer US$39bn loss in revenue. The Telecom Ministry's process of issuing licences lacked transperancy and was undertaken in an arbitrary, unfair and inequitable manner.

All the speculations of profit, loss and no-loss were put to rest when on February 02 2012, the Supreme Court of India (SC) delivered the judgement. The SC declared the allotment of spectrum as 'unconstitutional and arbitrary' and quashed all the 122 licences issued during the tenure of A Raja, the then Telecom Minister, the main accused in the 2G scam case. The SC's stinging judgement against the government in this scam case is an extermly significant by the country's highest court to curb the corrupt nexus between and politics. Aside from its impact on the major telecom players, the SC verdict is a measure of how far-reaching the 2G scam's fallout is on the political economy of India.

Source: Various newspaper articles

As pointed out earlier, SLC implies that if a firm recruits more subscribers, it is awarded more spectrum. However, the number of subscribers does not necessarily follow usage. This gives rise to skewed incentives for the companies, as they benefit from getting a large customer base with a low average usage level, which may have accentuated the urban-centric wireless penetration and growth that India has seen till date, and poor demand for rural spectrum. The allocation of spectrum rights in turn impacts firms' incentives to invest in infrastructure. To some extent infrastructure investments and spectrum are substitutable. Lack of frequencies can be compensated for by a denser distribution of base stations. Hence, better allocation of spectrum may help firms economise on investments in the network, and thereby produce their services more efficiently and cost effectively.

Company Structure

As pointed out above, a problem with an administrative procedure for allocating spectrum, with low up-front payment, is that the rent associated with the scarce resource spectrum will be allocated to the firms. As a result, there is likely to be too much entry in the market compared with the socially optimal level. One of the main challenges relates to company structure. There are presently a large number of companies in each circle. A large number of competitors mean that competition is fierce, which is good for consumers. Due to scale economies and network externalities, there is a trade off between the number of firms and competition on one side, and scale economies on the other.

Hence, in most countries, there are restrictions in spectrum auctions regarding how much of the available resources could be granted to any one firm. Many countries, with populations comparable to a single circle in India, have aimed to have 3-4 competitors in the market, which is believed to provide a good balance between scale economies and competition. However, there is no clear consensus on the optimal number of operators.

However, a market share of more than 35 percent may reduce competition in the market significantly. This should be considered both in the initial auction of spectrum and in the second hand market for spectrum. It is recommended that regulators should not decide upon the exact number of operators in each circle in India. Rather, regulation should limit itself to ensure competition in each circle by setting a maximum market share of about 35 percent and a maximum spectrum held by each operator of about 25 percent.

Different forms of infrastructure sharing should also be on the agenda. If firms share infrastructure and spectrum management, economies of scale can be exploited, while keeping the level of competition high in the retail market. The opening for MNVO entry in the market may also facilitate both high competition and the utilisation of scale effects. In view of the international debate on this issue, it seems that company structure in India is far too fragmented, and that consolidation is needed. It is extremely important that a consolidation process be market based.

Trunking Efficiency and Scale Economics

Closely related to the inefficient company structure is trunking efficiency. Trunking efficiency is one of the important sources of scale economics in mobile telecommunications.[23, 24] Trunking efficiency is related to how much traffic a given bandwidth of spectrum can support. If the amount of spectrum allocated to an operator increases, the operator can uphold more traffic by a greater proportion than the increase in spectrum, i.e. traffic capacity per MHz increases. More spectrum allows an operator to reduce costs by supporting more traffic given the number of base stations (cells) or by having a lower number of base stations given traffic.

Spectrum efficiency reaches saturation at about 2x12 MHz for an operator.[25] When allocated spectrum exceeds that point, efficiency does not improve significantly with increased spectrum. The average spectrum allocation per operator is about 2x5.5 MHz. Significant gains can be achieved by letting operators utilise larger shares of spectrum. For example, an operator with 2x12MHz can carry 50 percent more traffic per MHz than an operator with 2x6 MHz. The typical international allocation of spectrum to operators varies between 2x15 MHz and 2x30 MHz. Allowing Indian companies to utilise spectrum on the international average may reduce costs in the telecom sector by more than 20 percent.

The Role of Second-Hand Markets

An inefficient initial allocation of spectrum on firms may not lead to large inefficiencies in the end if spectrum can be reallocated later on through spectrum trading. If there are well functioning 'second hand' markets, then spectrum can be allocated to those firms that have the greatest willingness to pay. Thus, even if the initial allocations of spectrum and licences are inefficient – either due to administrative discretion, or because different firms were charged unequal prices for scarce resources – if spectrum resources can be traded in a well-functioning second hand market, the final allocation will be efficient.

Unfortunately, there is no second hand market for spectrum rights in India hence this channel to obtain efficiency is blocked. One implication of the regulation that firms are required to return their licences to the authorities if they do not use them, is that inefficient firms have incentives to stay in the market for too long. If firms are awarded scarce resources, for which the alternative value exceeds the firm's return from using the resources internally, and these resources must be returned without compensation in case the firm is liquidated, an option value associated with staying in the market is created. This is an obstacle to a necessary restructuring process.

Consequently, current regulations on spectrum resale impair the efficiency of administrative allocations even further, instead of mitigating them. As a consequence, the shadow value of available spectrum increases, delaying new investments and the entry of new firms. It is, therefore, recommended that the spectrum sharing as proposed in the NTP 2011 be allowed at the soonest.

In the absence of second-hand markets for licences, M&As might, in principle, improve the allocation of spectrum. Firms that initially have been awarded scarce resources, but have a low internal income potential from the resource, are potential candidates for acquisitions by firms with a higher income potential. In principle a well-functioning market for ownership rights may also correct for initial misallocations. However, M&As are restricted in India and must be approved by the authorities.[26]

The analysis so far indicates that the combination of administrative procedures for the allocation of spectrum, no second-hand markets for licences, and restrictions on M&As of firms is potentially detrimental to efficiency. Due to the restrictions on spectrum trade and on the market for ownership, there is a risk that initial misallocations become persistent. Thus at the present stage, liberalising the market for licences and spectrum, and removing the legal constraints on M&As may substantially improve the efficiency of the telecommunications market in India.

In addition, administrative discretion may give rise to opportunistic behaviour, rent seeking and corruption, with the risk that huge values are extracted by those who manage to get access to the valuable scarce resources. It is also a concern that the authorities may give away valuable resources that might otherwise have given the government substantial income. This aspect is particularly problematic since the government charges fees that are potentially distortive. Efficiency would be improved if the fee system were partly replaced.

To summarise, it is recommended that spectrum is allocated on firms through an open auction mechanism. This will ensure an efficient allocation of spectrum on firms, and imply that most of the rents associated with the scarce resource go to the government coffers and not rent seekers. Alternatively, one may use a system of licences that is enforceable and not prone to manipulation. For this to work smoothly, licence fees should be uniform per unit of spectrum in each area. If firms only pay for spectrum through licence fees, the fees should be tuned in order to avoid excessive entry and problems with trunking inefficiencies. In addition, the licences should be tradable and M&As should be allowed as long as competition is effective.

There are, and will continue to be, rural areas in India where investments are low or absent. The reason is that the purchasing power and/or density of potential customers are so low that firms cannot generate enough revenue to cover investment costs. Universal service policies can ensure that underdeveloped areas within each telecom circle get mobile phone coverage. One approach is to subsidise investments in these areas. However, it is difficult to identify which areas to subsidise, and the appropriate subsidy level is hard to measure and may vary depending on the area.

Another approach is to give one firm an exclusive right to operate in an identified area, on the condition that a given level of coverage is reached within a certain time period. A third suggestion has been to auction of the urban spectrum and give away the rural spectrum free, or bundle urban and rural spectrum and auction the bundled product. These rights should be auctioned among operators that hold spectrum in the respective circles. In some cases the outcome may be a negative price, in which case the government should compensate the operator for developing phone coverage (viability gap funding).

Fiscal Aspects of the Regulatory Regime

One of the major grounds for introducing the NTP 1999 was the inability of operators to honor their (exorbitant) fixed licence fee commitments under NTP 1994. Their start up costs was high because of huge capital investments, while their revenue expectations from the fledgling Indian market were belied, resulting in serious financial difficulties. Currently, operators are charged lower licence fees than in 1999. The percentage of AGR payable as a licence fee varies by service and by service area. From a high of 15 percent in 1999, the prevailing rates are 10 percent or lower. TRAI is of the view that differential licence fees gives rise to arbitrage opportunities, citing evidence in this regard.

Most major telecom service providers are integrated, and provide various telecom services through multiple licences. It is possible for integrated operators to use common resources to provide various licenced services. For instance, there could be cases where ISP services are provided using spectrum allocated under the CMTS/UAS Licence. An effective licence fee regime should be simple, easily verifiable, ensure a level playing field, prevent revenue leakage and should have built in safeguards against possible misuse. Accordingly, TRAI has recommended that there should be uniform licence fees across all telecom licence and service areas.

International best practice recommends simple levies that are enforceable and less prone to manipulation. Apart from being high, government levies in India have been asymmetric across functions and services, which is a potentially distorting behaviour. A uniform structure would end this perverse incentive. As mentioned, historically, revenue sharing was introduced to mitigate the problems of firms facing credit constraints. In principle, the revenue sharing system mimics a spectrum leasing mechanism, where firms, instead of paying up front as in an auction, pay an annual fee per spectrum unit, though with an implicit insurance mechanism that eases payment obligations if revenue goes down.

Credit constraints are probably no longer an essential barrier to entry. The market has matured. Furthermore, revenue sharing is potentially distortive, particularly in emerging markets, though not to the same extent as in a market with a 100 percent penetration rate. In a mature market with a 100 percent penetration rate, revenue sharing is not necessarily associated with dead weight loss. If costs are mainly fixed, a tax on revenue replicates a cash flow tax, which is neutral. Certainly, for a given tax rate, the effective tax rate is much larger with a revenue tax than with a cash-flow tax, since the tax base for the latter is the difference between revenues and costs. Hence, the revenue tax should be lower than a cash-flow tax or a tax on profit.

However, in a growing market, revenue sharing can potentially create a severe source of distortion, such as delays in marginal markets where firms have to invest. A profit-based tax system or a cash-flow tax is still efficient. Although higher incomes from the investments are taxed, the cost of the investments is deductable. In effect the government finances the same share of the investments, in the form of lower taxes, as they receive from the return. As a result, a profit-based tax system does not reduce investment incentives. However, this is no longer the case with a revenue tax, since the costs of the investments are not deductible.

Hence the firms finance the entire investment cost, but receive less than the full return from the investments as part of the return paid to the government as a revenue tax. Hence, investments that are socially efficient and privately profitable without revenue taxes may be privately unprofitable with such taxes. The same kind of distortion arises with regard to decisions to invest in and develop new services. Typically these may require essential initial investments which are not deductible. Thus, there is concern that, according to recent news, the government has proposed to continue the revenue sharing arrangements.

If some firms are credit constrained while others have 'deep pockets', there is a risk that the initial allocation is not necessarily efficient. Obviously, revenue sharing mitigates this problem, but there is a risk that new severe inefficiencies may be created. In our view, problems associated with credit market imperfections should be dealt with by other means. One possibility is discriminatory auctions, discriminating in favour of newly established or local firms. Another is to link the auction mechanism to a credit mechanism, such as deferred payments or other credit arrangements. It is nonetheless essential that the arrangement does not negatively impact incentives to invest.

It may be noted that the distortions created by the revenue tax, to some extent, go in the opposite direction of the distortions associated with low licence fees. Revenue taxation reduces the incentives of firms to go into new markets, while a low licence fee increases the incentive to do so. Hence revenue taxation will be more harmful in a system where licences are auctioned rather than given away. However, the distortions do not cancel each other out. Revenue taxation harms firms with high revenues, while the gain from low licence fees benefits firms with low and high revenues equally. Therefore, a combination of the two will benefit low-revenue firms (likely to be inefficient firms) more than high-revenue firms.

A better approach to taxation is to abolish the revenue sharing system and get tax revenue from the telecom sector through a more general corporate tax system.[27] A tax on net profits, with deductions for items like capital depreciation and investments, is less distortive than a revenue taxation approach.[28] However, the tax revenue from net profit taxes is low in India. To derive tax revenue, most service sectors are subject to a sector specific service tax. This service tax is set to be harmonised across sectors in 2012 by introducing a general goods and service tax (GST). To derive tax revenue, the telecom sector can be taxed as per the average GST rates.

One aspect of the distortions associated with taxation is the phenomenon of 'regulatory truncation'. Regulatory truncation has been a concern in the telecommunications markets worldwide. Conditional on success, firms pay high taxes or are regulated on prices. If the same firms must take all the losses associated with a possible downside, the *ex ante* expected return may be very low. In India, price regulation is seemingly low powered, there is strong competition, and consumers enjoy low prices as a result. Hence, the problem with regulatory truncation in India is probably not associated with price regulation, but with the revenue sharing system. The problem is the following: if the authorities have discretion to alter fee levels, there might be a risk that the tax rate is increased, given that the companies' rates of return end up being high. It is tempting to increase the tax rate if surpluses are huge.

Furthermore, in the political process, high returns may signal that the initial payments were too low. An increase in the sharing rate can then be justified as a mechanism to compensate society for initial payments that were too low. The problem is that this is *contingent* on a particular *ex post* outcome – high profits. Thus, *ex ante*, investors take into account that the upside is taxed with no deduction for the downside – an element of truncation.

The signaling mechanism is an important issue. In the recent debate, it has been argued that the government has granted firms licences and spectrum at too low a price. However, it is also possible that the telecommunications market in India has experienced greater growth and higher profit rates than expected when investments were sunk. Thus, it is a concern that there is a specific tax system for telecommunications companies. As discussed in the next section, the problem of 'regulatory truncation' would virtually vanish if the sector taxation system were abolished and replaced by the ordinary corporate taxation system.

As with revenue taxation, the distortions from regulatory truncation may be reduced by the fact that licence fees are low. Hence regulatory truncation may be a more severe problem if spectrum rights are auctioned off, rather than allocated at a low or non-existent price. However, the distortions do not cancel each other out. The low licence fee may give the firms strong incentives to enter the market, but weak incentives to invest in new technology once they are in. If a sector specific taxation system is continued, it should be replaced by a net tax, a profit tax. As mentioned, the gross tax implies that the effective tax rate becomes unpredictable and highly distortive. A well designed net tax system is more predictable, and more efficient. However, for a given tax income, the tax rate must be much higher.

Transparency and Credibility

The final recommendation is with regard to a controversial topic, the credibility of the institutional system. However, recent debate about irregularities in administrative procedures regarding the distribution of licences and spectrum, underlines the importance of this problem. The prevailing multi-institutional approach to telecom regulation is vastly different from the single institution framework that existed when the first NTP was formulated in 1994. The new institutional framework reflects, in part, the greater complexity in telecom service provision, and therefore the need to create institutions that are specialised. In part, it also reflects the government's objective of ensuring transparency and fairness in the functioning of the regulatory regime as a result of private sector participation.

The importance of transparency and credibility in telecommunication policy, which is an issue in all countries, needs to be emphasised. Firms have sunk huge sums of money into infrastructure and customer bases. These investments have low alternative values. Thus, firms facing higher taxes might find it profitable to continue business, as the present value of continuing operation can be positive despite a negative return, if historic investments are included. Since telecommunication investments to a large degree are already sunk costs, this effect might be particularly strong. This also implies that firms that have already made considerable investments are typically willing to pay a high price to be granted the right to continue operation – they are locked in. But unless the incentive and regulatory structure is right, the incumbents will not invest in adequate infrastructure and technology upgradation, which will over time adversely affect the consumers.

Also, they are extremely vulnerable to the credibility of the system. If the government can not credibly commit to not extract *ex post* surplus, the firm's willingness to pay for spectrum, and to commit sunk costs in infrastructure investments, new services and customer bases, may crumble. However, it is possible to build up credibility through institutional reforms. The following needs emphasis:

1. The Ministry of Finance/Parliament should be in charge of the fee/ taxation system. There is a problem if the line ministries have discretion in these matters, in particular if the same institution or people are also involved in the process of auctioning spectrum, formulating policies and monitoring implementation. There should be no payments of any kind from the companies to the telecommunication department; all fees, taxes, and initial payments should be transferred directly to the Ministry of Finance.
2. The telecom sector specific taxation system should be abolished and incorporated in a more general corporate tax system, as in the GST. The economic value of the spectrum should be channeled to the government instead, through up-front payments in spectrum auctions. As emphasised above, it is much harder to build up regulatory credibility in a sector where investments are sunk costs and total costs are to a large degree fixed, than in sectors with highly variable costs.
3. Rules not discretion. Recent debates illustrate the risk that politicians adjust effective tax rates ex post, after observing how successful the companies have been. This may have a negative impact on firms' willingness to invest in new services and new infrastructure. It is therefore important that the authorities commit to certain rules.

   Introducing these institutional reforms will enhance transparency and credibility in the telecom market and may improve investment incentives and market efficiency.

Conclusion and the Way Forward

The telecom sector in India is featured by fierce competition for customers and low call rates. However, there are some important market and regulatory characteristics that give rise to inefficiencies in the sector. Addressing these characteristics may improve the social value of telecommunication services in India.

This chapter concludes that the most efficient way to allocate new licences is to have open auctions, as long as the number of licences offered is not so large that it hinders trunking efficiency. Auctioning licences will lead to more efficient spectrum allocation across firms. In addition, the economic rent associated with the spectrum will be allocated to the government. Furthermore, today's system with administrative discretion gives rise to opportunistic behaviour like rent seeking and corruption, with the risk that huge values are extracted by those who manage to get access to this valuable resource.

Alternatively, one may use a system of licence allocation that is enforceable and not prone to manipulation. For this to work smoothly, licence fees should be uniform. If firms only pay for spectrum through the licence fee, the fee should approximate the economic value of spectrum, to avoid market fragmentation. In particular, licence fees should be sufficiently high and the number of firms sufficiently low so that trunking efficiency is obtained. At the same time licence fees should not be so high that competition is hindered. Licences should be tradable, and M&As should be allowed as long as competition is effective.

Revenue taxes differ from profit taxes in that costs are not deductible. It is argued that in mature markets, the distortions created by revenue taxes are limited. Revenue taxation may be considered a fee on the use of spectrum that is paid *ex post*, after the spectrum is used. However, they are not equivalent, as more efficient firms with higher revenues pay a higher tax than do less efficient firms. This would not be the case to the same extent if spectrum were auctioned. In emerging markets, where investments are important, revenue taxes dampen incentives to invest. Our recommendation is that the revenue tax is either replaced by a profit tax, or abandoned if the spectrum is auctioned.

Finally, it has been argued that transparency and credibility are key in order to obtain an efficient allocation of resources in the telecommunications sector. It is proposed that 1) the Ministry of Finance or the Parliament should be in charge of the fee/taxation system; 2) telecom specific taxation should be abolished in favor of a more general corporate tax system (the economic value of the spectrum should instead be obtained by auctioning spectrum licences), 3) the sector should be governed by rules and regulations, not by the discretionary actions of government officials, which may open the door to corruption.

Endnotes

1 TRAI Press Release No. 57/2011, released on 8th December, 2011.

2 TRAI Press Release No. 13/2011.

3 TRAI (2010). Certain Issues relating to Telecom Tariffs, Consultation Paper No.12/2010.

4 The Herfindahl–Hirschman index ranges from 0 to 1 and is a measure of the size of firms in relation to the industry. A small number indicates many small firms in the industry, while a number closer to one indicates few firms with large market shares.

5 Malik, P. (2008). Telecom Regulatory and Policy Environment in India: Results and Analysis of the 2008 TRE Survey.

6 Sridhar, V. and Prasad, R. (2011). Towards a new policy framework for spectrum management in India. *Telecommunications Policy* 35, 172-184.

7 Malik, P. (2008). *op. cit*.

8 TRAI (2011). The Indian Telecom Services Performance Indicators. July-September 2010

9 On the other hand, media reports indicate that the recent around 20 percent tariff hikes by telecom firms in the country didn't lead to any appreciable change in the ARPU's realised in 2011-Q3.

10 TRAI (2011). *op. cit.*

11 As recommended by the 1994 National Telecom Policy, the DOT was corporatised in 2000 and restructured into two companies BSNL and VSNL.

12 Patel, U.R. and Bhattacharya, S. (2010). Infrastructure in India: The economics of transition from public to private provision*, Journal of Comparative Economics* 38, 52-70.

13 In 2011, 1 INR was approximately 0.02 US$.

14 Prasad, R. and Sridhar, V. (2009). Allocative efficiency of the mobile industry in India and its implications for spectrum policy, *Telecommunications Policy* 33, 521-533.

15 It has however been argued that inter-circle roaming agreements were allowed for the very beginning, and in 2008, the government also allowed intra-circle roaming agreements. Thus a company that has the licence for a circle, but hasn't installed its network, could start operations by hiring someone else's spectrum. Since then, many telecom companies have used this rule to roll out services. So spectrum sharing is not unknown to the sector; it's just that it's called 'roaming agreements'.

16 Singhal, P. (2011). Telecom sector - On the cusp of consolidation, Business Line, November 15.

17 In a perverse move, factions within the government have sought to disallow intra-circle roaming for 3G services. The TRAI, the law ministry and some

wings of the DoT want these roaming agreements to be declared illegal, arguing that the licence agreements do not allow such sharing of spectrum. Some have even said that this poses a security threat. This is surprising as the current 2G policy allows for both inter- and intra-circle roaming, which facility is used by companies having the licence for a circle but yet to install networks, to start operations by hiring someone else's spectrum to roll out services.

18 It should be noted that private service providers are not allowed to roam on the network of BSNL, which has a near universal coverage citing consequent overloading of network that would adversely impact the quality of service of BSNL's GSM subscribers. There is also the fear that allowing access to this widespread network to competitors would help them to virtually capture the rural market that BSNL has created over the years by more efficient and stronger private sector networks.

19 Silva, H. (2008). *ICT Infrastructure in Emerging Asia, Policy and Regulatory Roadblocks*, Samarajiva. R. and Zainudeen. A (eds). Chapter 10 - Access Deficit Tax?

20 *Times of India* (2011). SPV model proposed to develop rural broadband. *http://timesofindia.indiatimes.com/tech/news/telecom/SPV-model-proposed-to-develop-rural-broadband/articleshow/9825234.cms*

21 I lling, G. and Kluh, U. (2003). Spectrum Auctions and Competition in Telecommunications, London U.K. The MIT Press.

22 Gruber. H. (2005). The Economics of Mobile Telecommunications. Cambridge University Press.

23 Prasad, R. and Sridhar, V. (2009). *op. cit*

24 Sridhar, V. and Prasad, R. (2011). *op. cit.*

25 Plum Consulting (2008). An assessment of spectrum management policy in India.

26 Paving way for consolidation, in late December 2011, the Telecom Commission accepted liberal norms of upto 35 percent market share for M&As in the Indian telecom sector. TRAI had recommended that if an entity, post a merger or acquisition, has upto 35 percent market share, it would be considered in 'green line' or safe harbour. Cases above 35 percent but less than 60 percent would be referred to TRAI, which will carry out detailed examination to ensure that there is no market dominance abuse. On spectrum sharing too the telecom commission has accepted TRAI's recommendations which says that spectrum sharing would be permitted between any two licencees holding spectrum subject to the condition that the total bandwidth would not cross the permissible limit (not exceeding 25 percent of the total spectrum) under mergers. Now the government has to take a decision on telecom commission's recommendations.

27 Hausman, J. (1997). Valuation and the Effect of Regulation on New Services in Telecommunications. *Brookings Papers on Economic Activity: Microeconomics*, 1997, 1-38.

28 Hausman, J. (1998). Taxation by Telecommunications Regulation. *Tax Policy and the Economy*, 12(1), 29-48. 1998.

CHAPTER 11

Epilogue: The Unfinished and Urgent Agenda

Pradeep S Mehta

This is the last chapter of our third biennial report on the State of Competition & Regulation in India. The essence of the report is captured in the Introductory Chapter, while the Epilogue speaks about crucial things which can help improve the state of competition and regulatory architecture and the economic governance system in the country.

When I sat down to write the epilogue of our third biennial report on the status of competition and regulation in India (2011), there was a total power blackout for a day each in North and Eastern India (July 30-31, 2012) due to two grid failures. The second thing which happened is the change in guard – the reformist scholar-politician, Dr Veerappa Moily was given additional charge of Power Ministry in the Union Government and his predecessor: Sushil Kumar Shinde was shifted (promoted as some say) to the Home Ministry. One wonders what Dr Moily can do, given the mess that our power sector is in. But given his reformist zeal, one can definitely say that he will put in his best. The difficulty is that power is in the concurrent list, i.e. both Union and state governments have shared responsibility to run it. The efforts to deal with concurrent issues (not only power) by the Union Government are also mortgaged to increasing demands on federalism made worse by the coalition calculus.

The Most Critical Sector: Electricity/Power

In spite of various carrots and sticks over the past several years, states have not yet reformed the electricity sector, particularly distribution networks. Thus, they have abdicated their responsibility to reform and get us out of the power famine. The above-mentioned incidents of grid failure happened due to over withdrawal of power by some states due to increasing demand and poor supply. The reasons for this sad state of affairs are that there are information asymmetries and market failures in the system (the two critical ingredients for independent economic regulatory regimes). In

2003, we adopted a new and modern Electricity Act, which has dealt with these issues, so that we can get a better grip on them. Alas, states have not followed the new law either in letter or spirit.

One requirement under the Electricity Act, 03 is that there have to be really independent and competent regulators, so that corrections in the system can be carried out without fear or favour. Alas, most states have failed in establishing really effective and independent regulators and done so merely in a token fashion to comply with the law. Both 2007[1] and 2009[2] status reports on Competition and Regulation in India dealt with the electricity sector; it seemed there has been negligible progress over the last five years in this sector.

In the epilogue of the 2009 report, I wrote: *"The problem is one of poor implementation/use of regulations/norms/rights/facilities that are already in place – open access facilitation that is required of ERCs; selection of regulators through an independent and unbiased process; the rights of ERCs to raise revenue through levy of license fees, regulation fees etc. which, in turn, stimulates functional autonomy; payment of subsidy amounts by the state government in advance to distribution companies; and avenues for consumer participation provided by ERCs".*

Open access to promote competition is still lagging, and in spite of the legal mandate, it has not yet been implemented in most states. The only exception is Navi Mumbai in Maharastra, where open access is available to consumers even below the benchmark of one megawatt. Consumers of Tata Electricity can switch to Reliance network and vice versa. This has happened due to an enlightened regulator who is actually working on the mandate of the Electricity Act, 2003.

Among others, the Gujarat regulator is quite effective while most of the others are just functioning without making any substantial difference. The problem is that most of these regulators are selected by a committee comprising of bureaucrats who in turn recognise only other bureaucrats, and all of them are retired and seeking sinecures.[3] By virtue of this distorted practice we land up with regulators who will not rock the boat, or get kicked out of their cosy chairs, and lose red beaconed cars and government quarters.

The regulators are not allowed to raise their own revenues, and cannot even direct the government to pay off the subsidies to the bleeding discoms. Consequently, the tariff determination process is distorted. In any event, tariffs cannot be fixed by the regulator independently and they are guided by the state government which is driven by populism.

Coal Sector, the Black Gold and Essential Input

It is not only the distribution sector which needs to be reformed but also the coal sector, which is the main fuel for most of the power generating plants (estimates: 84 percent). This sector is also in a mess, and partial deregulation (allocation of coal mines for captive power plants) without following due process is mired in controversies, other than environmental issues.

The government has proposed an independent coal regulator but one is worried that such regulatory initiatives are often held in scorn by several as a 'passing the buck' exercise and transferring some responsibilities to an un-empowered regulator. Such a body will be most likely headed by a retired IAS officer as this has become the order of the day. His or her only claim to domain knowledge will be that s/he has worked in the coal ministry at some level in the past. Quite often it will be a malleable bureaucrat and that's the reason that Dr Moily in his ten point memo to the PM on eradicating corruption included the stoppage of sinecures. In any event, do we need another regulator, particularly for a goods sector, when the regime is used mainly for service sectors. We and the Planning Commission have long argued for composite regulators, which would cover all cognate sectors, such as an Energy Regulator to deal with coal, electricity and fuel. Alas, once again, politics trumps economics, as each of the line ministries would like to have a subject regulator which can serve as a handmaiden of the ministry.

The coal sector is already besieged by corruption scandals, and the power sector becomes an unwilling victim. In order to ensure a cleaner allocation system and address corruption, in 2011, the government had established the Committee on Allocation of Natural Resources (CANR) headed by Ashok Chawla, the then retired Finance Secretary and now Chairman, Competition Commission of India. Its remit covered coal, minerals, petroleum, natural gas, spectrum, water, land and forests. The CANR's membership included Secretaries of all the ministries and Planning Commission other than the two leading business chambers. It had made several crucial recommendations, within a record 100 days, to clean up the system. But there was resistance from the coal ministry along with objections from the mines and petroleum and natural gas ministries, which are motivated by vested interests, fence sitters and *status quoists*. In fact the report has also not been made public, such is the pressure. The issue came up during the parliament session in August, 2012 but not much has progressed since.

Power sector is one of the key infrastructure sectors at the core of all reforms and its poor state also affects inflation and growth adversely by its various downsides, including falling industrial production, rotting

vegetables and fruits, human needs and safety and so on and so forth. It is therefore, that there is an urgent need for the Government to address reforms in the power and coal sectors on a war footing. Secondly to perish the idea of a coal regulator and create a composite energy regulator and appellate body which will oversee coal, electricity and all fuels under one roof.

Regulatory Architecture: Aiming for the Good, Not the Best

The CANR had also dealt with reforms in our regulatory architecture as a cross cutting issue. It did not frown on the issue of sinecures and rather prescribed several well-meaning recommendations:

a) on appointment and removal of regulators to be distanced from the line ministry and entrusted to a statutorily defined body (without going into the details of the same);
b) for staffing, to create a specialised cadre of regulators (a standing recommendation of the administrative reforms commission also);
c) on funding directly through a charge on the budget directly rather than through the line ministry;
d) higher compensation to the regulators, which had already been agreed to and implemented as a consequence of the 6th Pay Commission, and
e) curbing the power of issuing directions to the regulator unless approved by the minister.

The last is a bit of an incongruity considering that the first recommendation speaks about distancing the regulator from the line ministry, and hence what did the CANR have in mind when making this recommendation or did it mean that the Cabinet Secretariat would have the power to issue directions and that such directives would be issued after the consent of the PM. Importantly, the CANR also brought up a live example from our governance model on arm's length relationship,[4] which is perhaps the only one in our system. That is the Railway Safety Commission reports to the Ministry of Civil Aviation and not the Ministry of Railways. This was done by the British government when they were ruling India. The safety body is also staffed by experienced railwaymen, because they know the system, but these people would not revert to Railways thus ensuring their independence.[5]

The CANR did not address the issue of sinecures, but argued that the staff has to be with domain expertise. Perhaps, the committee did not wish to condemn the practice as that would have amounted to putting an axe on their own feet. In order to curb sinecures particularly against retiring Secretaries being appointed as regulators under the same ministries, the

Planning Commission's Committee on Infrastructure, headed by the Prime Minister himself, had mooted a proposal to ban their appointment for at least two years. Expectedly, the proposal was shot down by a committee of secretaries. Full blown vested interest powers at work, and even though the proposal was mooted by the CEO of the country.

We have been running a debate on this contentious issue on the CUTS FunComp e-groups for long and while the beneficiaries (or their compatriots) defend themselves, several policy honchos are very critical. Even during debates in the parliament whenever such occasions arise, parliamentarians too have condemned the issue of parking spaces or lots for retired bureaucrats.

Yet the practice continues to go on shamelessly without any hiccups. In most cases, it is quite evident that retiring IAS[6] officers get such appointments through the ministers they had served faithfully. Judges are not far behind as they too seek sinecures after – or just before – they retire, and during the last few years ensure that they are not too anti-establishment. Many a times malleable retirees from other services also get such appointments, which is perhaps crumbs being thrown to them, so that they do not feel left out from the gravy train. There are exceptions also, as many retirees refuse sinecure appointments.

In recent times, former Finance Secretary, Sushma Nath refused any post-retirement job. She had also refused an extended retirement age of 62, which is the norm for Cabinet Secretary and Defence, Home and Foreign Secretaries. In two cases: B K Chaturvedi and K M Chandrasekhar had even beaten this ceiling and stuck on for four years, and thus upsetting many in their own services, who could not become Cabinet Secretaries.

Furthermore, all after their retirement, many regulators are not bad and do perform pretty well. However, these are in a minority, particularly those who had joined a constitutional authority. Here let me quote two examples. First, T N Seshan, former Cabinet Secretary, who became the Chief Election Commissioner (the elections regulator) is noteworthy. Though as a civil servant he was known to be sycophantic and pliant, but changed when he entered his new empowered job. He cleaned up the election system hugely and left behind an institutional legacy which continues to function well. The second person is Vinod Rai, the incumbent Comptroller and Auditor General. He has been blazing a trail of exposures which has spurred a huge debate on corruption in the government in the areas of spectrum, coal, PPP projects etc.

Our infrastructure regulatory architecture has evolved in haphazard ways without any coherence. Different ministries drafted their own regulatory laws which inevitably differed from another similar law. Alas, the Law &

Justice Ministry which is required to provide the coherence always fails to do so.

The first such regulatory law was in the area of telecom in 1997. The same was replaced by a new law in 2000. This change was triggered by the rigorous application of the 1997 law by the people in charge, who had a poor appreciation of the political economy. This has always been made worse in our country because of egos of people which counters rational behaviour. A former regulator: Pradip Baijal once publicly said that he is but Joint Secretary (Regulation) in the Ministry, because he has to take orders from the Secretary of the Ministry, even though he is always junior to him when he was in service.

In the case of the first TRAI, removing the earlier chairman and deputy chairman from their posts was not easy. As a consequence the whole law was scrapped and a new one adopted to give the government unbridled powers *inter alia* to sack the head and members of the regulatory agencies. The same provision was then uniformly inserted in all regulatory and similar laws, thus affecting the independence of regulators adversely. These provisions have not been used, but their existence ensures that regulators fall in line.

Other than that, all regulatory laws also have a provision which empowers the government to issue policy directives to the regulator. In theory there is nothing wrong in having such a provision, but in many cases instructions have been issued which crossed any semblance of policy. For example, in one case a State Government Ministry issued a policy directive to appoint a particular person on the regulator's staff, who the Chairman did not want. In the case of sudden rise in air fares by private airlines, when Air India staff was on strike, the Ministry of Corporate Affairs sent a letter to CCI to start investigations, apparently egged by the parliament.

The government cannot really issue such instructions on operational functions of a regulator, which it is expected to do. Though the government could itself be a complainant (informant under the Competition Act), but in our history, albeit empowered, governments have never filed a complaint before such quasi-judicial forums. In any event, the sudden rise of air fares cannot be an outcome of collusion but purely a business strategy decision and parallel behaviour. After all when faced with vigorous competition, airlines do operate on low fares in order to keep their airlines running.

Regulatory certainty is a crucial factor to facilitate investment whether foreign or domestic, and therefore it is important to ensure that we have a predictable legal environment which is transparent and fair. Good regulatory frameworks also provide higher consumer satisfaction.

In order to improve the regulatory architecture and bring in coherence, the Planning Commission has prepared a draft Regulatory Reform Bill, 20**[7] in 2009, following the publication of a paper: "Approach to Regulation of Infrastructure"[8] in 2008 at the behest of the Prime Minister. The draft bill has undergone much debate, but is yet to be turned into a law. In his Independence Day speech on August 15, 2011, the PM emphasised:[9] "We have no legislation which would enable monitoring of the work of these regulatory authorities and make them more accountable, without, however, compromising their independence. We are also considering enactment of such a law".

At CUTS, we have worked with the Planning Commission closely on this matter for long, but there is no traction because of strong turf issues.[10] This is made worse due to coalition politics, as the Union Government cannot bear on ministries which are under junior partners in the government. The Bill makes an effort at evolving a normative law which can guide ministries to draft and/or amend regulatory laws in their domain to develop a common and efficient framework.

This section requires many recommendations, but we will cover few critical ones:

- ***a) Amend sections in the law which require qualifications such as having worked as a Secretary to the Government of India and also bring a ceiling in the age limit of regulators to 60 years.***
- ***b) The section should necessarily say that half the members, including the Chairman should be from the non-government sector.***
- ***c) Every search and selection committee should comprise of at least half members from the non-government community to ensure that it is non-partisan.***
- ***d) Amend sections governing removal and policy directives in regulatory laws to imbue them with mandatory due process and only in very critical circumstances.***
- ***e) Detach regulators from line ministries and make them accountable to a special parliamentary committee on regulatory regimes, as well as provide their budgets from the treasury directly.***
- ***f) Create composite regulators and appellate bodies for cognate sectors such as energy, transport, finance etc, and thus insulate them from any particular line ministry, but directly accountable to the Parliament.***
- ***g) Create an Indian Regulatory Service which should be kept at par with IAS, so that it can flourish without being suffocated by IAS trade unionists.***

From 'Rent Raj' to 'Resource Raj'[11]

After reforms were adopted in 1990, the licence-permit-quota 'rent raj' was whittled down with several reforms in industrial policy etc, and thus cutting off rents to the polity and bureaucracy. Their attention then shifted to other areas such as natural resources as cash cows where they could extract rents.

Concomitant with the release of animal spirits in our entrepreneurs, our polity too unleashed their animal spirits and got into a high gear to extract high rents. Voluntary and involuntary bribes which used to range in few lakhs now became figures in multiple of crores, which business could afford due to the high profits they could make. The quantum of bribes went up due to simple economics of demand and supply. So, we now have the 'resource raj'.

Crony capitalism and oligarchy have become the order of the day, with economic democracy being given the short shrift. Several big houses became bigger houses (several of their owners also got listed in the Fortune magazine's richest in the world), though many a smaller entrepreneurs also grew along with them as supporting enterprises. The issue has been raised by some parliamentarians, such as Mani Shankar Aiyar, and the Prime Minister too has questioned whether we are encouraging crony capitalism, but there has been no concerted effort to deal with it. Or perhaps the capitalists are so well entrenched like the IAS community that they cannot be challenged or corrected. Big business houses cultivate large number of politicians and bureaucrats who then become sound allies in their exploitative activities.

Scams relating to natural resources started hitting headlines, not only at the Centre but also states. The scams got exposed due to an active Comptroller & Auditor General[12] and an equally active Supreme Court. The government appointed the CANR to deal with the situation as a reaction to curb corruption but did not show any seriousness in following its prescriptions. Like many other kneejerk reactions to hotly debated issues, this too was done in a hurry but when it came to address the recommendations, the government's knees turned weak.

There is an imminent need to address the issues of corruption in our system, and also to promote economic democracy, so that the growth process can be reharnessed. In particular, the natural resources sector needs special attention for reasons mentioned above. Political will is needed to implement the recommendations of the CANR. The first step is to make the report public by putting it out on the Government's website and invite comments on it. This process will help to raise the ante, restore trust with people and investors, and thus add to growth.

Secondly, to build up capacities on auction theory and practice in the country, as most natural resources can be allocated best through auctions or competitive bidding.

National Competition Policy: 2nd Big Wave of Economic Reforms

To ensure fair market processes in government rules covering business operations, one of the recommendations of the draft National Competition Policy (NCP) is to reduce the regulatory burden which would on their own curb corruption and crony capitalism. The other principles of the NCP are to: a) promote competitive neutrality; b) promote an integrated national market including the adoption of GST; c) effective competition rules; d) coherence between competition agency and sector regulators; e) institutional separation between policy making, operations and regulation; f) fair pricing and inclusionary behaviour, and g) third party access to essential facilities.

The idea of an NCP was mooted by CUTS in our 2005 report: "Towards a Functional Competition Policy for India"[13] and reiterated in our "Competition & Regulation in India, 2007"[14] report with a road map. We lobbied the government to start work on it but continued to face insouciance. We did succeed with Yashwant Sinha, Chairman, Parliamentary Standing Committee on Finance who was convinced, and he persuaded the Ministry of Corporate Affairs to take the agenda forward. The Ministry set in motion the process of drafting an NCP in June, 2011. The draft[15] is now ready and under discussions in the Cabinet.

Furthermore, the Committee on NCP and Allied Matters, of which CUTS was a member, also commissioned 13 sector studies to look at how competition impediments affected the sectors.[16] A dynamic minister, Dr Veerappa Moily took on this policy as a crusade and termed it as the '2nd biggest wave of economic reforms after the 1991 reforms'. One hopes that the Policy will be adopted and implemented soon.

To operationalise the NCP, the Ministry of Corporate Affairs has proposed to establish a Cabinet Committee on Competition headed by the Prime Minister assisted by a small Advisory Council headed by the Corporate Affairs Minister. The idea for the PM to head such a body will give it the teeth required to correct competition distortions in the system which can aid economic growth hugely. When Australia undertook reforms through their National Competition Policy in 1995, it added 5.5 percent growth to their economy over time.

The Advisory Group will set in motion assessment of competition impediments in various sectors which will then be required to be reformed. It will create a system to carry out the studies through various agencies, such as the

Indian Institute of Corporate Affairs, policy research institutions like CUTS, NCAER, ICRIER etc. and consultancy organisations.

Competitive neutrality is one important principle of the NCP which many business houses are very keen to see turned into effective policies because they suffer disadvantage due to preferences to public sector undertakings. There are several such examples, which have been captured periodically by CUTS through its Competition Distortions Dossiers.[17] For instance, private sector banks do not get one per cent subsidy on agricultural loans which only public sector banks get.

Another important principle is on separation of policy, regulatory and operational roles in the government. For instance, the government operates the telephone system, sets policies and also oversees the telecom regulator. One glaring example of the intertwined functions which arose in the power grid collapse was that state load despatch centres report to the local electricity boards/companies and hence were not effective. For long, it has been recommended that load despatch centres should be kept out of the control of local electricity companies/boards and thus ensure their independent and effective functioning.

Another important principle of the NCP is to create an integrated internal market. One of the tools to do so is through the adoption of the Goods & Service Tax. This would also need amendments in the Constitution, and in the overall many states are reluctant to agree to this change due to political economy considerations. They are apprehensive that such changes will lead to a reduction in their powers to levy sales taxes and whether the Union government will stand by its commitment to make good any losses that states may incur due to the changes etc.

An Empowered Committee of State Finance Ministers, headed by the Deputy Chief Minister of Bihar: Sushil Modi is working on it, and one expects that the proposal will be implemented soon.

Integration of the internal market is extremely vital for our growth. While India is entering into Free Trade Agreements (FTAs) with several countries, a friend once said that we need an "FTA with India". For e.g. Articles 301 to 304 speak about the issue of a national market, but we still have a fissiparous market in India. Article 307 speaks about establishing a statutory authority to free inter-state trade, so that barriers are torn down.

No less than three high level bodies: Sarkaria Commission (1998), Venkatchaliah Commission (2000) and Punchi Commission (2010) have recommended the same. There are various Supreme Court orders also which buttresses the need. To quote from Venkatchaliah Commission: "*In order that* *the country's competitiveness in trade, commerce and industry is enabled to respond to the increasing pressures of globalisation, it is necessary that barriers to Interstate trade and commerce, particularly, the free movement of goods on the inter-state routes should be progressively reduced with a view to their final elimination. A statutory authority contemplated under article 307 of the Constitution requires to be set-up.*

Punchi Commission took it forward and said: "*We are convinced of the need for such an authority and recommend the setting up of an Inter-State Trade and Commerce Commission under Article 307 read with Entry 42 of List-I. This Commission should be vested with both advisory and executive roles with decision making powers. As a Constitutional body, the decisions of the Commission should be final and binding on all States as well as the Union of India. Any party aggrieved with the decision of the Commission may prefer an appeal to the Supreme Court.'*[18]

Overlap conflicts between competition authority and sector regulators is another difficult reform. This leads to delays and unnecessary friction, as well as forum shopping other than creating regulatory uncertainty. A proposal has been mooted in the NCP for mandatory consultation between the competition authority and sector regulators, on the lines of similar practice in European Union. This was also voiced by the Planning Commission in its Policy Document: Inclusive Growth which was adopted by the National Development Council in December 2007 and also featured in a recent study undertaken by CUTS, "Harmonising Regulatory Conflicts."[19]

However, due to turf issues many ministries such as telecom and finance are reluctant to agree to this proposal, and wish to protect their own domain on competition issues, particularly merger regulation. One cannot shrink the role of the CCI and thus adversely affect the integrity of the economic governance system in the country.

A Group of Ministers has reviewed the proposals and on August 21, 2012 recommended that CCI will have oversight of mergers in all sectors and that there should be mandatory consultations between the CCI and sector regulators wherever there is an overlap.[20]

In August, CUTS has launched a project to study reforms required in three sectors: electricity, pharmaceuticals and agriculture marketing, so that there is better competition and thus increased revenues. Termed as National Competition Policy and Economic Growth in India (ComPEG),[21] the project will develop a methodology for undertaking similar studies in other sectors.

The National Competition Policy and its recommendations need to be implemented soon and the implementing institutions properly empowered and resourced to carry out competition reforms.

Article 307 of the Constitution has to be operationalised and an Interstate Trade & Commerce Commission be established as already proposed by several commissions so that internal market reforms can bear fruit.

Cutting Down Regulatory Burden: Cross the Red Tape Rubicon

The Cost of Doing Business reports done by the World Bank/IFC[22] have been regularly tracking the problems being faced in starting and running a business in large number of countries. India has been benchmarked at one of the worst countries. We are at 132 in 183 countries. We are at the lowest rung in terms of getting construction approvals (181) and in enforcement of contracts (182). Construction approvals are handled at the municipal level and there is institutionalised corruption. Mumbai launched an online approval system but even that was overcome by the corrupt *babus*. Enforcement of contracts is due to the lethargic and corrupt court system in India and the absence of alternate dispute settlement system. Efforts to ensure reduction in time taken in courts are going on but the lawyers lobby will scuttle them, as the *babus* in municipalities have done, because delays means more money for them.

In an interview to *Hindustan Times* in July, 2012, the Prime Minister, soon after he took over the Finance Ministry[23] portfolio temporarily, called for unleashing animal spirits to take the nation to newer heights and promising *ad nauseum* to create transparency and cut down corruption. That can be done only if the obstinate animals imposing irrational regulatory barriers are bridled, if not put into stables forever.

Other than unshackling enterprise, cutting red tape also attacks corruption systematically. A recent survey by Regus showed red tape as an important factor of business perceptions (38 percent) afflicting growth. However, political instability (58 percent) was the most worrisome factor, followed by inflation (41 percent). Wonder what the government can do about the political instability, but it can certainly target inflation by — among other measures — curbing the fiscal deficit which is unbridled.

Controlling fiscal deficit was one of the five challenges identified by the PM in his interview. Other challenges to promote inclusive growth include: clarity in tax matters, revival of the mutual fund and insurance sectors, clearing a backlog of FDI proposals, and boosting infrastructure. He added that he wanted to show that his government would be fair, and that he was also keen to cut red tape. "We will…work towards improving the response time of government to business proposals, cut down infructuous procedures, and make India a more business-friendly place".

At the macro level, speaking about swift disposals of business proposals needs much more than tautology. We have been there, and we have heard it before, several times, but things move at the same pace as they always did. Procedures are the bane, because everyone wants to be more cautious than the man who stops when a cat crosses the road. Let's take the issue of FDI in pharma, which is a union subject, and we are still debating endlessly. The simple way is to empower the CCI to vet all such mergers and takeovers with a special dispensation and leave it to them. That's their job.

At the macro level, there are many other things to be done. To name a few: public procurement policy, a PPP policy, skills development policy, a holistic natural resources allocation policy, legal reforms to cut down on delays and so on. Many of these initiatives get trapped in incessant turf battles among various ministries promoted by either status quoism or vested interests. Legal reforms are mortgaged to the powerful bar, who thinks that they would lose if the system improves. The power situation is bad, which is also due to the policy on coal among other issues. The PMO and the Cabinet Secretariat are making hectic efforts to work as the policy coherence units, but they too have limited time and resources. Besides this, the government also has to deal with difficult coalition partners, some of whose ministers cannot even spell the word: 'bee' correctly.

Major infra projects are lagging behind badly, which is affecting the whole economic and social fabric of the country. At the micro level, which involves every possible state and local government, it is a maze (see adjoining chart prepared by Booz & Co for the Planning Commission). Yojana Bhawan has prepared a national manufacturing plan which aims to increase the share of manufacturing from the current 15.5 percent to 25 percent by 2025. This exercise was done under a Steering Committee on Industry chaired by Arun Maira, of which CUTS was an active member. The proposal also speaks about cross cutting issues such as reforming the business regulatory framework, so that manufacturing sector can start and work without unnecessary hindrances. The solutions would apply to the services sector *pari passu*, and that would then rejuvenate the whole business scenario. CUTS was the facilitator and knowledge partner for the Working Group on the Business Regulatory Framework.

One of the issues that has been highlighted in Planning Commission's proposed impetus for the manufacturing sector in the country (under the 12th Five Year Plan) is the need for the private sector to play a more prominent role in facilitating inclusive growth and sustainable development. In spite of the fact that there is still a fair bit of confusion about the best way for firms to meet societal expectations, the government is determined in pushing the responsible business agenda in the country. The Ministry of Corporate Affairs led the process by developing the *National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business*[24] (referred to as the NVGs), which was adopted by the Government of India in July 2011. It provides a framework comprising 9 (nine) principles to help define 'business responsibilities' applicable for India. It has also initiated a process of operationalising the NVGs in specific sectors.

CUTS has been involved with this process through another initiative (*Exploring the Interplay between Business Regulation and Corporate Conduct in India,*[25] referred to as the BRCC project), to explore ways to operationalise business responsibility across specific sectors in select states. This study will create a methodology and template for similar studies across states and sectors.

Our study reveals that in addition to public regulations, co-regulation (implemented by sectoral business associations) and self-regulation (implemented at the firm level) play a crucial role in ensuring that firms meet societal expectations, effectively. As far as public regulation and co-regulation are concerned, the implementation process has to start from the level of the state. The capacity of state governments in implementing regulations varies considerably, and needs to be strengthened. Further, state chapters of sectoral business associations need to be involved more actively in such processes, which seem to have been lacking.

Therefore, a major problem with many of the micro issues is that these are under the jurisdiction of states. Each state has its own peculiarities and contours, which vary according to the leader in charge. Some states have done well due to dynamic leadership with the right bureaucrats in place. Some have also developed good institutions and regimes but many of them are not run properly due to bad bureaucrats and poor leadership. One way forward is to establish a non-partisan Chief Ministers Governance Forum, somewhat on the line of views advocated by Prime Minister Atal Behari Vajpayee in a speech at the CII Annual Conference in 2002, which can offer a structured platform for exchange of experiences of successes and non-successes. In our own experience comparativeness exchanges help hugely.

Macro issues can be best handled by a group of ministers with representation of states, parliament and key stakeholders, who can debate and find solutions as a national imperative. Similar exercise at the level of the states would also be needed, and their recommendations have to be taken upwards. These have to be non-partisan. The existing central bodies like the National Development Council deal with a whole panoply of issues and their meetings usually become a state vs. centre dialogue, more often acrimonious. The other intergovernmental body: Inter State Council is dysfunctional.

Even our GST parlays, though well designed because they are headed by an opposition leader, have not been able to make progress so far. Though such a measure would allow better movement of goods along state boundaries and promote national integration of markets. It could make life easier for business and add hugely to growth. Parochialism and apprehension are skewing progress.

Micro issues, particularly of regulatory burden, can be dealt with through the use of Regulatory Impact Assessments of both new and existing laws and praxis. For example,[26] in 1995, Mexico, a federal country, launched "The Agreement for Deregulation of Business Activity", which reviewed existing legislation for legal and economic justification, positive and negative outcomes, as well as the human and budgetary requirements for implementation. The exercise resulted in review and revision of 95 percent of the regulations, with an estimated ~ 40 percent reduction in either the scope or mandate.

In 1998, South Korea introduced the Presidential Regulatory Reforms Commission. Each ministry was given a target to guillotine their existing regulations by half. Regulations which hindered market access or competition were to be eliminated totally, while strengthening those relating to environment, health or safety. Consequently 35 percent of all regulations were thrown out of the window, which added to the industrial growth in the country significantly.

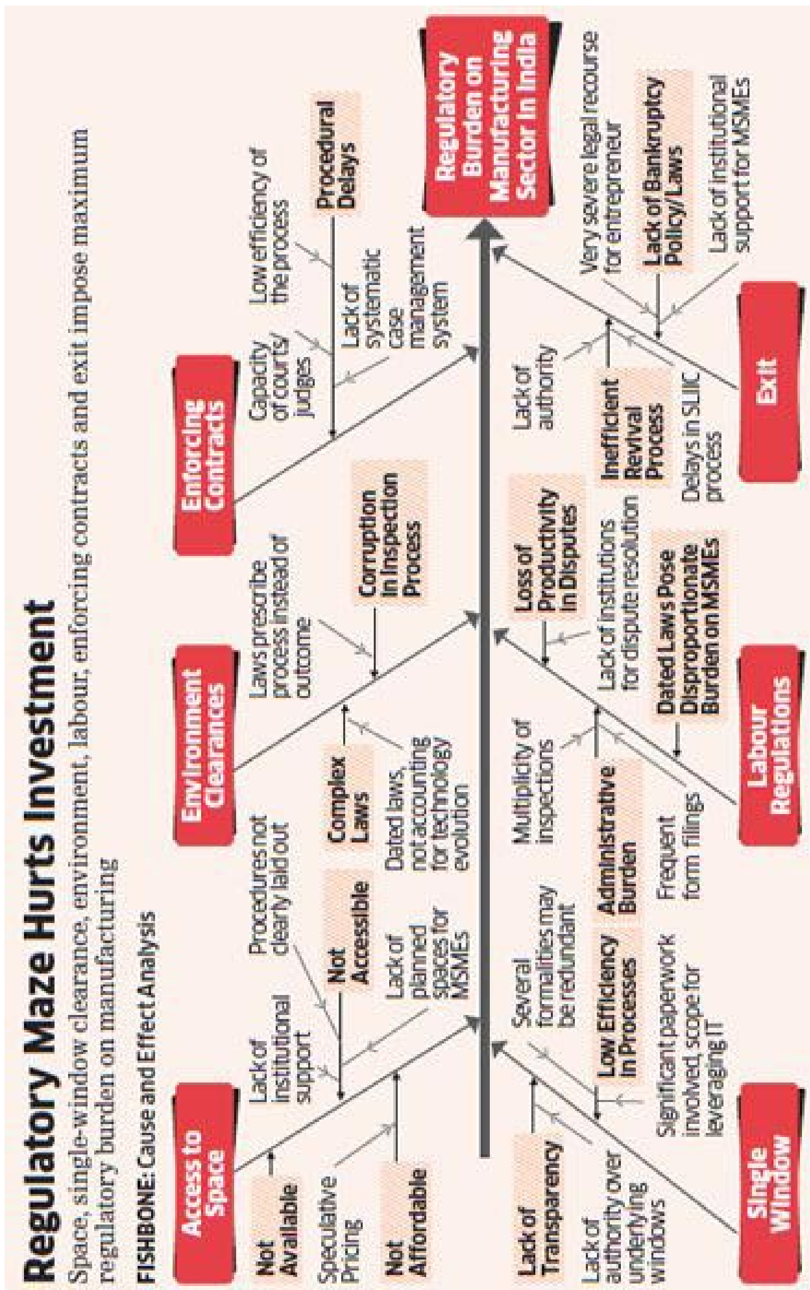
These were examples of two emerging economies, but many industrialised countries too have set up such systems. For example, the UK has the Better Regulation Executive and all new laws are required to assess the cost burden of each proposal as well.

Most OECD countries have carried out regulatory reforms and showed huge economic gains translating into lower costs to the business and lower prices for consumers. There is a huge amount of literature on this subject from which we can learn and adapt to our own situation. It is high time that India too launches regulatory reforms through regulatory impact analyses and establishing an Optimal Regulatory Commission in the centre and states. Of course the states have to be brought on board because most of the red lights are there.

Easing regulations need to be accompanied by creating benchmarks for business responsibilities, so that businesses, while making profits, also contribute to the society in advancing the agenda for inclusive growth.

Secondly, as states and municipal government have a bigger role to play in reforming the business regulatory framework, they should be a part

and parcel of such efforts. To design and carry out reforms effectively, lessons can be drawn from states which have done well. For this purpose, a non-partisan Indian Chief Ministers Governance Forum should be established to provide a structured platform for exchanges of successes and failures. Similar examples exist in federal countries like the US, Nigeria, Australia, Canada.



Source: Booz & Company Analysis , Jayeeta, Economic Times, August 23, 2012

In lieu of conclusion, let me state that the above mentioned agenda is not exhaustive but covers a broad swathe of regulatory issues which need to be reformed. To recap some of the major reforms required, which have been spoken about above.

1. Reforming the energy sector and establishing a cognate Energy Regulator
2. Creating a Natural Resources Allocation Policy
3. Operationalising the National Competition Policy
4. Establishing the Interstate Trade and Commerce Commission
5. Reforming the infrastructure regulatory architecture and ensure adoption of Regulatory Reform Bill
6. Improving the business climate environment in partnership with states
7. Introducing regulatory impact assessment to cut down regulatory barriers
8. Establishing a Chief Ministers Governance Forum for exchange of information
9. Promoting a bottom-up approach in several areas through real federalism

Other major issues which can create better governance such as administrative reforms, public procurement policy & law, PPP policy, land acquisition policy & law, etc. have not been discussed in this Epilogue but they too are critical and have an inalienable relationship with the ones which have been discussed here.

The major problem is that governance and politics are challenging issues and how we can steer these reforms on its own are equally challenging. Here I mean governance in several senses: clean governments, performing governments and real federalism.

If we aim to become a super power soon, then we will have to address these issues so that our economy moves faster than what it is doing. Without economic power, we cannot hope to become a political power.

Endnotes

1 www.cuts-ccier.org/icrr/icrr.htm

2 www.cuts-ccier.org/icrr09/icrr09.htm

3 http://articles.economictimes.indiatimes.com/2012-08-09/news/33118910_1_power-grid-collapse-grid-failure-power-minister. In this article Raghu Dayal writes: "As if the blow of drawing almost a blank at the ongoing London Olympics was not much of opprobrium for a country aspiring to be a superpower, the two-day power grid collapse made it a laughing stock. Symptomatic of a deep malaise, a systemic collapse of governance in the critical infrastructure sector, the grid failure must be seen in its due perspective. There has been clearly a missing order for efficient demand-supply balance according to the prescribed code and allocation. The Central and state electricity regulatory regime is stacked with habitually malleable bureaucrats, almost all of them from what today is country's most powerful trade union, IAS, with most of its senior members assured of guaranteed lifetime employment, ensconced in post-retirement high-profile, lucrative jobs".

4 Surely there would be other similar examples. Surprisingly most Indians are ignorant about this though railway accidents are quite common and advertisements by Railway Safety Commission to enquire into the accidents are issued quite regularly, which clearly show the name of the Civil Aviation Ministry. One other example of maintaining arms-length relationship is worth mentioning here. CUTS had litigated against morbidities and mortalities in family planning sterilisation operations in Rajasthan in late 1980s. In its order the Rajasthan High Court ruled that enquiries of a particular case should not be done by the Chief Medical Officer of the district where the mishap took place, but that it should be done by a team of doctors from three contiguous districts. Asking three different district doctors was to ensure that all of them could not be influenced easily. After all, all doctors working in the government service know each other well.

5 As against this good practice, most of our economic regulators have staff (still in service with years to go) from the regulated public sector, and hence their independence gets compromised as they do have to return back to their parent organisation once their tenure is over. For e.g. TRAI has always had staff from Indian Telecommunication Service who would have been working in BSNL/MTNL/DOT and who after completing their tenure returned back to BSNL/MTNL/DOT. During their work at TRAI they would be much more lenient against these bodies than face wrath after they return to their parent service. Not only that TRAI's offices are located in an MTNL building in Delhi. This is not unusual because the line ministry helps them find a convenient location. Optics do matter!

6 The civil services are hierarchical in nature and merit and skills are not a normal consideration in promotions or even postings. Indeed this will require discretion and hence the risk of manipulators to rise faster than others is always there. But in many cases the Peter Principle applies, i.e. people rise to their level of incompetence. The administrative reforms commissions have advocated for stage wise retirement of civil servants as per the practice in the armed forces, but that has been resisted strongly.

7 http://infrastructure.gov.in/pdf/Regulatory%20Bill%2020.pdf

8 http://infrastructure.gov.in/event_Regulation_Law_and_Policy_final.pdf

9 Quite often the PM makes such statements but is unable to turn them into action.

10 www.cuts-ccier.org/event-Regulatory_Reforms_in_India-A_Roundtable.htm

11 The term resource raj had been coined by Dr Raghuram Rajan before he joined Government of India as Chief Economic Adviser on August 30, 201

12 The CAG too is a retired IAS officer, but because he is empowered as a Constitutional authority he has not been shy in carrying out his mandate without fear or favour. He cannot be removed easily, and hence is assured of his tenure. Though not all CAGs (and Election Commissioners) have been as active.

13 www.cuts-international.org/Policy%20Briefs.htm

14 www.pradeepsmehta.com/pdf/Competition_and_Regulation_in_India_2007.pdf

15 www.mca.gov.in/Ministry/pdf/Draft_National_Competition_Policy.pdf

16 www.iica.in/images/120608(CIRC)SynthesisPaper-NCPSectorStudies.pdf

17 www.cuts-ccier.org/Competition_Distortions_India.htm

18 Para 10.3.06 of Chapter 10 'UNIFIED AND INTEGRATED DOMESTIC MARKET' Centre-state financial relations and planning, Volume iii, **Commission on Centre-State Relations report**, March 2010, Available at http://interstatecouncil.nic.in/volume3.pdf

19 www.cuts-ccier.org/pdf/Harmonising_Regulatory_Conflicts.pdf

20 http://m.financialexpress.com/news/no-blanket-exemption-from-cci-oversight/991280/

21 www.cuts-ccier.org/Press_Release-Competition_advocacy_is_a_key_to_take_the_reform_agenda_forward-M_Veerappa_Moily.htm

22 www.doingbusiness.org/data/exploreeconomies/india/

23 www.livemint.com/2012/08/01001016/Chidambaram-back-as-finance-mi.html. On August 01, 2012, P Chidambaram was moved from Home to Finance Ministry.

24 National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (2011) can be downloaded from: www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf

25 This project is referred to as the BRCC project (www.cuts-ccier.org/BRCC) and is being implemented in the Pharmaceutical and Private Healthcare sectors

26 Booz & Co research for Planning Commission

...The report lays out key issues such as adoption of National Competition Policy, ensure establishment of independent regulators, creation of an Indian Regulatory Service… shows the way forward to the government to implement regulatory reforms effectively, which can help in sharing the gains from liberalisation equally among stakeholders in India.

Kamal Nath
Minister of Urban Development, Government of India

…goes further in exploring what has happened, what is happening and what should be done in promoting effective competition and regulatory reforms in India…As this report reflects, action is needed on various fronts to overcome policy paralysis and to create a predictable environment to ensure investments and increase in competition to benefit the consumers.

Vijay Kelkar
Chairman, India Development Foundation, India

…the report also brings considered recommendations for improved policy: private rather than state ownership, more effective competition instead of monopoly franchises, and appropriate rather than disproportionate regulation. This is a valuable input to policy making nationally and internationally.

Professor Stephen Littlechild
Fellow, Judge Business School, University of Cambridge, UK

…CCI has demonstrated their ability and intention to make a difference by championing competition, and therefore, consumer interest. CUTS…playing a valuable role in helping the development of these institutions – which, in turn, is critical to the future sustainable growth of our economy...

Rajeev Chandrasekhar,
Member of Parliament, Rajya Sabha, India

…this report is a timely, incisive and valuable contribution to the literature on regulatory processes and regimes and provides clear guideposts for creating a regulatory apparatus that whilst encouraging competition and economic growth provides a forum for addressing the concerns of consumers, producers and the government...

Vikram S. Mehta
Chairman, Shell Group of Companies in India

… a most valuable and a welcome timely contribution in the discourse on competition and regulation in India, given the current spate of reforms adopted by the government. It lays down key policy recommendations, which must be adopted by the government.

Bhaskar Chatterjee
Director General & CEO, Indian Institute of Corporate Affairs

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