Competition and Regulation in India 2013

Leveraging Economic Growth Through Better Regulation

Edited by
Pradeep S Mehta

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Enhancing Knowledge, Strengthening Capacity

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Reflections

The fourth report by CUTS and CIRC – Competition and Regulation in India, 2013, lives up to the benchmark created by previous three reports in providing a thorough, comprehensive and frank analysis of the reality of economic regulation in the country. The focus of this report, deficiencies in regulatory designs, is also timely in the backdrop of sub-optimal growth experienced in recent past. The sectors covered (coal, healthcare, railways and finance), is an apt mix as being led by private as well as government enterprises. As this report reflects, compliance with principles of separation of powers in regulation, and adoption of consumer empowerment and competitive neutrality, more specifically the National Competition Policy, as focal points of regulation are need of the hour.

Vijay Kelkar
Chairman
India Development Foundation

India's regulatory system has grown in a haphazard unplanned manner without a clear roadmap as brought out in this excellent publication by CUTS. We have here examples of over regulation resulting in a kind of re-license raj, under regulation and regulatory capture in different sectors and need a revamp of the entire regulatory system and need for parliamentary oversight of staffing and structure.

Ajay Chhibber
Director General, Independent Evaluation Office
Government of India

The reports issued annually by CUTS and CIRC have tried to create awareness and advocacy for true competition principles. They highlight that competition requires effective economic regulation. While India created a flurry of regulators in the last 15 years or so, they vary in design, function, oversight, effectiveness and staffing. Few conform to the principles of adaptability, cost-effectiveness, independence and accountability, transparency and commercial sensitivity, predictability, commercial sensitivity, adaptability and promptness, etc. What is worse is the packing of all statutory regulatory bodies with retired central government service officers. They have violated every principle of good regulation. Since its effective establishment, the Competition Commission of India has investigated cases on its own and on references, taken speedy decisions and where there was guilt, imposed fines of a size never seen before in India. One hopes that the Appellate Tribunal will not dilute these punishments. The basis for determining penalties perhaps needs more clarity. The Appellate Tribunal should also be asked to decide matters much more speedily. These reports serve an important purpose in advocating competition and as a watchdog on economic and competition regulation.

S L Rao
Member, Board of Governors
Institute for Social and Economic Change

The CUTS 4th Biennial Report on Competition & Regulation is a must read for those wishing to understand more about the factors underlying the recent dismal performance of the Indian economy. Often in discussions on macro-economic growth, commentators ignore or pay insufficient attention to the micro-economic foundations. Empirical research and individual country experience strongly suggests that sustainable and widely shared economic growth depends importantly on the nature and degree of competition prevailing in the nation's domestic markets, and sound regulatory framework and Institutions. The Indian policymakers have paid scant attention to these critical factors. As a consequence India is presently a rudderless economy lacking direction. CUTS Report is timely by clearly identifying the competition and regulatory issues where urgent action is needed but importantly by putting forward concrete steps that can be taken. The Government decision-makers should pay heed.

R S Khemani
Former Adviser, Competition Policy
The World Bank Group, Washington DC

This 4th Report of CUTS and CIRC on the status of competition and regulation in India is an invaluable contribution both to knowledge and possibility. The Report looks closely at four key sectors – coal, railways, private healthcare and the financial sector, two of which are public dominated and two of which are private dominated, and it contains special sections on regulatory independence and its critical importance, and regulatory conflict and modes for its prevention and resolution. The Report's diagnosis of shortfalls and its concluding proposals to enhance competition and efficiency for the benefit of the people of India deserve close attention. They should be implemented.

Eleanor M Fox
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Foreword

The report on Competition and Regulation in India, 2013, is an excellent compendium of evidence-based policy relevant research, with a focus on regulatory design. This report is the fourth in the series of biennial reports published by CUTS that review the status of competition and regulation in key economic sectors along with cross cutting issues.

A successful regulator essentially has characteristics. It makes right and fair decisions, and knows how to transmit them efficiently. To achieve these, it must be adequately equipped. This is where the structure of the regulator and the quality of its personnel become important. A sound regulatory design achieves the right balance of ostensibly contradictory principles such as independence and accountability, transparency and commercial sensitivity, predictability and adaptability, cost-effectiveness and promptness, and it is for this reason that achieving it becomes critical, and yet challenging.

It was with this object that the financial sector regulators were recently asked to implement the recommendations of the Financial Sector Legislative Reforms Commission relating to regulatory governance, transparency, improved operational efficiency, that do not require legislative action. The intention is not to delay implementation till the laws can be enacted or amended. The subliminal desire to achieve efficient design has also prompted the Reserve Bank of India to initiate the process of re-examining its priorities and objectives. The Working Group on Resolution Regimes in India is taking due care in designing the resolution authority.

India is thus at a precipice of structural changes in regulation, and this report could not have been timed better. As always, this report has selected an interesting mix of sectors for the study: the private sector-led finance and healthcare, and the public sector-led railways and coal. While consumer protection and empowerment in financial sector and private healthcare regulation needs to regain its importance as consumers are the *raison d'etre* of all economic activity, there is a need to rethink the strategy to regulate coal and railways, inefficiencies in which have held back economic growth. We are increasingly witnessing legitimate calls for outsourcing the regulation of hitherto government led-and-regulated sectors such as coal and railways to an independent regulator, and truly empowering the existing regulators, by manning them with experts recruited through an objective and transparent process.

The report rightly highlights that while designing a regulator, the environment and the political-economy factors in which such regulator has to operate, must be taken into account. Due regard must be given to the structure of market, level of growth of the sector, prevailing level of competition, patent and latent business distortions, industry preparedness, and overarching government policy. This is where this report becomes relevant, as it reminds us of the ground reality, i.e. the perception amongst consumers and other stakeholders about regulation. It is a pity that owing to absence of regulatory accountability, consumers still face difficulties in getting essential services/utilities, such as electricity, piped cooking gas, and tap water connections. The report offers some practical suggestions to improve the situation.

While designing a regulator, the roles, responsibilities, and jurisdictions of existing regulators must be taken into account. It must be ensured that the objectives of the proposed regulator are clear and distinct from the existing regulators. Provisions to resolve conflicts, and ensure coordination with other regulators, specifically the competition regulator must be built-in in the regulatory design as recommended by the government appointed Committee on National Competition Policy (NCP).

A correct regulatory design helps achieving clarity in regulatory objectives, ensures that appropriate tools are in place to make and implement regulation, and facilitates periodical review and improvement of regulation. International experience also suggests that to achieve their objectives, regulations must be clearly drafted and subject to periodic review.

Stakeholder and consumer participation in regulation making and review helps achieve clarity and buy-in of regulation. To facilitate this, tools such as regulatory impact assessment (RIA) are being increasingly being used in other jurisdictions. While we have made limited progress in this regard (such as inviting public comments on draft regulations), RIA needs to be institutionalised in the regulatory process of the country. I would request CUTS to seize the initiative and engage with government and regulators to evince utility of RIA and facilitate its adoption. The Planning Commission, too, has recommended the adoption of RIA in India so as to make it easier for businesses to do business and improve our investment climate. Furthermore, it is pertinent that the Independent Evaluation Office, attached to the Planning Commission of India, has been recently made operational to undertake assessment and evaluation of government plans and programmes.

The report reveals that awareness about competition distortions and the competition regulator is still at a nascent stage in the country. Adoption of NCP by the government is an imperative so as to usher in the second wave of reforms in India. Further, competition principles need to be adopted by economic regulators and the Competition Commission of India should establish regional offices, which could prove crucial in generating awareness about competition issues, and ensure greater public participation in identifying and checking anticompetitive practices.

CUTS has been at the forefront of evidence-based policy relevant research, of which the reports on state of competition and regulation, have been shining examples. Over the last several years, CUTS under the active stewardship of Pradeep Mehta, has successfully led policy interventions in the areas spanning from competition, consumer protection, regulation, trade, investment in India and abroad. My best wishes to CUTS to continue this good work.

I am delighted that CUTS has brought out this fourth biennial report, and it would undoubtedly serve as an important guide to regulatory design and functions, as the previous ones. It is also a valuable contribution towards enriching the available literature on promoting a healthy competitive environment as evolving an appropriate regulatory culture is always a learning curve.

I am confident that this report will generate sufficient interest among practitioners, policymakers, lawyers, consultants, think tanks and others, alike. I commend this report to all, who wish to see India progress faster and deliver economic growth with equity, on the back of efficient regulation.

Dr. Arvind Mayaram
Secretary
Department of Economic Affairs
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Government of India

Preface

In the past, the Indian economy was characterised by significant Government involvement marked by dominance of large state-owned public sector enterprises. India embarked on the path of economic reforms during 1990s by shifting to market-driven economic policies. The thrust of reforms has been to preserve and promote competition as a means to ensure efficient allocation of resources, resulting in the best possible choice of quality, the lowest prices and adequate supplies to consumers. Most importantly, unlike many other reforming economies, India is following a mixed-economy approach, where the public sector is required to compete with the private players, rather than handing over the public sector units to the private sector. Examples of these include: airlines, telecom etc. Exceptions include the electricity sector, while other sectors are being opened up gradually. On the one end of the spectrum, we have one of the lowest rates in the telecom sector with large number of private players. On the other end, we have the electricity sector, where there is hardly any competition and thus poor growth and a huge supply shortage.

The decreasing role of state as a producer of marketable goods and services and the increasing role of market in such areas simultaneously enhance the role of state as a "regulator" and "facilitator". The regulatory role comes into play in order to maintain competitive conditions in the market and to ensure that every one follows the basic rules of the game. These issues have been assessed in this report in some depth, and a future agenda has been outlined succinctly. Establishment of competition authority by itself does not resolve all problems relating to the creation of competitive conditions. Unless there is a strong political will, even the competition and/or the regulatory authority may not be able to function effectively. However, in order that competition may prevail, competition and regulatory laws need to be supplemented by an appropriate National Competition Policy (NCP) which will ensure a full play of competitive forces. Such a programme must oversee all Government policies so that there is no intended or unintended adverse impact on competition.

The fourth ICRR report is well-timed as it coincides with efforts at adoption of NCP and implementation of Competition Amendment Act. 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 Railways, Coal, Finance, and Private Healthcare sectors apart from cross-sectoral issues such as Regulatory Independence and Regulatory Conflicts.

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, 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., 2012- 2013. The NRG members met thrice 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 endeavour 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 led by Udai S Mehta and Amol Kulkarni, working closely with Rajeev Mathur, Vikash Batham, etc.

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 miles to go.....

Investment and competition are the two sides of a coin. The government is promoting investment seriously and is also addressing bottlenecks through the Cabinet Committee on Investment. Many of the investment bottlenecks are due to entry barriers and thus promoting competition reforms can enable investment flows and immersion better and easier. Fortunately, the government is also considering competition reforms seriously and to oversee it by establishing a Cabinet Committee on Competition to be headed by the Prime Minister.

PM Manmohan Singh, speaking at the 3rd BRICS Competition Conference at New Delhi on November 21, 2013, said: "Growth, development and poverty reduction are the most important challenges that our governments have to face. To meet these challenges, governments look for a sound architecture of policy in which beneficial effects of markets can be maximised by action to prevent market failure. The development of a sound National Competition Policy is an essential element of such anarchitecture.

The PM went on to say that state-owned or public sector enterprises (PSEs) are another challenge, because they have been sheltered from competition. "Several possible distortions can arise because of the advantages some PSEs have due to their government ownership. Competitive neutrality requires that the government does not use its legislative and fiscal powers to give undue advantage to its own business over the private sector."

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, the third one in 2011 and the fourth one in 2013.

While the first two reports were supported by the British High Commission in Delhi, the Royal Norwegian Embassy (RNE), New Delhi decided to support the 3rd and 4th 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 2011 focussed on sectoral issues and covered competition/ regulatory issues in key sectors such as microfinance, natural gas, real estate, retail, passenger transportation and telecom, while covering certain cross cutting issues such as essential facilities doctrine, review of regulatory mechanism. The 2009 report 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 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 Finance, Railway, Coal and Healthcare apart from cross-sectoral issues such as regulatory independence and overlap issues between competition and sector regulatory authorities. We continue to implement the competition 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 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 its 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. A list of NRG Members is annexed to this Note.

Udai S Mehta and Amol Kulkarni as Project Managers, worked under my overall guidance. Both of them have worked hard to produce an excellent report. The 2007 version was led by Manish Agarwal, the 2009 version was led by Siddhartha Mitra and the 2011 report was led by Udai S. Mehta.

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 miles to go.....

Pradeep S Mehta
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Efforts of several people have gone into making this report a reality. Involvement in various forms, such as direct inputs, thought provoking discussions, timely reviews, incessant encouragement and guidance have been crucial, in development of the report.

We acknowledge the hard work and efforts of Amol Kulkarni, Gaurang Meher Diljun, Lalitha Narayanan, Manbar Khadka, Molshree Bhatnagar, Rajeev D Mathur, Rishika Mishra, S. Sundar, Sarbojit Pal, Shri Prakash, Sonal M, Tanushree Bhatnagar and Udai S Mehta, for writing different chapters of the report.

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We also appreciate the efforts of Madhuri Vasnani for editing, and Mukesh Tyagi and Rajkumar Trivedi for preparing layout of the report.

In addition, our sincere gratitude to Dr. Arvind Mayaram, Secretary, Department of Economic Affairs, Ministry of Finance, for writing the encouraging Foreword.

Last but not the least, this report would not have seen the light of the day without the skillful direction and guidance of Pradeep S Mehta, Secretary General, CUTS International and Chairman, CUTS Institute for Regulation & Competition.

Words alone cannot convey our sincere gratitude to each and every individual who have contributed in every small way towards bringing out this report. But it is only words that this world thrives on. We express our sincere gratefulness to all such individuals, whether or not named above, without whom the publication of this report would not have been possible.

Abbreviations

AAI	:	Airports Authority of India
ACCC	:	Australian Competition and Consumer Commission
AERA	:	Airports Economic Regulatory Authority
AIOCD	:	All India Organisation of Chemists and Druggists
ANATEL	:	Agência Nacional de Telecomunicações
APTEL	:	Appellate Tribunal for Electricity
CADE	:	Administrative Council for Economic Defence
CAG	:	Comptroller and Auditor General
CAGR	:	Compound Annual Growth Rate
CCI	:	Competition Commission of India
CCRS	:	Chief Commissioner of Railway Safety
CDSCO	:	Central Drug Standards Control Organisation
CE	:	Clinical Establishments
CEA	:	Clinical Establishment Act
CIL	:	Coal India Limited
CL	:	Compulsory Licencing
CMPDIL	:	Central Mine Planning & Design Institute Limited
CNMC	:	National Commission of Markets and Competition
COMPAT	:	Competition Appellate Tribunal
CONCOR	:	Container Corporation of India
CRC	:	China Railway Corporation
CRS	:	Commission of Railway Safety
CSOs	:	Civil Society Organisations
CVD	:	Countervailing Duty
DCA	:	Drug and Cosmetics Act
DCGI	:	Drug Controller General of India
DCI	:	Dental Council of India
DERC	:	Delhi Electricity Regulatory Commission
DLA	:	District Level Chemists and Druggists Association
DoT	:	Department of Telecommunications
DPCO	:	Drug Price Control Order
EAC	:	Electricity Authority of Cambodia
ECA	:	Electronics Communication Act
EGoM	:	Empowered Groups of Ministers

ERB	:	Energy Regulatory Body
ERCs	:	Electricity Regulatory Commissions
FCC	:	Federal Competition Commission
FDCs	:	Fixed Dose Combinations
FDI	:	Foreign Direct Investment
FMCG	:	Fast Moving Consumer Goods
FSC	:	Financial Services Commission
FSDC	:	Financial Stability and Development Council
FSLRC	:	Financial Sector Legislative Reforms Commission
GDP	:	Gross Domestic Product
GIC	:	General Insurance Corporation
GMP	:	Good Manufacturing Practices
GoI	:	Government of India
GSI	:	Geographical Survey of India
GTL	:	General Telecom Law
IAS	:	Indian Administrative Service
ICASA	:	Independent Communications Authority of South Africa
ILIPs	:	Index Linked Insurance Products
IMA	:	Indian Medical Association
IR	:	Indian Railways
IRB	:	Indian Railway Board
IRDA	:	Insurance Regulatory and Development Authority
KCC	:	Korea Communications Commission
KFTC	:	Korea Fair Trade Commission
KYC	:	Know Your Customer
LAAR	:	Land Acquisition, Rehabilitation and Resettlement
LIC	:	Life Insurance Corporation of India
M&As	:	Mergers & Acquisitions
MBP	:	Market Based Pricing
MCI	:	Medical Council of India
MD	:	Medical Devices
MIC	:	Ministry of Information and Communication
MMDRA	:	Mines and Minerals (Development and Regulation) Act
MNCs	:	Multinational Corporations
MoC	:	Ministry of Communications
MoHFW	:	Ministry of Health & Family Welfare
MoR	:	Ministry of Railways
MoT	:	Ministry of Transportation

MoU	:	Memorandum of Understanding
MRFTA	:	Monopoly Regulation and Fair Trade Act
MRTPA	:	Monopolies and Restrictive Trade Practices Act
MT	:	Metric Tonnes
MTNL	:	Mahanagar Telephone Nigam Limited
NBFC	:	Non-Banking Financial Company
NCHRH	:	National Commission for Human Resources for Health
NCI	:	Nursing Council of India
NCMP	:	National Common Minimum Programme
NCP	:	National Competition Policy
NGO	:	Non Governmental Organisation
NHAI	:	National Highways Authority of India
NLEM	:	National List of Essential Medicines
NoC	:	No Objection Certificate
NPAs	:	Non Performing Assets
NPPA	:	National Pharmaceutical Pricing Authority
OECD	:	Organisation for Economic Cooperation and Development
OFT	:	Office of Fair Trading
PCI	:	Pharmacy Council of India
PFRDA	:	Pension Fund Regulatory and Development Authority
PIS	:	Product Information Services
PLIPs	:	Pension Linked Insurance Products
PMCs	:	Private Medical Colleges
PNGRB	:	Petroleum and Natural Gas Regulatory Board
PSUs	:	Public Sector Undertakings
R&R	:	Rehabilitation and Resettlement
RBI	:	Reserve Bank of India
RCT	:	Railway Claims Tribunal
RoCS	:	Registrar of Cooperative Societies
RRT	:	Railways Rates Tribunal
RTA	:	Railway Tariff Authority
SAE	:	Secretariat for Strategic Affairs
SAT	:	Securities Appellate Tribunal
SBDC	:	Brazilian Competition Policy System
SBI	:	State Bank of India
SC	:	Supreme Court of India
SCCL	:	Singareni Collieries Company Limited
SDE	:	Secretariat of Economic Law of the Ministry of Justice

SEAE	:	Secretariat for Economic Monitoring of the Ministry of Finance
SEBI	:	Securities and Exchange Board of India
SEBs	:	State Electricity Boards
SERC	:	State Electricity Regulatory Commission
SLA	:	State Level Chemists and Druggists Association
SoEs	:	State-owned Enterprises
SRA	:	State Railway Administration
TBA	:	Telecom Business Act
TDSAT	:	Telecom Disputes Settlement and Appellate Tribunal
TRAI	:	Telecom Regulatory Authority of India
ULIPS	:	Unit Linked Insurance Products
UPSC	:	Union Public Service Commission
VSNL	:	Videsh Sanchar Nigam Limited
ZCC	:	Zambia Competition Commission

CHAPTER 1

An Overview

Prevailing Economic Scenario

After a brief economic recovery after the financial crisis of 2008, the Indian economy again went into slump. The benefits of measures undertaken by government such as liquidity injections, economic packages, and loan waivers, remained short-lived and slump in key economic sectors pulled down the growth rates to record low in recent times.

Figure 1.1: A Snapshot of Growth Rate of GDP in India[1]

As can be deduced from the Figure 1.1, the GDP growth has halved from the peak of 9.4 percent in 2009-10 to 4.7 percent during 2012-13. The growth rate registered by the Indian economy, during the year 2013, over the corresponding periods in 2012, is as follows:[2]

Table 1.1: The Growth Rate Registered by the Indian Economy in 2013		
S. No	**Period**	**Growth rate (in percent for the periods mentioned)**
1.	April-June 2013	4.4
2.	July-September 2013	4.8
3.	April-October 2013	0.0
4.	April-December 2013	(-) 0.1

The growth of key economic sectors during the year 2013, over the corresponding periods in 2012, stood as follows:[3]

Table 1.2: Growth of Key Economic Sectors in 2013						
S. no	**Sector**	**Period (in percent for the periods mentioned)**				
		April-December 2013	**December 2013**	**October 2013**	**April-October 2013**	**April-June 2013**
1.	Mining	(-) 1.8	0.4	(-) 3.5	(-) 2.7	(-) 4.5
2.	Manufacturing	(-) 0.6	(-) 1.6	(-) 2.0	(-) 0.3	(-) 1.2
3.	Electricity	5.6	7.5	1.3	5.3	6.4

After a continuous fall in the value of Indian Rupee, in late August 2013, its value slid to ₹68.85 for US$1. The stubborn rise in rate of inflation has also been a matter of concern. The inflation rate stood at 6.46 percent for the month of September, 2013 (over September, 2012) as compared to 6.10 percent for the previous month. Build up inflation rate in the year 2013 up to October 2013 was 5.64 percent compared to a build-up rate of 4.84 percent in the corresponding period of the previous year. The annual inflation rate based on all India general consumer price indices (combined) for December 2013 (over December 2012) and January 2014 (over January 2013) was 9.87 and 8.79 percent, respectively.[4]

Inefficient Economic Regulation

Reduced growth rate, high inflation and consistent depreciation in the currency have largely been attributed to *inter alia* inefficient regulation of key economic sectors by the government and sector regulators, wherever present. In recent past, many infrastructure projects have been delayed due to lack of regulatory approvals. The courts have struck down some of the government decisions and reforms undertaken by government (such as allowing FDI in the retail sector) have not resulted in expected benefits, due to uncertainty and cumbersome policies.

The government has been accused of writing vague and ambiguous policies, resulting in crony capitalism and latent entry barriers to competition and business. Uncovering of various corruption scandals by the proactive Central Bureau of Investigation, backed by an active Supreme Court and Comptroller and Auditor General (CAG), has resulted in retired bureaucrats and directors of large corporates being made an accused party, and the Prime Minister is also looking vulnerable. This has resulted in crucial projects worth thousands of crores being stuck and nation's progress being stalled. Private players have been pulling out of critical projects due to inordinate delays in obtaining requisite environment clearances etc. Furthermore, the country is forced to resort to costly imports to mitigate the short supply of key inputs in domestic market. This has highlighted the urgent need to look into the issue of rampant policy paralysis adversely affecting growth and even potential investments. Among other steps, a complete overhaul of the regulatory process is the need of the hour.

The prevailing situation has led experts to wonder whether the government and regulators are suffering from regulatory amnesia as they seem to be directionless, operating without clear objectives, and most importantly, are not being held accountable for their inappropriate actions or the failure to act.

What Constitutes Sound Economic Regulation?

The key economic sectors in India are not being adequately regulated, and thus there are problems with economic regulatory process of the country. In order to understand what is wrong with the economic regulatory process, it would be useful to recapitulate what constitutes sound economic regulation.

Principles of Sound Economic Regulation

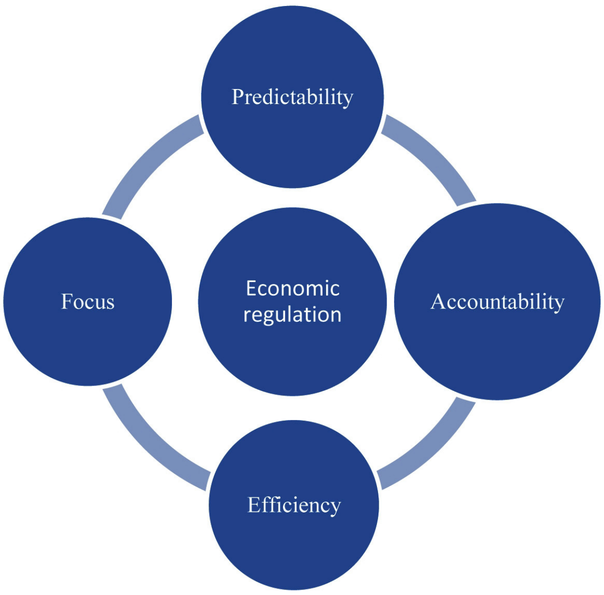
Sound economic regulation is generally seen to be that part of regulation which seeks to achieve the effective functioning of competitive markets and where such markets are absent, to mimic competitive market outcomes to the extent possible, while keeping interest of consumers at heart. It also identifies and addresses subsidies and cross-subsidies in the pricing of infrastructure services. States generally use economic regulation in a broader context to achieve a range of non-market objectives which includes ensuring universal and equitable access, consumer protection, and maintaining safety and health standards.[5]

The UK Department for Business Innovation and Skills has identified following principles of sound economic regulation:[6]

- **Accountability:** Regulatory decisions should be taken by a body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs. The decision making powers must be exercised transparently, within the constraints imposed by the need to preserve commercial confidentiality, and must be subject to appropriate scrutiny and challenge.

- **Focus:** The role of economic regulators should be concentrated on protecting the interests of end users. To ensure this, economic regulators should have clearly defined, articulated and prioritised statutory responsibilities focused on outcomes and adequate discretion to choose the tools that best achieve such outcomes.

- **Predictability:** The framework for economic regulation should provide a stable and objective environment enabling all those affected to anticipate the context for future decisions and to make long term investment decisions with confidence. It should not unreasonably unravel past decisions, and allow efficient and necessary investments to receive a reasonable return, subject to the normal risks inherent in market. Retrospective amendments to taxation laws to the detriment of taxpayer are classic examples of inefficient economic regulation.



Principles of Economic Regulation

- **Coherence:** Regulatory frameworks should form a logical part of the government's broader policy context, consistent with established priorities, and enable cross-sector delivery of policy goals.

- **Adaptability:** The framework of economic regulation must be capable of evolving to respond to changing circumstances and continue to be relevant and effective over time.

- **Efficiency:** Policy interventions must be proportionate and cost-effective while decision making should be timely, and robust.

Theories of Economic Regulation

There are two main theories regarding the genesis of economic regulation. One is the "public interest" theory which conceives regulation as arising from the need to rein in the free exercise of market forces and consumer and producer impulses in cases where such a display can act as an obstacle to the maximisation of societal well-being or to remove externally applied obstacles to market forces when their play is desirable.

An alternative theory is that of "capture" wherein regulation is being seen as being supplied in response to the demands of interest groups struggling among them to maximise the incomes of their members. This theory gives importance to the political economy factors which get manifested in the unequal bargaining powers of different vested interest groups which in turn result in their unequal influence over regulatory rules/norms and hence outcomes. In other words, regulation is seen as a tool which can be manipulated by different interest groups to their advantage using their respective bargaining powers with the regulating machinery.

While the former focuses on what "should be", the latter concentrates on what "could be" in real world situation.[7] The Organisation for Economic Cooperation and Development (OECD) Report on Regulatory Reform recognised way back in 1997 that vested interests have often been able to install regulations that benefit them, and block needed reform even when broad or long-term benefits are vastly larger than concentrated costs. In some countries, a 'regulatory culture' has emerged, as businesses have come to look to government protection for survival rather than to their own performance. Lack of transparency is a key problem here. Vested interests are strengthened by opaque decision processes and unaccountable administrative discretion.[8]

This seems to be applicable to the prevailing regulatory scenario in India as well, which is explained by this capture theory of economic regulation. Such situation results in regulators wavering from their stated objectives and larger goal of achieving growth and development.

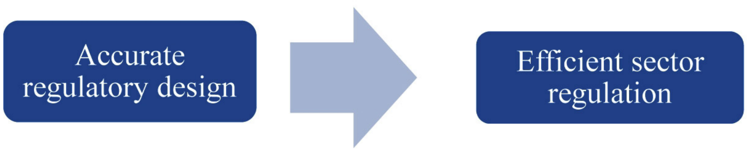
Barriers to Sound Economic Regulation

Common sense suggests that a situation wherein regulators are not acting in the manner expected, is possible in two alternative scenarios viz. either the regulators are incapable of identifying the appropriate regulatory responses to the prevailing scenario, or should the regulators be aware of the appropriate actions required, there are problems with regulation/ policy delivery process and consequently the regulators are not able to translate intention into action on the ground.

The Report on Competition and Regulation in India, 2011, dealt with the problems in policy delivery process, policy induced competition distortions and suggested relevant solutions. Consequently, it is apt that the 2013 edition assesses the capacity of regulators in identifying and formulating appropriate responses.

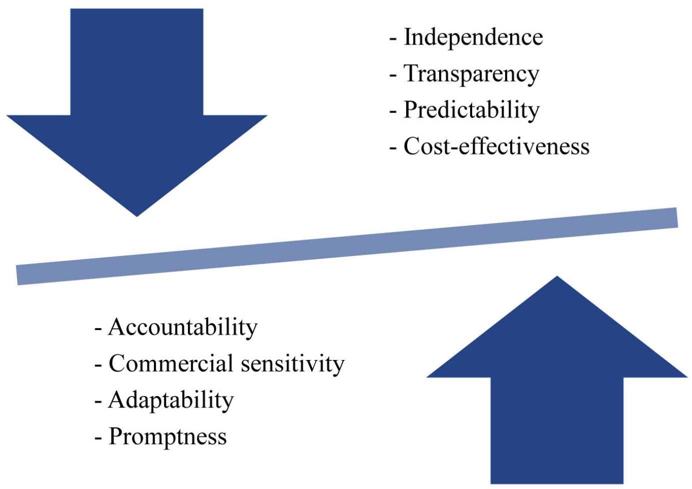
A regulator will be able to determine the most appropriate policy response if its design: (i) facilitates clarity in objectives it is required to achieve, (ii) provides appropriate tools (or ability to develop tools), and the flexibility to utilise such tools as per the situation, and (iii) makes it possible to hold the regulator accountable for its actions and inactions.

The ongoing avalanche of unpredictable and incredible regulatory actions resulting from wide discretion and broad objectives of unaccountable regulators point towards deeper problems in the regulatory architecture, and could possibly be symptoms of faulty regulatory policy design. This calls for a review of the design of regulators of key economic sectors of the country, in order to identify the precise malady which the design is suffering from, and suggest appropriate cures.



Getting the Regulatory Design Right

An accurate regulatory design has the right mix of ingredients, which might at times be considered contradictory, such as independence and accountability, transparency and commercial sensitivity, predictability and adaptability, cost-effectiveness and promptness, etc. An aptly designed regulator has the appropriate tools, or the ability to develop them, to efficiently manage changes and innovations in the sector, and navigate the sector to benefit the market players and build their confidence, ensure value to the consumers, and ultimately contribute to the growth of the economy.



Finding the right balance

Sappington (1993) points out that regulatory objectives and resources, the institutional structure of the environment for which regulatory policy is designed, and various industry conditions in the regulated environment, are key factors that influence the form, function, and scope of regulatory policy design.[9] Consequently, understanding structure of market, level of growth of the sector, prevailing level of competition, patent and latent business distortions, and overarching government policy, are keys to appropriate regulatory design and consequently efficient sector regulation.

These factors are necessary to determining the appropriate level of independence to be provided to the regulator, designing the procedure and modes for making it accountable, setting its objectives, and providing appropriate tools to achieve the objectives. Inappropriate approach to any of these issues would be a recipe for disaster, and waste of taxpayers' money, a luxury that one cannot afford.

OECD (2012) recommends that independent regulatory agencies can be justified in situations where public confidence is required to be maintained; government as well as private entities are regulated under the same framework and competitive neutrality is therefore required; and where the decisions of regulatory agencies can have significant economic impacts on regulated parties and there is a need to protect the agency's impartiality.[10]

Different regulatory designs could be adopted on the basis of different sectoral requirements. Key economic sectors in India are differentially regulated at present. The regulatory framework in the infrastructure sectors has developed autonomously within each infrastructure sector with very little co-ordination or cross fertilisation of ideas across sectors. A survey of the provisions of the existing statutory and institutional framework suggests the absence of a common regulatory philosophy guiding the evolution of regulatory institutions in infrastructure sectors. Political constraints and ministerial preferences over time seem to have dominated the reform agenda in different infrastructure sectors.[11]

Variations exist from absence of regulators, to having regulators housed in government departments, to independent regulators. While complete government control exists in hitherto natural monopolies such as railway transport, multiple independent regulators function in sectors such as finance. Increasingly, various sectors are witnessing instances of under-regulation, regulatory overreach, regulatory conflicts, and demands for real regulatory independence and restructuring.

Review of regulatory designs is increasingly being carried out internationally. It is being realised that mere formal regulatory independence might not be sufficient and the level of regulatory discretion should be guided by the local conditions. As the regulatory models and governance systems are located within the political, constitutional, and legal arrangements of the country, they should also fit the country's regulatory commitment, institutional development, and human resource capacity.[12]

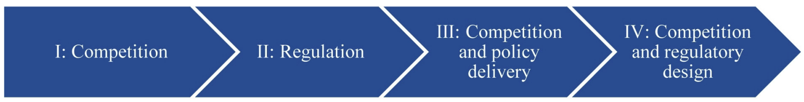
Consequently, it is necessary that similar reviews of regulatory designs in key economic sectors are carried out in India.

Reports on Competition and Regulation in India

CUTS, in association with New Delhi-based CUTS Institute for Regulation & Competition, has been publishing biennial reports on the state of competition and regulation in India. This edition has been published in partnership with the Oslo-based Norwegian School of Management (BI) under a grant from the Ministry of Foreign Affairs, Norway represented by the Norwegian Embassy, New Delhi. The reports are designed to undertake reviews of level of competition and regulation to assess functioning of markets in the country. This is desirable given the existence of distortions in economic management of the country that impede realisation of competitive outcomes. The objective is to improve the quality of regulation and enhance the level of competition in select sectors of the economy through research, network and advocacy based on research findings.

Three reports (2007, 2009, and 2011) have been published till date. A systematic approach has been adopted to identify the areas and sectors which the reports cover, while also adapting to the changes in competition and regulatory environment in the country and taking into account findings of the previous reports. While the 2007 report dealt with competition issues in general, the 2009 report made a transition to deal with regulatory issues and assess the interplay between regulation and competition in select sectors.

In the process of determining what impedes efficient economic regulation, the 2011 report dealt with the constraints in efficient regulatory policy delivery and competition distortionary policies, and made relevant suggestions to improve the policy delivery process. In this process, it is now natural that this 2013 report studies how faulty regulatory design impedes efficient economic regulation, deals with interplay between competition and regulatory design, and makes suggestions to achieve better economic regulation.



Progress of the reports

Provided below is a brief summary of the hitherto published reports.

Competition and Regulation in India, 2007

The 2007 report dealt with the subject of regulation in telecommunications, electricity and social sectors (healthcare and education) with a broad brush, while discussing the need for competition policy and law, its evolution in Indian context and throwing light on anticompetitive practices prevailing in India.

The report outlined rigourously the rationale for a competition policy and law – the need to tackle anticompetitive practices and discourage the use of unfair means by firms against consumers, and the need to inculcate a competitive spirit in the market. The primary rationale for promotion of competition policy and law is the promotion of fair competition among firms. The merits of this promotion are seen in the relationship between competition and economic growth, and competition helping in achieving and maintaining reasonable prices. The policies of the Central Government were also evaluated by the report in terms of their tendency to generate anticompetitive outcomes. A sketch of the history of India's competition regime and its possible future was discussed, and institutional and administrative challenges facing the competition enforcement machinery were also highlighted. The report further provided a broad overview of anticompetitive practices (cartelisation, abuse of dominance and others) and associated challenges. The report called for establishment and capacity building of state level competition laws and agencies to deal with competition abuses as well as to protect local consumer interest, because it is not possible for one central agency to deal with the large number of problems in the country.

The report called for level playing field for imports to promote competition, pushed for privatisation and disinvestment to replace public sector monopolies, and suggested a wider civil society involvement in the issues of competition and consumer protection.

Competition and Regulation in India, 2009

The 2009 report made transition from competition to regulation as primary focus. It went much beyond depicting the state of the world in sectors and pinpointed the institutional and other root causes of the state in several sectors. The report took a more focused sector-specific approach, by discussing competition and regulation issues in agriculture markets, power, ports, civil aviation, and higher education sectors.

Political economy and implementation issues formed important part of the 2009 report. Each sector study commented on the appropriateness of the regulation, assessed modalities involved in implementation, and conducted competition assessment of regulations to look at ways in which the laws restrict or promote competition. In brief, the 2009 report examined the evolution of regulatory problems from a political economy perspective and assessed the quality of regulation in terms of the suitability of content for tackling market failures, the effectiveness and independence of the regulator and the extent to which the set of sector regulations fosters competition.

The report called for greater functional and financial autonomy in regulation of sectors. It highlighted political economy factors as source of substantial competition and regulatory distortions and the need for negation of pressures exerted by vested interest groups to figure prominently in the reform agenda. It concluded that entry barriers existed in all sectors to some degree which could at least be partially attributed to lack of regulatory independence and political economy factors. It recommended that negation of pressures exerted by powerful vested interest groups as well as facilitation of independence of sector regulators are two related tasks which should figure prominently on the agenda of reformers.

Competition and Regulation in India, 2011

The 2011 report assesses the need for and status of regulation and competition in select sectors, the importance and effectiveness of regulatory institutions/ processes, and awareness of competition and regulation issues among consumers and other stakeholder groups. The sectors covered by the report were microfinance, natural gas, real estate and residential housing, retail distribution, public road (passenger) transport, and telecom.

In addition, the report looked at some thematic issues, namely political economy of regulation, essential facilities doctrine, with the objective of creating awareness about the functioning of the extant regulatory systems in the country and identifying possible methods of improving the current system.

The report highlighted that interference by government functionaries/ ministries and their political masters continue to emasculate many regulators, and have made their role irrelevant, and thus called for reducing the administrative and political interference in regulators' functioning. It also concluded that institutional issues such as overlapping jurisdiction with the Competition Commission of India (CCI), and effective coordination with other regulators should be addressed in a definitive manner so that regulators function as per their mandates, and that transparent and simple regulations (and/or reduction of regulatory complexities) that establish basic rules for fair competition should be developed and implemented. It also emphasised on the importance of open access in improving operational efficiency and promoting competition in infrastructure sectors.

Table 1.3: Summary of the Competition and Regulation Reports

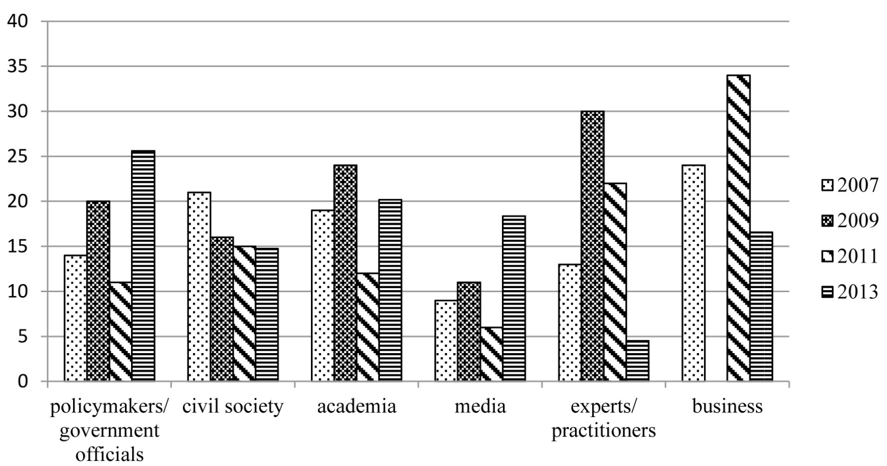
Year	Areas covered	Outcomes
2007[13]	Generic issues of competition policy and law, along with telecommunication, electricity, healthcare and education	Highlighted the need for a National Competition Policy (NCP), which was recognised lucidly in the Eleventh Five Year Plan document. It was so recommended in the Ninth Five Year Plan document also
2009[14]	Sector specific focus on power, ports, civil aviation, agricultural markets, and higher education	Recognised that quality of regulation varies from sector to sector. Further, highlighted that functional and financial autonomy in regulation are lacking which needs urgent redress
2011[15]	Sector for review consisted of retail, natural gas, micro finance, real estate, passenger transport and telecommunications. Cross-cutting issues of regulatory performance, and essential facilities doctrine, were also assessed	Highlighted the need to (i) address reforms in power and coal sectors, (ii) reform regulatory governance and create an Indian Regulatory Service, and (iii) implement NCP.

Stakeholder Perception Surveys

An inherent part of the reports have been stakeholder perception surveys. The surveys are done to gauge the level of awareness on competition and regulation among members of civil society, academicians, policymakers, government officials, businessmen, media personnel and various sectoral experts in the country. The survey findings lend support to the analysis and findings of the secondary research.

In addition, as the surveys have been regularly conducted since 2007, the findings have led to formulation of a Perception Survey Index that compares the findings of surveys over time and examines whether perception on competition and regulation has changed over the years or not.

Figure 1.2: Distribution of Respondents in the Surveys



Post 2011 Developments

Since the 2011 report, while the growth remained subdued, and inflation remained high, the government has started sending positive signals indicating its willingness to review its policy and regulatory approach. The Project Monitoring Group in the Cabinet Secretariat was created by the Central Government to track large investment projects, and pro-actively pursue them so that such investment projects are commissioned on time. In addition, the government was actively considering adopting non-legislative recommendations of the Financial Sector Legislative Reforms Commission (FSLRC), which is an encouraging sign. In addition, the competition regulator has taken action against the anticompetitive practices of state owned Coal India Limited, and calls from experts for establishing coal sector regulator have strengthened.

The Reserve Bank of India (RBI) has also undertaken several monetary policy measures to rein in inflation. Further, after a long delay, the Indian Parliament passed the new Companies Act in 2013, in order to streamline and consolidate regulations applicable to companies. Further, the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 was also adopted, with the objective to ensure participative, informed, and transparent process for land acquisition for industrialisation, and development of essential infrastructural facilities. In addition, the National Food Security Act, 2013 was passed with the objective to ensure access to adequate quantity and quality food at affordable prices. Both these laws are controversial as there are varying opinions.

Report on Competition and Regulation in India, 2013

The environment created by the bleak economic scenario, inactive regulators, but government's openness of being receptive to suggestions and adopting reforms provides an opportunity for a comprehensive review of regulatory process, and more importantly, regulatory design of Indian economy.

This report is a step in this direction. It attempts to review the design of regulatory process of key economic sectors of Indian economy. Indian economic sectors are dominated either by public sector firms or private sector firms. Such dominance in the sector is the key feature which determines the state of sector, prevailing competition, and consequently becomes necessary to determine the regulatory architectural model. Thus, while considering sectors for review, an appropriate mix of public-sector dominated as well as private-

Table 1.4: The 2013 Report

Sections	Areas of attention
Coal	Problems being faced by the industry in light of government monopoly, resulting in inefficiency and scarcity of coal for power production
Railways	Monopoly position enjoyed by the Indian railways and its effect on quality and affordability of rail travel
Private healthcare	Focus on competition and regulatory aspects, with regard to consumer interests
Financial sector	Competition, regulatory and consumer protection issues in banking, insurance and non-banking finance companies
Regulatory independence	Importance of regulatory independence in regulatory competence and efficient economic regulation
Regulatory conflicts	Possible models managing and harmonising conflicts between competition and sector regulators

sector dominated sectors must be selected. As a result, the sectors selected for the 2013 report are coal and railways, dominated by public sector, and finance and healthcare, wherein competition exists between public sector and private sector firms. In addition, dedicated sections on regulatory independence and conflicts are included in the report.

In accordance with the tradition of previous reports, perception survey sections are included in the 2013 report also. These record the perceptions of stakeholders involved, being consumers in general, as well as the market participants, and policymakers.

Overview of the 2013 Report

The remaining part of this chapter highlights what to expect from the following chapters of this report. Scope of individual chapters has been briefly discussed and summary of key findings has been provided.

The next chapter discusses the results of stakeholder perception surveys carried out to assess the perception of regulation and competition in economy, in general, and sectors covered in the report, in particular. Two different types of survey questionnaires were administered via stratified random sampling method to informed stakeholders. While one was the general set of questionnaires, the other was business-related questionnaires focused on various sectors namely, coal, railways, private healthcare and finance, the subject of this report. The survey covers a total of 13 states in the country, thereby representing varied geographical locations. The survey was conducted via face-to-face interviews with various stakeholders.

The survey findings showed that a majority of stakeholders were ignorant about existence of CCI, the competition regulator. Setting up of regional offices of the CCI is thus the need of the hour to ensure adequate awareness about the competition regulator. In addition, the survey findings showed that consumers face difficulties in getting essential services/utilities such as electricity, piped cooking gas, and tap water connections. Reasons for difficult access include lengthy/complex procedural requirements and uncooperative behaviour of officers in governmental departments and offices. Further, in sectors such as coal and private healthcare, significant portion of the respondents argued for the need of an independent regulator to regulate these sectors.

Chapter 3 deals with the importance of regulatory independence and competence in regulatory performance. The chapter recognises that functional independence for an institution implies achieving the desired degree of autonomy and maintaining an arm's length relationship from interest groups. The line between independence and autonomy is thin, but is clearly recognisable. The chapter stresses on the need of independent regulators, examines if select regulators are truly independent i.e. whether regulators have acted independently.

The chapter finds that while the regulators are legally empowered with independence, such sovereignty is limited. The delegated independence is much lower than the mandated independence due to control exercised by the executive. The regulators have limited powers to implement the law and in most cases the regulators have delivered what the political masters wanted. In the event there is a conflict, the functioning of regulators takes a hit at times. The regulators end up reporting to the line ministry, which also manages state-owned incumbents.

The chapter recommends a set of measures to make regulators more independent. These include ensuring functional clarity for regulators, guaranteeing their financial independence, and regulators maintaining arms-length distance from line ministry. It also suggests appointing experts to the regulators governing body/board, ensuring regulatory accountability, and achieving efficient co-ordination with relevant government departments.

Chapter 4 deals with the subject of harmonising regulatory conflicts between competition agency and sector regulators. While function of a sector regulator ought to be promoting competition; competition authority must focus on preventing/prosecuting anticompetitive practices. The chapter discusses institutional models adopted across jurisdictions to manage regulatory conflicts. These range from competition authority administrating sector rules; to appellate interventions; to mandatory consultations. The chapter analyses relevant provisions under the Competition Act, 2002, and the recommendations made under the NCP.

The chapter recommends that the best approach for India is a concurrent framework, envisaging a mechanism for mandatory consultations between sector regulators and competition authority. It calls for recognition of role and competencies of regulators, designing a framework mandating cooperation, and creation of an independent body to resolve conflicts, should they arise. It stresses upon the immediate need to adopt NCP.

Chapter 5 focuses on competition and regulatory issues in the railways sector and suggests appropriate regulatory framework for the sector. In spite of gradual decline of share of railways in goods and passenger transport, little has been done to improve the situation. The railway infrastructure remains inadequate and the quality remains sub-optimal. Government-owned Indian Railways continues to be the monopoly in rail passenger transport, in spite of having been rated below other modes of transportation on indicators such as quality, reliability, price, connectivity, cost-friendliness, amongst others.

The chapter highlights the disadvantages of housing policy making, regulation and operations in a single body, while listing the drawbacks in current system of tariff fixation, safety management, and grievance redressal. The chapter stresses the need for separation of policy making, regulation and operations in the sector, while relying on benefits of similar international experience and experiences in other sectors in the country. It calls for setting up of an independent Railways regulator to regulate tariff, protect consumer interests, establish quality standards, and ensure transparency. In addition, it calls for the repeal of competition distortionary policies and housing policy making in the Ministry of Railways, while the Railway Board could be reconstituted into an authority to operate and manage Indian Railways.

The next chapter suggests appropriate regulatory design in the coal sector, while studying interactions between regulation and competition in the sector. Coal India Limited, a public sector entity, accounts for approximately 80 percent supply in the coal sector. The legislations in coal sector are skewed in favour of public sector companies by restricting entry and conferring them exclusive rights. The coal blocks are allotted to public sector companies while the private sector companies are required to participate in auctions of coal blocks for designated end-use (captive mining).

The chapter recommends establishment of an independent coal regulator to coordinate the activities of statutory players across various activities involved in coal mining, import and distribution. It further lists reforms required in the coal sector, in the order of ease of adoption, to ensure efficient economic regulation. These include ensuring level playing field in allotment of coal blocks, surface rights, and mining clearances; developing a coordinated approach for environment clearances and other permits; streamlining sectoral regulatory activities to reduce time taken in obtaining clearances; and ensuring inter-ministerial coordination for development of infrastructure facilities, amongst others.

Chapter 7 deals with regulation, competition and consumer protection in the financial sector, with the focus on banking, non-banking financial services and insurance segments. The chapter assesses reforms adopted by regulators across jurisdictions, post financial crisis, and suggests measures to improve regulation, competition and consumer protection focus in the Indian financial sector. It highlights the defects in licencing policy, regulatory under-reach and over-regulation prevailing as a result of faulty regulatory design, absence of co-ordination between regulators, including with the CCI, policy preference of public sector entities and differential treatment of non-banking finance companies and banks. The chapter finds that consumer protection has taken backstage in financial sector regulation and supervision, as the sector is rife with practices of product bundling, non-availability of comparison, complex 'know your customer' requirements, and ineffective redressal mechanism.

The chapter concludes that economies that were not affected by the financial crisis might have missed the opportunity to undertake a complete overhaul of financial sector regulation. It calls for withdrawal of benefits from public sector enterprises to ensure fair competition, greater co-ordination between regulators to prevent leakage from gaps in regulation, adoption and implementation of principles of fair treatment to consumers, and introducing simple financial products in India. It stresses on the responsibility of civil society organisations (CSOs) to generate demand from stakeholders such as consumers and market players, for adoption of such recommendations and sensitise policymakers and regulators on importance of their importance.

Chapter 8 traces the growth of private healthcare in India and assesses competition and regulation in the private healthcare sector, including medical education. 70 percent of the medical colleges are concentrated in southern and western states of India, which has distorted the distribution of health care professionals in the country and indicates the violation of the Medical Council of India (MCI) rules. The chapter highlights the anticompetitive practices of All India Organisation of Chemists and Druggists (AIOCD) and action of the CCI against AIOCD. With respect to clinical establishments, the chapter notes that while the adoption and implementation of Clinical Establishment Act across states will bring uniformity in healthcare delivery but highlights that it places enormous responsibilities with the district-level authorities which often function without adequate capacity and staff.

The chapter recommends greater mandate for the CCI to check prevailing anticompetitive practices in the health delivery sector; adequate regulation of functioning of associations in private health care sector; need for greater advocacy and protection of whistle blowers; and requirement to label generic drugs.

Conclusion

While economic regulation of various sectors in India differs substantially, certain key principles that must find place in regulatory design of each of the Indian regulators to ensure efficient economic regulation, have been highlighted by the 2013 report. These include ensuring users/beneficiaries at the centerpiece of the regulation and ensuring competitive neutrality between public sector and private sector market participants. In addition, writing independence in the law will not be sufficient, and the regulators must act independent of the vested interests of stakeholders including the line ministries, for which sector experts must be appointed at the helm of regulatory agencies. In order to obtain better functioning from the regulatory officers, fixing their accountability is a must.

Further, ensuring appropriate regulatory design might not be sufficient for ensuring improved sector regulation. The CCI will have to play its part, and ensure that anticompetitive practices remain in check and promptly prosecuted by achieving greater co-ordination and co-operation with sector regulators.

The key findings and recommendations of the report are as follows:

- Unawareness still persists about existence of CCI. Setting its regional offices could resolve the situation.

- As a result of lengthy/complex procedural requirements and insensitive government officers, consumers face difficulties in getting essential services/utilities such as electricity, piped cooking gas, and tap water connections. Fixing of regulatory accountability will be a key in this regard.

- Regulatory independence is importance for ensuring efficient economic regulation. It can be achieved by a mix of measures including financial autonomy, expertise, arms-length relationship with line ministry, and accountability, amongst others.

- In order to resolve conflicts and ensure better co-ordination between competition authority and sector regulators, a concurrent approach is required wherein mandatory consultations between sector regulators and competition authority take place on issues of mutual interest.

- There is a need for strict compliance with the principle of separation of powers. In sectors dominated by public sector entities, policy making, regulation and operations must be immediately separated. In addition, such sectors must be regulated by aptly designed independent regulators in order to ensure efficient economic regulation.

- The primary focus of sector regulation should be consumer protection and empowerment. Further, principle of competitive neutrality must be adopted and benefits provided to public sector entities must be withdrawn. Regulators must improve co-ordination between them and develop channels for greater communication and co-operation.

- CSOs must play a greater role in generating demand for reforms from the policy makers. Such organisations must facilitate greater interaction between regulators and relevant stakeholders, including consumers, to ensure continuous improvement in regulatory design and efficient economic regulation.

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CHAPTER 2

Perception and Awareness Reporting

Introduction

The perception and awareness survey on competition and regulatory scenario in India is being conducted biennially by CUTS. The survey is done mainly to gauge the level of awareness on competition and regulation among members of civil society, academicians, policymakers, government officials, businessmen, media personnel and various sectoral experts in the country. Similar surveys were conducted previously in 2007, 2009 and 2011. Findings of the current survey 2013 will be useful in comparing with the findings of the past surveys and examining whether perception on competition and regulation has changed over the years or not.

This chapter covers findings of the perception survey that aims at exploring competition and regulation in India's business environment. The survey is done among a randomised sample of informed stakeholders between February-December 2013, asking their views on the existing regulatory system and the competition enforcement status in India. The survey intends to assess the perception as well as awareness of stakeholders about the competition and regulation regimes prevailing in the country. The survey also assesses the quality of regulation as well as the nature and impact of various government policies/measures on existing regulatory regimes.

Data & Survey Design

Two different types of survey questionnaires were administered via stratified random sampling method to informed stakeholders. While one was the general set of questionnaires, the other one was business-related questionnaires focused on various sectors namely, coal, railways, private healthcare and finance, covered in this report. The survey covers a total of 13 states in the country, thereby representing varied geographical locations (Table 2.1). The survey is conducted via face-to-face interviews with various stakeholders. Out of total 332 sample size, 177 are in the general category (civil society, academia and media) and 155 are in the business category (policymakers, government officials, business, sector experts). While the similar queries in the two sets of questionnaires (business and general) are

Table 2.1: State-wise Stakeholder Participation (2013)							
State/Region	**Civil society**	**Academia**	**Media**	**Policymakers /Government officials**	**Business**	**Sectoral experts**	**Total**
South							
Tamil Nadu	7(20)	5(14)	6(17)	4(11)	11(31)	2(6)	35 (10.54)
North							
Uttar Pradesh	7(28)	1(4)	14(56)	3(12)	0(0)	0(0)	25 (7.53)
Haryana	0(0)	0(0)	1(100)	0(0)	0(0)	0(0)	1(0.30)
NCR (Delhi)	13(10)	30(23)	21(16)	38(29)	26(20)	1(1)	129 (38.85)
West							
Gujarat	0(0)	0(0)	0(0)	7(78)	0(0)	2(22)	9 (2.71)
Rajasthan	8(42)	6(32)	3(16)	2(11)	0(0)	0(0)	19 (5.72)
Punjab	1(100)	0(0)	0(0)	0(0)	0(0)	0(0)	1(0.30)
Maharashtra	5(11)	13(29)	11(24)	8(18)	3(7)	5(11)	45 (13.55)
East							
Jharkhand	0(0)	0(0)	0(0)	4(80)	1(20)	0(0)	5 (1.50)
Orissa	0(0)	3(33)	0(0)	4(44)	2(22)	0(0)	9 (2.71)
West Bengal	3(9)	9(27)	0(0)	8(24)	9(27)	4(12)	33 (9.93)
Bihar	2(18)	0(0)	2(18)	5(45)	1(9)	1(9)	11(3.31)
Centre							
Madhya Pradesh	3(30)	0(0)	3(30)	2(20)	2(20)	0(0)	10 (3.01)
Total	**49(15)**	**67(20)**	**61(18)**	**85(26)**	**55(17)**	**15(5)**	**332**
Note: *figures in brackets indicate percentage shares.*							

Table 2.2: Comparative Status of the Stakeholder's Participation				
Stakeholder's by Group	**2013**	**2011**	**2008**	**2006**
Policymakers/Government Officials	85(25.60)	108(11)	99(20)	94(14)
Civil Society	49(14.75)	148 (15)	78 (16)	137 (21)
Academia	67(20.18)	115(12)	118 (24)	126 (19)
Media	61(18.37)	55 (6)	54 (11)	59(9)
Other Experts/Practitioners	15(4.51)	221 (22)	150 (30)	83 (13)
Business	55(16.56)	337 (34)	-	160(24)
Total	**332 (100)**	**984 (100)**	**499 (100)**	**659 (100)**
Note: *figures in brackets indicate percentage shares.*				

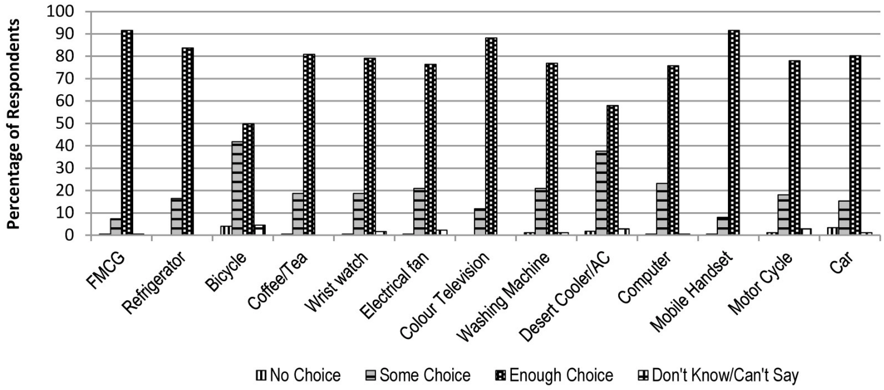
analysed in an aggregated manner, sectoral specific questions are analysed separately.

Compared to past perception/consumer surveys, the survey of 2013 has the least sample size of 332 (Table 2.2). It is a representative one that comprises policymakers/government officials, members of the civil society, academicians, media personnel, businessmen and various sectoral experts.

Level of Competition

In order to assess the level of competition that prevails in the economy, the stakeholders were asked whether they found enough choices in various products or not (Figure 2.1).

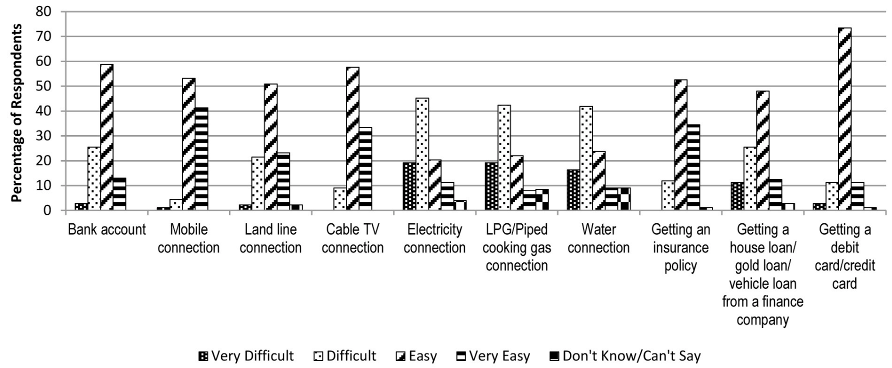
Figure 2.1: Prevalence of Choice in Various Products



Interestingly, a significant share of the respondents indicated the prevalence of competition in selected product categories (Figure 2.1). For example, more than 90 percent of the respondents said that there were enough choices under fast moving consumer goods (FMCG) category in the market. Likewise, the respondents said that there were enough choices in various products such as mobile handsets, TV, electrical fan, and tea/coffee among others. This is consistent with the survey findings of 2011 that showed high incidence of competition in various product categories in the Indian market.

Similarly, the stakeholders were asked about the ease of getting various essential services/utilities. And the responses were mixed (Figure 2.2).

Figure 2.2: Ease of Getting the Essential Services/Utilities



While they were able to get some essential services easily, they faced difficulties in getting other essential services. For instance, creating bank account, getting mobile connection (as opposed to mobile handset as mentioned above), cable TV, and landline connections were some of the services that were easily available to general consumers. However, getting electricity, piped cooking gas, and tap water connections were other essential utilities that were not easily available to general consumers (Figure 2.2). Furthermore, the stakeholders were asked about the reasons for not getting some specific services/utilities with ease. And a significant share of the respondents opined that the lengthy/complex procedural requirements as well as uncooperative behaviour of officers had caused difficulties in getting the said services.

When asked about ever facing a dubious marketing or promotional scheme for a financial product, almost half of the respondents indicated receiving promise of extra-ordinary return within a short period of time, upon purchase of a specified product (Figure 2.3). Another 20 percent of the total respondents said that they had been promised a false offer of high return on the financial product if they helped financial institution procure more customers (Figure 2.3).

The respondents were asked about the need for standardised basic products and services in financial sector. More than 80 percent of the respondents agreed with this need while 7 percent of the total respondents did not feel the need for such standardised basic products and services.

Similarly, the respondents were asked about the ease of switching suppliers for a list of service providers such as mobile, land line and others.

Figure 2.3: Ever faced a Dubious Marketing/Promotional Scheme for a Financial Product

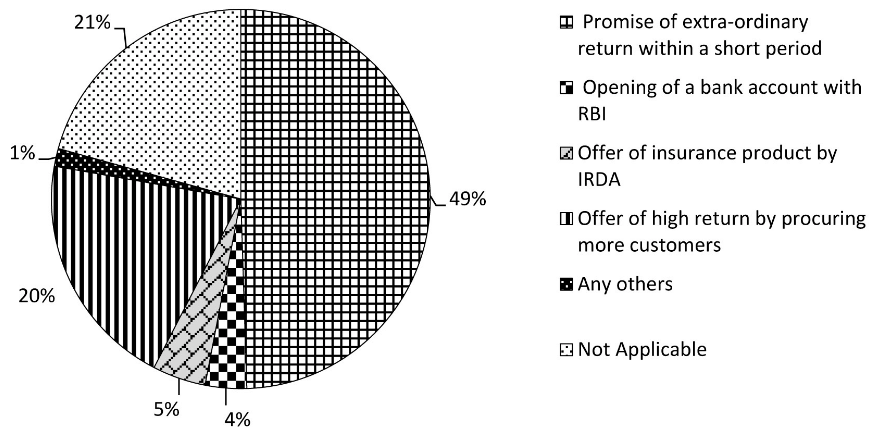


Table 2.3: Ease of Switching Suppliers

Services	No option to change supplier	Very Difficult	Difficult	Easy	Very Easy	Don't know/ Can't say
Mobile service provider	1%	7%	21%	51%	18%	2%
Land line service provider	2%	8%	29%	45%	9%	6%
Cable TV operator	1%	5%	16%	59%	17%	3%
LPG supplier	3%	15%	33%	37%	3%	9%

On this question, one can observe that the customers were able to switch the service providers easily as they need not face any hassles and financial burdens. 59 percent of the total respondents said that they could easily switch the cable TV service provider and 51 percent of the total respondents said that they could easily switch the mobile service provider (Table 2.3). This is an indication of the prevalence of fair competition in the market.

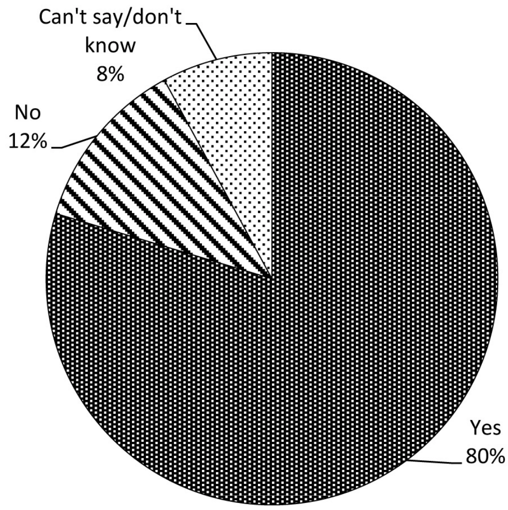
When asked about the quality of service, majority of respondents were satisfied with the quality of service received from various utility companies.

Table 2.4: Quality of Service					
Services	Very bad quality	Bad Quality	Good Quality	Very Good Quality	Don't know/ Can't say
Mobile	1%	7%	62%	29%	1%
Landline	2%	13%	62%	20%	2%
Cable TV	3%	12%	62%	21%	1%
Electricity	7%	28%	48%	15%	2%
Water	7%	33%	44%	15%	2%
LPG/Piped cooking gas	3%	30%	42%	19%	6%

91 percent of the total respondents said that they received good to very good quality of service from mobile service providers. 82 percent of the total respondents were satisfied with the landline service provider. Nearly a quarter of the total respondents said that the quality of service was bad in electricity, water and cooking gas utilities (Table 2.4).

When asked about whether the public sector financial service providers (such as SBI, LIC) were safer to transact with than private sector financial service providers (such as HDFC, ICICI Lombard), 80 percent of the total respondents said they felt safer with the public sector financial service providers (Figure 2.4).

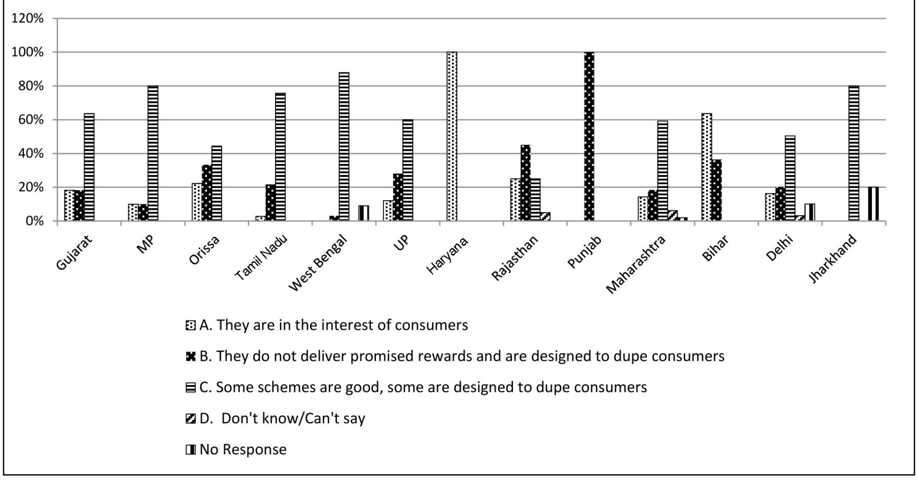
Figure 2.4: Trust on Public Sector Financial Providers



Nature of Practices

A range of questions were asked to stakeholders regarding the nature of practices that prevail in the market place. Some of them are presented here for our understanding of the functioning of the market.

Figure 2.5: Opinions (state-wise) on Various Promotional Schemes Run by Sellers

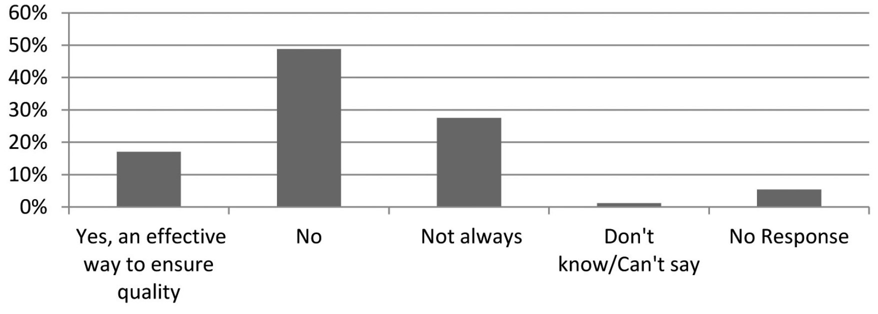


Interestingly, a majority of the respondents across all the surveyed states said that while some promotional schemes run by sellers were good, others were designed to dupe consumers (Figure 2.5). Moreover, they were of the opinion that the various promotional schemes did not deliver the promised rewards to consumers. This finding indicates that the market regulation is weak across the country. Because the sellers/producers are exploiting the general consumers with the false promises merely to increase their sales.

Usually, the practice of 'tied-selling' is prevalent in the market. This practice basically means that doctors ask patients to get diagnostic tests done from prescribed laboratories; schools ask students to buy uniforms from prescribed shops/sellers and so on. So the stakeholders were asked whether or not such practice was appropriate (Figure 2.6).

An overwhelming 49 percent of the respondents said that the practice was inappropriate. This was a means to make easy money and hence provided a limited number of choices for consumers. 28 percent of the respondents said that the practice was not always inappropriate because such practice sometimes helped ensure quality. Only 17 percent of the respondents opined that the practice was an effective way to ensure quality as reliability was a matter of concern in these services (Figure 2.6).

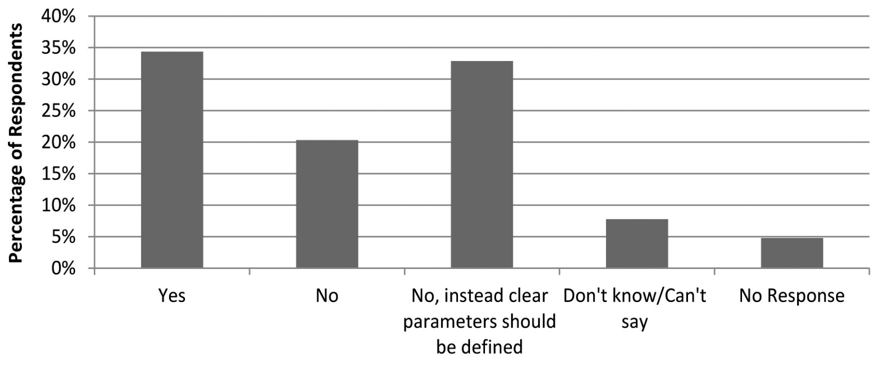
Figure 2.6: Practice of 'Tied-Selling'



Again, the stakeholders were asked about their opinions on the present restrictions on advertisements from certain professionals like doctors, lawyers, and charter accountants (Figure 2.7).

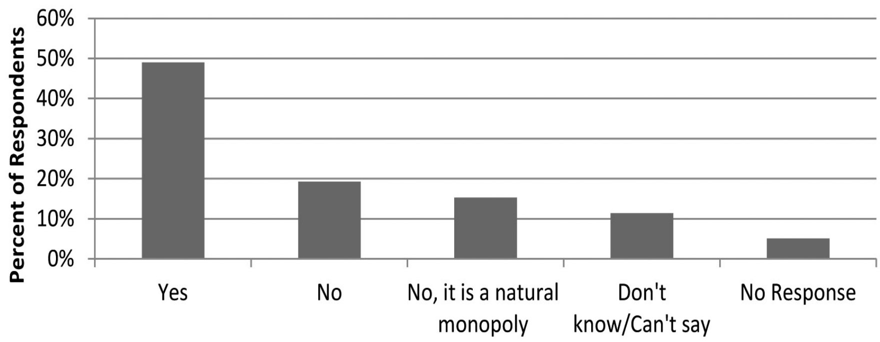
33 percent of the respondents opined that instead of outright bans on advertisements, clear parameters should be defined for advertisements, thereby ruling out inducements and misleading claims. However, almost equal share of the respondents believed that such restrictions protected the public from misleading information (Figure 2.7). And, 20 percent of the respondents believed that such restrictions favoured established firms, restricted entry and had anticompetitive effects in the local and national economies (Figure 2.7). This indicates that it is time to review such restrictive policies because market efficiency will be compromised in the absence of free competition.

Figure 2.7: Justification of Such Restrictions



Certain industries in India are characterised by one or two dominant firms. The respondents were asked about their views on such dominance. Was the dominance an outcome of natural monopoly? Or was it due to perfect competition that evicted the unsuccessful firms out of the market?

Figure 2.8: Dominance of One or Two Firms: A Matter of Concern



Interestingly, 49 percent of the respondents said that the emergence of dominant position of one of two firms was a matter of concern (Figure 2.8). While 19 percent of the respondents said that there was nothing to worry as market forces ensure enough competition, 15 percent of the respondents said that such dominance was an outcome of natural monopoly due to the nature of industry/technology *per se* (Figure 2.8).

Awareness/Knowledge on Competition & Regulatory Issues

A range of questions were asked to stakeholders regarding their level of awareness/knowledge on competition and regulatory issues in India. For example, when asked whether or not the stakeholders were aware of the 'Competition Commission of India', ironically a large proportion of respondents (48 percent) said that they were totally unaware of the existence of such commission in the country (Figure 2.9).

This shows a bleak scenario of the level of awareness on competition and regulatory bodies in the country among informed stakeholders (Figure 2.9).Consequently, there is a need for greater advocacy at the state level by the Competition Commission of India (CCI). Regional/state level benches of Commission might be an effective way to increase awareness. The stakeholders were asked whether or not the existing regulatory mechanisms such as competition authority, consumer forums, and any other agencies at state/sub-state levels were effective for addressing anticompetitive practices (Figure 2.10).

Figure 2.9: Awareness on the 'Competition Commission of India'

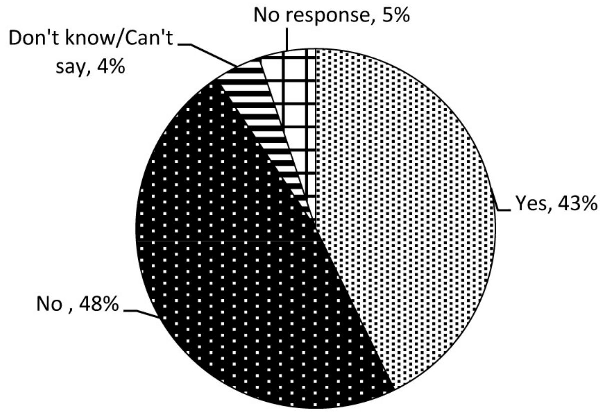
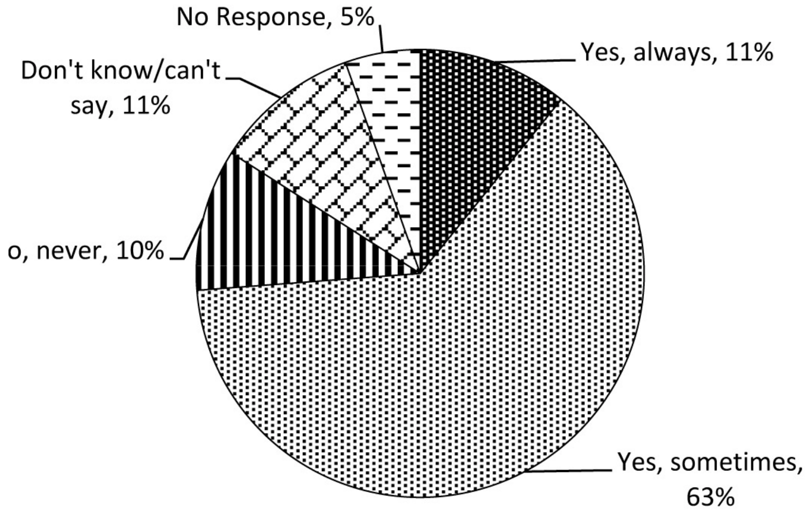


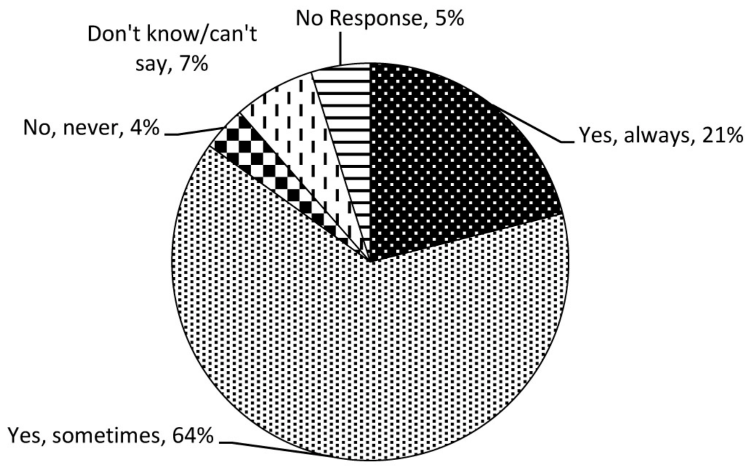
Figure 2.10: Effectiveness of Existing Regulatory Mechanisms



While just 11 percent of the respondents answered that such mechanisms were always effective, more than 60 percent of the respondents answered that such mechanisms were sometimes effective (Figure 2.10). These findings are congruent with the findings of 2011 Perception Survey, which shows that around 10 percent of the respondents were unaware of the existing regulatory mechanism in the country.

The stakeholders were further asked about the capability of independent regulators in enforcing regulatory orders at the local levels (Figure 2.11).

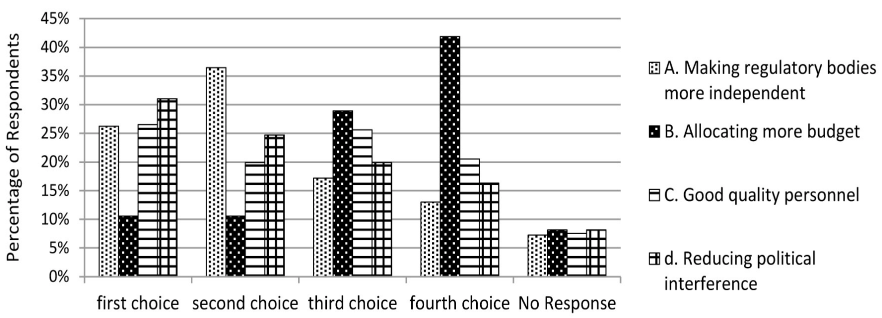
Figure 2.11: Capability of Independent Regulators in Enforcing their Tariff/Regulatory Orders



The survey findings show that 64 percent of the total respondents believed that the independent regulators have been effective, at times, in enforcing their tariff/regulatory orders at the local level (Figure 2.11). Again, these findings are congruent with the findings of 2011 Perception Survey, which shows that around four percent of the respondents were unclear about the capability of independent regulators in enforcing their tariff/regulatory orders.

The stakeholders were asked about their views on improving the quality of regulation. They were provided with four different measures, namely, i) making regulatory bodies more independent, ii) allocating more budget, iii) good quality personnel, and iv) reducing political interference. They were asked to choose these measures on the basis of priority (Figure 2.12).

Figure 2.12: Mechanisms for Improving the Quality of Regulation

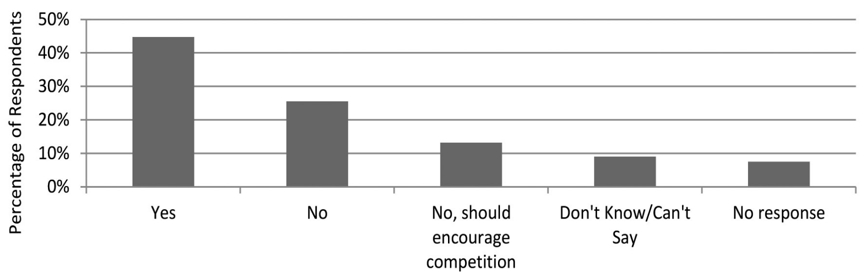


31 percent of the total respondents accorded the reduction of political interference as their first priority for improving the quality of regulation. More than 1/4th of the total respondents indicated the pronounced independence of regulatory bodies as their first priority for improving regulatory institution (Figure 2.12). These findings show that more independence of regulatory bodies and reduced political interference matter the most than budget and other resources. Again, these findings are congruent with the findings of 2011 Perception Survey, which shows that around 30 percent of the respondents felt that reducing political interference was the topmost priority for improving the quality of regulation in the country.

Nature & Impact of Government Policies/Measures

A range of questions were asked to stakeholders regarding the nature and impact of government policies on existing regulatory mechanisms. For example, India has experimented with price control of select patented products. The stakeholders were asked about their views on such action of price fixing (Figure 2.13).

Figure 2.13: Action of Price Fixing: Is It the Right Way to Protect Interest of Consumers?



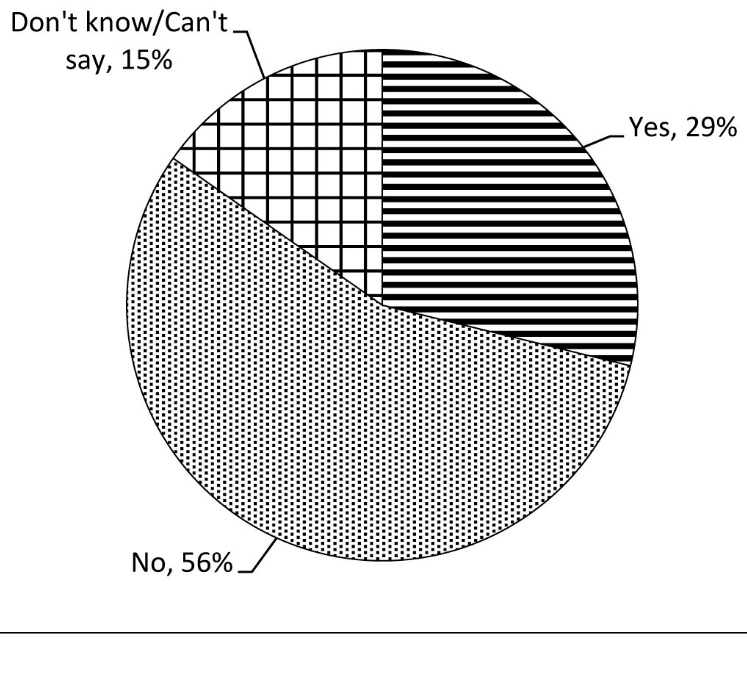
45 percent of the total respondents said that such price fixing mechanism was indeed the right way to protect the interest of consumers. 26 percent of the total respondents did not agree with such mechanism. Instead, they said that the government should have entrusted the task of fixing prices for patented goods to a specialised body such as the patent authority. And just 13 percent of the total respondents said that the government should have instead encouraged competition (Figure 2.13). Again, these findings are congruent with the findings of 2011 Perception survey which shows that around 27 percent of the total respondents were unclear about the effectiveness of existing governmental policies on competition and regulation issues.

Similarly, the survey findings show that 40 percent of the total respondents believed that the government intervention in pricing of essential commodities was always correct. Again, these findings corroborate the findings of 2011 Perception Survey.

The respondents were also asked whether the government's policy of giving purchase preference to public sector units (PSUs) in government procurement was right or not. 38 percent of the total respondents agreed with such policy as it compensates PSUs for social objectives that they are required to fulfill and enables them to compete with private companies. 21 percent of the respondents disagreed with the policy as it creates an uneven playing field and distorts the market process. And 20 percent of the respondents said that the government should instead give PSUs autonomy and allow them to operate.

The respondents were asked about their views on provision of appointing retired bureaucrats and judges as regulators. 56 percent of the total respondents said that such appointments were inappropriate as they hindered appointment of professionals and reduced regulatory effectiveness in the country.

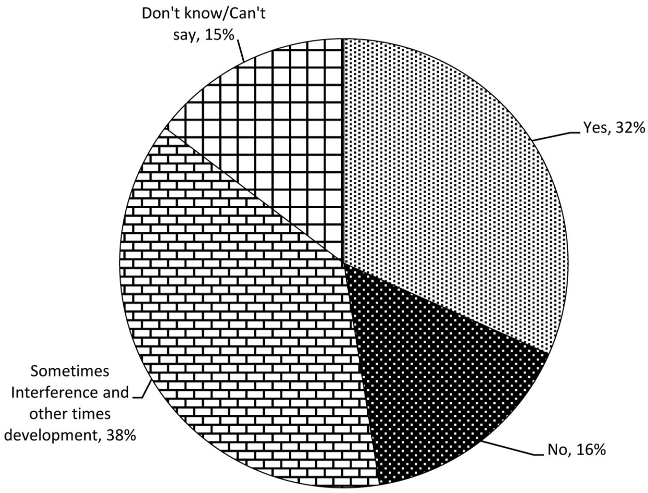
Figure 2.14: Appointment of Retired Bureaucrats and Judges as Regulators



And just 29 percent of the total respondents said that such appointments allowed regulators to maintain a congenial relationship with the government and enhanced regulatory effectiveness (Figure 2.14).

Finally, the respondents were asked whether policy directives/fees and charges announced by a Minister/Department affected the functioning/ autonomy of a regulator or not.

Figure 2.15: Policy Directives Affecting the Functioning of a Regulator



32 percent of the total respondents said that these actions interfered in the functioning of the regulator and reduced regulator autonomy. And 38 percent of the total respondents believed that these actions sometimes amounted to interference and other times helped in the development of the sector (Figure 2.15).

Awareness and Perception on Sector-specific Competition and Regulatory Issues

In addition to a set of general questionnaires, the state of awareness and perception on sector-specific competition and regulatory issues were analysed through other sets of business questionnaires. The respondents in this category mainly comprised business stakeholders, sectoral experts, and policy makers.

On **finance**, the stakeholders were asked about the need for an increased competition in the sector, and approximately, 77 percent of the total respondents agreed with the need for an increased competition in the financial sector (Figure 2.16). Approximately 81 percent of the total respondents believed that the government would not let the public sector financial service providers fail (Figure 2.17). And around 46 percent of the total respondents believed that the differential regulation of banking and non-banking financial company (NBFC) sectors was creating an uneven playing field and transfer of risk from NBFC to banking sector (Figure 2.18).

Figure 2.16: Need for an Increased Competition in Financial Sector

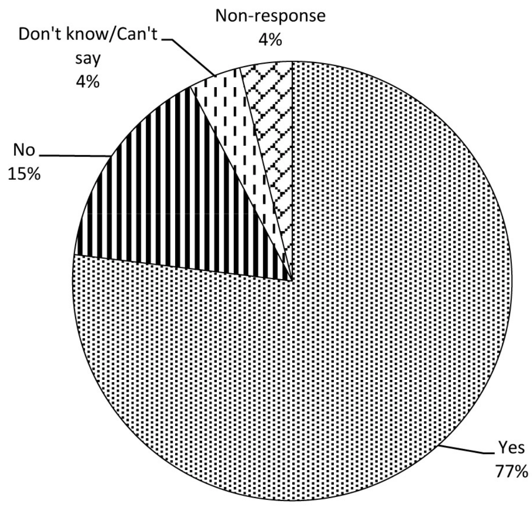


Figure 2.17: Government will not let the Public Sector Financial Service Providers Fail

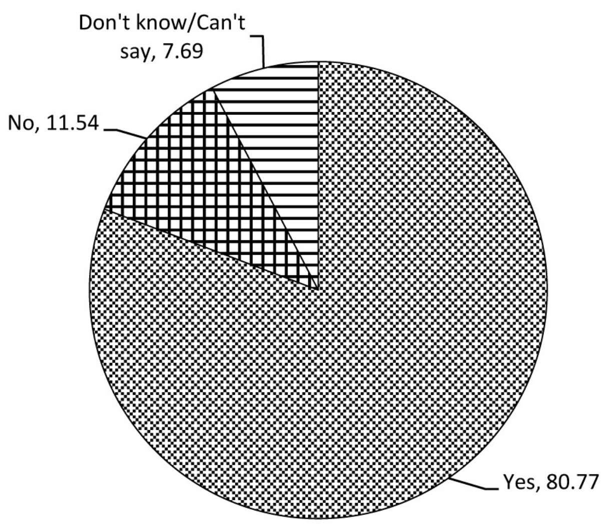
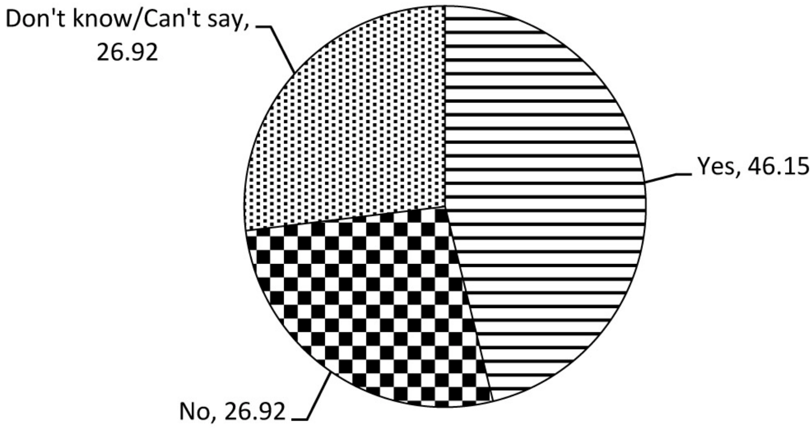


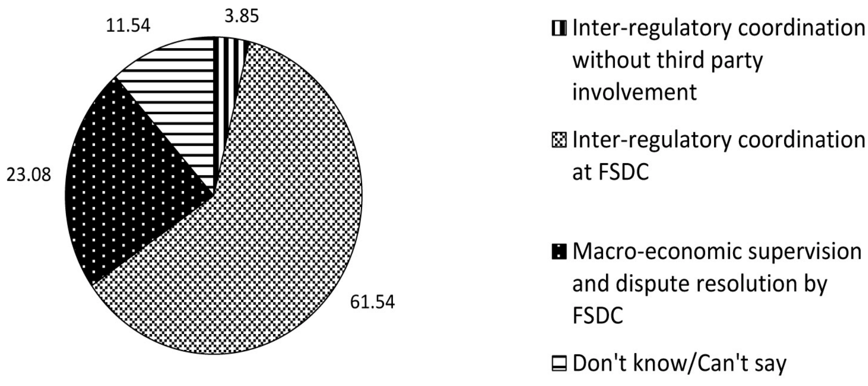
Figure 2.18: Differential Regulation of Banking and NBFC Sector is Creating an Uneven Playing Field and Transfer of Risk from NBFC to Banking Sector



Furthermore, the stakeholders were asked regarding the most preferred solution to manage systemic concerns and inter-regulatory disputes in the financial sector (Figure 2.19).

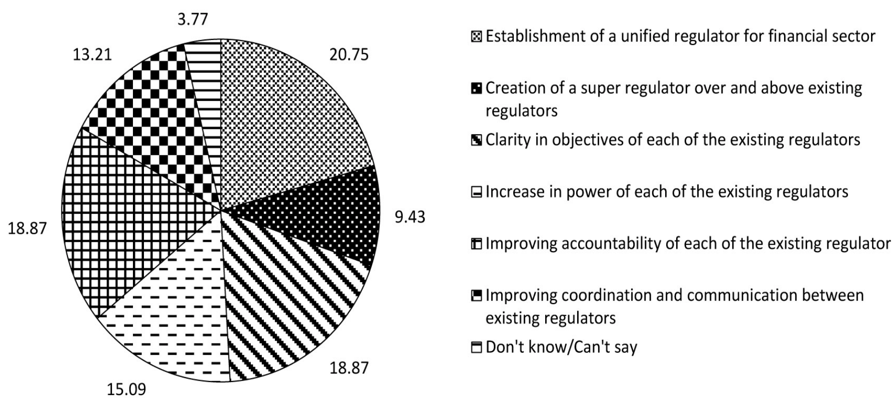
Approximately 62 percent of the total respondents said that inter-regulatory coordination at Financial Stability and Development Council (FSDC) was the most preferred solution to address systemic concerns and inter-regulatory disputes. And around 23 percent of the total respondents said that macro-economic supervision and dispute resolution by FSDC was the most preferred solution (Figure 2.19).

Figure 2.19: Solutions to Manage Inter-Regulatory Disputes



The stakeholders were asked about their views on avoiding problems related to over-regulation and under-regulation in the financial sector (Figure 2.20).

Figure 2.20: Means to Avoid Problems Associated with Over-regulation and Under-regulation



Note: n = 53 due to multiple select option

Approximately 21 percent of the total respondents believed that the establishment of a unified regulator was the most appropriate solution to avoid such problems in the financial sector. About 19 percent of the total respondents believed that improving accountability and bringing clarity in objectives of each of the existing regulator was the most appropriate solution to address such issues. And 15 percent of the total respondents believed that improving coordination and communication between existing regulators was the most appropriate solution to address problems associated with over-regulation and under-regulation in the financial sector (Figure 2.20).

Around 62 percent of the total respondents believed that, if an independent regulator is setup, the body should be accountable to the Ministry of Finance. And 27 percent of the total respondents believed that it should be accountable to the Parliamentary Standing Committee.

Overall, the stakeholders perceive that there is a greater need for an increased competition and a balanced regulation, i.e. accountable towards the society, in the financial sector.

On **coal**, the respondents were asked about their perception on nationalisation of the coal sector.

Table 2.5: Perception on the Nationalisation of the Coal Sector? (Multiple select)				
Views	**Policy makers/ Government officials**	**Business**	**Sectoral experts**	**Total**
It was done to preserve the coal deposits	13	2	1	16 (17)
It was done to protect the environment	19	6	1	26 (27.6)
It was done to keep the quality of coal standard	6	3	1	10 (10.6)
It was done to keep production levels of coal at par	11	6	0	17 (18)
It was done to provide better quality of life for the mine workers	19	4	1	24 (25.5)
Don't know/Can't say	1	0	0	1(1.06)
***Note**: (figures in brackets indicate percentage shares)*				

Around 26 percent of the total respondents believed that the nationalisation of the coal sector was done to protect the environment. While around 24 percent of the total respondents believed that it was done to provide better quality of life for the mine workers, 18 percent of the total respondents felt that it was done to keep production levels of coal at par, 17 percent of the total respondents opined that the nationalisation of the sector was done to preserve the coal deposits (Table 2.5). When asked about whether or not nationalisation of the coal sector had achieved its objectives, around 82 percent of the total respondents said that the objectives had been achieved.

But when asked about the barriers in coal exploration and mining markets, 19 percent of the total respondents said that ban on private sector participation in coal exploration was the principal barrier. Approximately 35 percent of the total respondents said that long delays in allotment of surface rights and mining clearances remained as the major barrier in coal exploration and mining markets.

A series of questions pertaining to the participation of private sector in coal exploration/production were asked to the stakeholders. Approximately 78 percent of the total respondents thought that it was necessary to allow private sector participation in coal exploration (Table 2.6). And about 65 percent of the total respondents believed that an opening up of the sector to private players across the coal production chain would help increase sectoral productivity (Table 2.7).

Table 2.6: Private Sector Participation in Coal Exploration	
YES	NO
35 (77.77)	10 (22.22)
Note: (figures in brackets indicate percentage shares)	

Table 2.7: Opening up of the Sector to Private Players Help Increase Sectoral Productivity	
YES	NO
29 (64.44)	16 (35.55)
Note: (figures in brackets indicate percentage shares)	

When asked about the need for a regulator in the coal sector, approximately 82 percent of the total respondents agreed with this requirement in the sector. And approximately, 30 percent of the total respondents believed that, if an independent regulator is setup, the regulator should be accountable to the Ministry of Coal. And 39 percent of the total respondents believed that it should be accountable to the Parliamentary Standing Committee. These statistics are indicative of the high prevalence of awareness on regulation in the country.

On **Railways**, the respondents were asked about the need for an independent regulator in the Railways sector. 69 percent of the total respondents said that the sector needed an independent regulator. This is an indication of increased level of awareness on the significance of regulation among the informed stakeholders. Around 60 percent of the total respondents thought that the independent regulator was an essential prerequisite for fostering private participation in railways' transport operations.

Table 2.8 depicts the stakeholders' perceptions about the role of the regulator in the Railways sector in India.

Table 2.8: The Role of Regulator in the Railways sector (Multiple select)				
Choices	**Policy makers/ Government officials**	**Business**	**Sectoral experts**	**Total**
Tariff fixation	15	7	3	25 (27.17)
Help to improve performance	13	10	4	27 (29.34)
Help to increase productivity	11	11	2	24 (26.08)
Ensuring 'Level Playing Field'	6	5	2	13 (14.13)
Don't know/Can't say	2	0	1	3 (3.26)
Note: *figures in brackets indicate percentage shares.*				

Approximately 29 percent of the total respondents said that the regulator in the Railways sector should work towards improving the performance of the sector. While 27 percent of the total respondents believed that the regulator was essential for tariff fixation, 26 percent of the total respondents said that the regulator should focus on increasing the productivity of the sector (Table 2.8).

When asked about the areas where the autonomous regulator could intervene, almost an equal share of the respondents pointed out areas such as safety, services, route operation, and ticket procurement procedures, where the regulator could intervene. Around 22 percent of the total respondents said that the regulator could intervene on fare structure (see Table 2.9).

Around 41 percent of the total respondents believed that, if an independent regulator is setup, the body should be accountable to the Ministry of Railways. And 36 percent of the total respondents believed that it should be accountable to the Parliamentary Standing Committee. Approximately 55 percent of the total respondents believed that the Independent Regulatory Body (with an arm's length from the Indian Railways) would more efficiently provide a 'Level Playing Field' between incumbent and the private operators.

Table 2.9 depicts the share of respondents who indicated issues that needed the topmost priority.

Table 2.9: Issues that Needed the Topmost Priority	
Issues	**Respondents (%)**
Pricing/Tariff	7.32
Quality of service in passenger trains	19.51
Infrastructure maintenance work	14.63
Increase in the number of passenger/freight trains	4.88
Security of passengers (in the wake of the increase in accidents)	17.07
Availability of tickets/ ticket procurement procedures	21.95
PPP ventures to make Railways of international standards	14.63

Around 22 percent of the total respondents believed that if the sector is to be improved, then issues pertaining to ticket procurement procedures must be addressed first. Similarly, 19 percent of the total respondents said that the quality of service in passenger trains must be maintained with the topmost priority. And 17 percent of the total respondents said that the security of passengers must be addressed with the topmost priority (Table 2.9).

The respondents were asked about their thoughts on the impact of 'Separation of Infrastructures and Operations' on competition, transparency and such others. Separation of Infrastructures and Operations implies management of railway infrastructure by a separate entity, so that there is a certain degree of arm's length between the infrastructure ownership and operations of railways. Table 2.10 depicts the findings.

Table 2.10: Impact of 'Separation of Infrastructures and Operations'				
Possible Impact	**High**	**Low**	**Moderate**	**Not Applicable**
Reducing barriers to entry by increasing transparency	25(59.52)	2 (4.76)	12 (28.57)	3 (7.14)
Increasing the level of competition	22 (55.00)	8 (20.00)	7 (17.50)	3 (7.50)
Provision of non-discriminatory access to essential infrastructure	14 (33.33)	6 (14.29)	20 (47.62)	2 (4.76)
Level playing field between public sector units and private players	19 (46.34)	5 (12.20)	14 (34.15)	3 (7.32)
***Note**: figures in brackets indicate percentage shares.*				

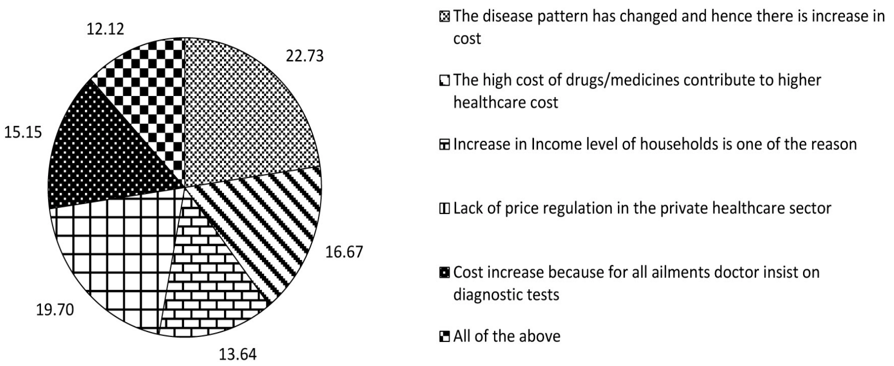
When enquired about impact of separation of infrastructure and operation, around 46 percent of respondents believed that separation has high possibility of bringing level playing field between public sector units and private players. However, around 48 percent of the respondents believed that such separation would have moderate impact on achieving non-discriminatory access to essential infrastructure (Table 2.10).

Overall, the stakeholders perceive that the sector needs an independent regulator as it will help improve the performance of the sector. They believe that the autonomous regulator can play a significant role in enhancing the services that are delivered.

On **private healthcare**, the stakeholders were asked about the need of an independent regulator for private healthcare sector. Overwhelmingly, 83 percent of the total respondents said that they needed an independent regulator to regulate the private healthcare sector.

The cost of delivering healthcare services by private establishments has increased manifolds over the period of time. The stakeholders' views on this matter were assessed, the results of which are shown in Figure 2.21.

Figure 2.21: Stakeholders' Views on Increased Private Healthcare Services



Almost 20 percent of the total respondents said that the increased cost of private healthcare services was mainly due to lack of price regulation in the private healthcare sector. While 17 percent of the total respondents believed that the increased cost was due to increment in medicinal prices, around 15 percent of the total respondents said that the increased cost was due to many diagnostic tests that have become compulsory in today's private healthcare system (Figure 2.21).

There are various bodies which look at different aspects of healthcare regulation, such as state department health, state medical councils, and consumer courts. But concerns loom across the country that none of these regulatory bodies can effectively address key regulatory concerns of the sector on their own. And interestingly, 76 percent of the total respondents in the survey agreed with this notion. This indicates that reformatory actions are needed in the regulatory bodies so as to make them more accountable towards the society and the nation. And very interestingly, 68 percent of the total respondents thought that every state should adopt Clinical Establishment Act to make the private healthcare sector more accountable.

When asked whether controlling the price of all essential drugs is the right way or not, 67 percent of the total respondents said that controlling the price of all essential drugs was the best option considering that it was the doctors and retailers that played an important role in purchase decisions. While 17 percent of the total respondents said that government should instead encourage competition with appropriate monitoring of prices, 10 percent of the total respondents said that price control should instead be restricted to only a few medicines that have seen excessive price increase and others should be put on a watch list.

Around 77 percent of the total respondents believed that, if an independent regulator is setup, the body should be accountable to the Ministry of Health and Family Welfare. And just 7 percent of the total respondents believed that it should be accountable to the Department of Pharmaceuticals under the Ministry of Chemicals & Fertilisers. Overall, the stakeholders perceive that there is a greater need for an independent regulator to regulate the private healthcare sector given the incidence of ever-increasing cost of private healthcare.

Conclusion and Key Messages

The survey findings clearly show that a significant level of competition prevails in the Indian economy. But when the stakeholders were asked about the existence of the CCI, a large number of respondents said that they were unaware of the existence of such commission. This shows a bleak scenario of the level of awareness on the existence of competition and regulatory agencies in the country. Setting up of regional branches of the CCI, is thus the need of the hour to ensure adequate awareness about the competition authority.

Furthermore, mere existence of competition does not ensure that consumers get quality products because many times, products have been marketed with misleading arguments and/or facts. And there are various promotional schemes, run by sellers to promote their goods, which dupe consumers.

The survey findings show that consumers face difficulties in getting some specific services/utilities such as electricity, piped cooking gas, and tap water connections. They face difficulties because of lengthy/complex procedural requirements and uncooperative behaviour of officers at governmental departments and offices. And in sectors such as coal and health, significant share of the total respondents argued for the need of an independent regulator to regulate these sectors. Thus, these findings clearly indicate that the regulatory regime in the country is weak and needs to be strengthened not only for securing consumer welfare but also for attaining greater economic efficiency.

Overall, the level of perception and awareness among stakeholders on competition and regulation in India is high. But the sample size is comprised of policymakers, government officials, businessmen, academicians, sectoral experts and other informed individuals. These represent an educated class of the society.

But what about the level of awareness on competition and regulation in India among the working class people? Do they know what competition and regulation really mean? If yes, are they aware of the existing competition policy in India? Hence, these questions remain unanswered at this point of time and need to be explored in future to gauze the exact level of perception on competition and regulation via survey i.e. representative of the entire populace across the country.

The other important point is that the levels of awareness on competition and regulation as well as the practical efficacies of regulatory regimes in India tend to vary among states. This is because states in India are allowed to 'implement their own laws in certain areas or even amend certain legislations before implementing them' (Conway & Herd, 2009).[1] In this light, it would be interesting to disentangle the efficacies of regulatory regimes in ensuring competitive environment among states. But given the small sample size, one finds really difficult to unravel the perception level as well as the effectiveness of regulatory regimes among states from this survey. So this can be analysed in future perception survey studies.

Endnote

1 Conway, P., and R. Herd (2009), "How Competitive is Product Market Regulation in India? An International and Cross-state Comparison", OECD Journal: Economic Studies.

CHAPTER 3

Regulatory Performance: Independence and Competence Matters

Introduction

In developing countries, like India, introduction of regulation or any reform often originates from the criteria other than economic efficiency, with objectives of equity (distribution of welfare) and institutional efficacies often dominating. Institutional efficacy and optimal performance *inter alia* demands competent personnel and functional independence. Functional independence for an institution implies achieving the desired degree of autonomy and maintaining an arm's length relationship from interest groups. The line between independence and autonomy is thin, but is clearly recognisable.

To be truly independent from the government, not only must the regulator be an independent statutory authority, it must also be financially and administratively independent from the government. The executive cannot be allowed to either interfere, or arm-twist the regulator to do its bidding. More importantly, since the onus of meeting the regulator's objectives lies with the regulator, the government cannot be allowed to have unbridled discretion in how the regulator hires and manages personnel, and uses its finances.[1]

This chapter tries to study if the regulators in India are as independent as they claim to be by the government and upon finding the answer to be in negative, the chapter will try to analyse the reasons for such failure and will suggest a way forward.

Introduction of Economic Reforms in India

In the past, most developing countries were characterised by significant government involvement in their economies marked by dominance of large state-owned enterprises (SoEs).

For example, in India all telecommunication services 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. The private sector was limited to producing selected goods and licencing was used as one of the policy instruments to channel private investment. Cross-border trade was not encouraged and strict restrictions were imposed on imports. Many enterprises, including commercial banks, were nationalised and a license and quota regime was adopted to direct and control activities. A bureaucratic opaque decision making process led to increased corruption.

These measures created distortions in allocative efficiency and constricted domestic production and competitiveness in Indian industry. By mid-1980s, adverse outcomes of excessive reliance on government and underutilisation of private resources started to surface. The economy continued to reflect low growth rates or stagnancy. Reliance on foreign borrowing increased substantially and the impact of 1990 Gulf war on oil prices compounded the problem and led to a severe balance of payment crisis in 1991.[2]

However, the pattern changed drastically, following the 1990s reforms marked by policies of deregulation, privatisation and trade liberalisation. One of the many important goals of the reforms was to encourage the private sector participation in the economy for better economic growth.

The economic liberalisation process, involving the use of market forces and competition, first started in US, Chile and the UK in the late 1970s and thereafter spread to most developed and developing countries during the 1980s and 1990s. In many developing countries such reforms were brought about by pressure from multilateral lending institutions which religiously followed the Washington Consensus. Market intervention policies were replaced by privatisation, trade and financial market liberalisation, deregulation and decentralisation of government structures. The shift in policy sought to increase the flexibility of economy to improve the mechanism of resource allocation and ultimately to enhance economic growth, since, in liberalised markets, customers are assured of wider choices, better quality and lower prices.

The resulting increase in participation by private players in the newly liberalised economy pointed out to a glaring need for independent sector regulations. The sectors where economic regulation was then ushered included telecom, electricity, water, oil and gas. The sector specific measures tried to eliminate public monopolies or open up strategic sectors such as telecommunications to private participation. These sectors were opened up to private investment, both greenfield and brownfield, unlike many other developing countries, which pursued large scale privatisation, mostly at the behest of multilateral lending institutions.[3] Fortunately India, being a big economy, was inure to such external pressures and thus went about the process in its own way.

Need for Independent Regulators

In India, initially, it was thought that the private sector firms would enter within the existing framework of incentives and invest using the revised and amended sectoral framework. However, the same did not happen and a need was realised for establishing independent regulators so as to provide a level playing field to private players and thus assure them of predictability and fair treatment.

There was a realisation that government intervention in markets to correct market failure in various sectors (e.g. utilities) was inappropriate and hence, a new form of economic governance emerged with independent specialised sectoral agencies for correcting market failure and ensuring competitive outcomes, with decision making based on transparent and participatory processes.

There was a need for separation of policy-making, regulation and operation functions. By 1994, the government decided to open up the telecom sector to private firms and that is when the Telecom Regulatory Authority of India (TRAI) was born. Other sectoral regulatory authorities included Central Electricity Regulatory Commission (CERC) at the federal level and State Electricity Regulatory Commissions (SERCs) in most states, Securities and Exchange Board of India (SEBI) to regulate the capital market, etc.

Recently, there have been proposals for a biotechnology regulator, a real estate regulator, a coal regulator and even a roads regulator. In the financial sector, the report of the Financial Sector Legislative Reforms Commission (FSLRC) recommends an overhaul of the financial sector regulatory architecture by merging some existing regulators, and creating new ones.

Independent regulatory regimes have been set up with the expectation of insulating economic decision making from political control, ultimately contributing towards a consistent and rational policy environment; providing a level playing field to competitors; and reducing regulatory uncertainty amongst private investors.[4]

Are Regulators Truly Independent?

Although the main focus of setting up regulators was tending to signal investors about the credibility of the investment regime- the real reason however, is to send out signals that the system is alive for interested users, not just investors. According to a CUTS 2009 study, "Creating Regulators is not the End, Key is the Regulatory Process" around 40 new regulatory agencies were being created each year between 1994 and 1996, in India. Independent regulations became the new global consensus and India did not want to be found wanting.[5]

In practice, however, whether the purpose is fulfilled or not is a tricky question. The standard arrangement of post-regulatory reform is to leave the development of policy framework in the hands of the government, whilst implementation becomes the function of regulatory agency.

Reforms and regulations are always work-in-progress. Governments choose the regulators and they are also prone to capture over time. Every sector's regulatory laws have provisions of empowering the government to issue policy directives and also remove the regulator, thus keeping the regulator virtually under government control. The prevailing confusion over difference between a policy matter and a regulatory matter, has often found the government departments to deal with typical regulatory issues under the garb of 'policy' matters. This severely undermines the ability of a regulator to function independently.

The need for institutional independence worldwide has arisen from diverse factors, depending on the domain for which the institution is intended. In UK, by the end of the 16th century, when the reign of Elizabeth I ended, a large number of people not belonging to the privileged, aristocratic, landed classes had become prosperous and were demanding a say in political and economic power and began protesting over the King's right to tax anything that he pleased. They wanted it subject to some scrutiny and, where necessary, abridgement. The first constitutional case involving the independence of the Judiciary fought in 1618, ruled that the King did not have such an absolute right. The judgment set the tone for what was to follow over the centuries.[6]

In the US, which had learnt its lessons from the events in its mother country, Britain, such independence was guaranteed in the Constitution. However, even the independence was interpreted to mean that the institution in question would not act against the wishes and agenda of the government of the day. The story was much the same in most other countries. However, the state of affairs changed after the Second World War, largely because of the emergence of civil society groups.[7]

Institutional independence has an inverse relationship with external influences over the authorities. The lesser the influence, the higher will be the scope for functional autonomy. Institutions are necessary for a healthy functioning of political and economic democracy, but they come into conflict while exercising their independence to make social welfare meaningful. In

India, the problem has been compounded, because the Parliament also wants to exercise some control over the way institutions function.[8]

The core objective for setting up these institutions outside the government's control was to redefine and demarcate regulatory functions from that of policy-making. However, it appears that the government is yet to articulate its vision and objectivity cogently for optimising the degree of independence to be delegated to these institutions.

An example of regulatory capture is that of TRAI, which in 1999, after holding extensive consultations issued its first tariff order, a landmark for infrastructure regulatory agencies in India as it attempted to set tariffs to reflect costs more closely. After an uproar in the Parliament, and opposition from other quarters, the Department of Telecommunications sent TRAI a 3-line note directing it to put its order on new phone rates on hold. TRAI refused. In response the government issued two gazette notifications, the first related to salaries, allowances and conditions of service of TRAI officials. Here, instead of setting rules for the chairman of TRAI, it made different rules depending on if he were a retired judge of the Supreme Court, a retired chief justice of a high court or if he were a serving judge. It also cut down on the allowances for foreign travel of TRAI, ostensibly in the wake of a recent Comptroller and Auditor General (CAG) report.[9]

Independent tribunals or some other appellate mechanisms are usually created to entertain appeals or disputes from orders of regulators. SEBI has Securities Appellate Tribunal (SAT), the CCI has Competition Appellate Tribunal (COMPAT), TRAI has Telecom Dispute Settlement and Appellate Tribunal (TDSAT), the CERC and SERCs have the Appellate Tribunal on Electricity (APTEL), appeals from Petroleum and Natural Gas Regulatory Board (PNGRB) go to APTEL, and so on. While tribunals, headed by a retired High or Supreme Court judge, perform an adjudicatory function, and are thus not as prone to interference from the executive as the regulators, their relationship with the executive also needs to be looked into.

One such example is the use of APTEL's use of its *suo-moto* powers. In November 2011, APTEL passed an order exercising its *suo-moto* powers, directing all SERCs to revise electricity tariffs regularly. Under the Electricity Act, 2003, all SERCs are mandated to revise electricity tariffs regularly on the basis of documentation provided to them by state electricity utilities. This was, however, not being done by most SERCs, and electricity utilities continued to suffer losses as tariffs remained low compared to the cost of producing and supplying electricity.[10]

Ostensibly, the reason for tariff increases, politicians were guided by populist pressures of keeping tariffs low, particularly for the farm sector. However, the Electricity Act 03; National Electricity Policy, 2005; and National Tariff Policy, 2006 have provided for subsidies to the deserving being made good by the government through a budgetary support, but in many cases the cost of subsidies were borne by the discoms on their books and eventually by tax payers. Thus many discoms continue to show red in the balance sheets.

Independent regulation as a mechanism of governance in India has been captured by a cartel of bureaucracy, mostly from the Indian Administrative Service (IAS). It is a post-retirement perquisite usually given on the basis of how they had functioned when in service. Today almost all regulatory bodies and several other bodies, such as Information Commissions, are headed by retired IAS officers. Members are retired bureaucrats and other former government servants. Most are subservient to the opinions of ministers and bureaucrats in service. Few function truly independently. Where there are state regulatory commissions, they are even more subservient.[11]

A former Power Secretary became the 2nd CERC chairman after his term as Power Secretary ended. It is alleged that as Power Secretary he was partly responsible for selecting the chairman and he kept the chair of the CERC vacant for more than 10 months to slip into it himself. Although various attempts have been made to highlight the non-transparent regulatory appointment process, not much success has been achieved in this respect. There is as yet no attempt to introduce accountability of regulators and legislative oversight over them due to major lack of political will.

The issue of independence of regulators is important in almost all these sectors as the government holds a major share in operations leading to the problem of competitive neutrality. Independence and accountability are properties that are required for good regulatory governance. Independence ensures that interests of various stakeholders are accorded due importance in formulating and implementing regulation and prevents regulatory capture by vested interests. Accountability ensures that regulation is based on careful weighing of pros and cons; arbitrary decisions are not taken as consumers have access to facilities for redressal and appellate authorities and courts for remedial action against incorrect regulatory decisions. One basic form of accountability is transparency in the regulatory decision making process which, to a certain extent, can be achieved through public participation.[12]

Reasons for Failure

In India, regulators are legally empowered with independence, through enactments, though such sovereignty is limited in various aspects. Besides there exists vast differences between mandated and delegated independence, with the latter much lower than the former, due to control exercised by the executives.

Under the laws, the regulators have limited powers to implement the law. In most cases the regulators have delivered what the political masters wanted. In the event that there is a conflict, the functioning of regulators takes a hit at times, as was the case with TDSAT in 2007, where due to a face-off between the ministry and regulators over TDSAT's composition resulted in a situation where TDSAT was unable to function because it did not have enough members for some time.[13]

The regulators end up reporting to the line ministry, which also manages state-owned incumbents.

Further, successful implementation of independent regulation requires financial and functional autonomy of the regulator which, in turn, depends on security of tenure of members, a mature political system as revealed by an arm's length distance between the line ministry and the regulator, earmarked sources of funds for the regulator etc.; as well as effective coordination and delineation of functions among sector regulators and competition agency.

Though regulators in India are supposed to be independent of the government, in practice they are often seen as functioning as government agents. One former telecom regulator publicly said that regulators are akin to Joint Secretary (Regulation) because they work under the Secretary to the line ministry. The regulators, such as Electricity Regulatory Commissions (ERCs), themselves have contributed to this tendency by not making use of the powers granted by the respective Acts to exercise financial autonomy. The government also always finds ways and means to conveniently distort the nature and extent of functional independence.

Functional independence is also cramped because of dependence of regulators on the concerned ministry for budgetary allotments, endorsement of staff appointments and the need for former to report to the latter, etc. There is no uniformity on funding of regulators. Although a few 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.[14]

Furthermore, it is widely claimed that the 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 also burdening the courts with new disputes, instead of resolving them. For example, recently, there was a dispute between SEBI and IRDA over which of them will have power to regulate Unit Linked Insurance Products (ULIPs). Finally, the government was forced to intervene and settle the tussle by passing an ordinance maintaining that ULIPS would be regulated by IRDA.[15]

Another reason for regulatory ineffectiveness is that in many sectors, the principal actions had been taken before the regulators were set up. For example, the Airports Economic Regulatory Authority (AERA) was set up after major airports in Delhi, Mumbai, Hyderabad and Bangalore were handed over to the private sector under a public-private partnership (PPP) arrangement and the regulator is still battling with some of the huge favours bestowed on the operator by the government in the concession contracts.

Few other reasons for such regulatory failures include lack of young, willing and competent regulatory professionals who are ready to take a strong stand, lack of transparent selection process of regulators, lack of laws limiting selection of retired civil servants to regulatory positions, ambiguous and incoherent sectoral laws, etc.

Putting Things Together and Way Forward

Special attention needs to be given to bring in greater transparency, accountability and hence effective independence in the regulatory structure in India. Various steps may be taken in this respect, including, *inter alia*, the following:

1. Clarity of Functions: As mentioned earlier, it is important to separate the functions relating to policy-making, regulation and operation in order to achieve better regulatory reforms. Confusion, however, prevails over what is a policy matter and what is a regulatory matter and the government departments seek to deal with typical regulatory issues under the garb of 'policy' matters. This undermines the ability of a regulator to function independently.

Inspiration may be taken from the Electricity Authority of Cambodia (EAC) in this context. The Act establishing EAC clearly separates EAC's function as a regulator from that of the ministry concerned and interaction between EAC and the ministry is clearly stated in the law and hence provides sufficient clarity. Laws establishing regulators must therefore, be drafted to protect against such conflicts. At the same time, there must also be mechanisms to ensure regulators remain accountable to the Parliament.

2. **Financial Independence:** An important aspect of regulatory independence is financial independence. Dependence on uncertain budgetary allocations reduces the independence of regulatory bodies. To be truly independent from the government, not only must the regulator be an independent statutory authority, it must also be financially and administratively independent from the government. The executive cannot be allowed to either interfere, or arm-twist the regulator to do its bidding. More importantly, since the onus of meeting the regulator's objectives lies with the regulator, the government cannot be allowed to have unbridled discretion in how the regulator hires and manages personnel, and uses its finances.[16]

The report of the FSLRC recommends physical, legal and administrative separation of the regulator from the government, implying that regulators must have independent infrastructure and personnel. With regard to financial independence, the FSRLC recommends independent sourcing of finances from avenues such as fees.[17]

In Zambia, the government amended the relevant legislation to enable the Energy Regulatory Body (ERB) to retain a certain percentage of amount collected from undertakings as license fees, instead of sending the entire amount into government's coffers. It is time to emulate such practices in India also.

In India, ERCs, with few exceptions, depend upon state exchequers although the Electricity Act 2003 empowers them to generate revenue through licence fees etc. The lack of financial independence also leads to problems relating to quality and capacity of personnel. The ceiling on salaries imposed by governments prevents the ERCs from appointing quality personnel. At the same time, financial constraints prevent them from conducting adequate training programmes to enhance the capacity of their staff."[18]

Financial autonomy may be ensured through the following measures:[19]

- Regulatory agencies should be allowed to generate resources on their own through a reasonable fee, cess, etc. wherever possible, and be allowed to spend it;

- The financial requirements proposed by the regulator should be linked with their work plan for a certain time period and approved by the Parliament; the regulator's budget should ideally be a charged expenditure on the consolidated fund; and

- Regulators should be given the liberty to hire required staff on contract and appoint consultants in a transparent manner.

3. Distance from line ministry: Micro-management by the line minister rendering independent regulators ineffective or powerless must be prevented.

In India, we have just one example of arm's length relationship between the line ministry and regulatory institution. The Commission on Railway Safety reports to the Civil Aviation Ministry and not the Railways Ministry, thus it is partially immune from pressures of the Railways Ministry to influence its work. The safety body is manned by experienced railway staff to carry out inspections etc, and the staff is also provided immunity from reprisals as they need not return to the Railways Ministry, but to serve the safety body until they retire.

The regulatory design followed in South Africa is also worth mentioning in this context, which has helped in avoiding such conflict of interest situation.

Eskom, the dominant vertically integrated state-owned utility in power sector in South Africa, reports to the Department of Public Enterprises and not the Ministry of Minerals and Energy, the line ministry for energy sector. In this scenario, the line ministry cannot protect Eskom, and the regulator is able to take action that affects SoE's interests. The regulator's assertiveness was shown when in year 2004 it turned down Eskom's request for an above-inflation tariff hike of 8.5 percent and instead approved a low 2.5 percent rise, which resulted in Eskom appealing to the Ministry of Minerals and Energy (which then enjoyed appellate powers), but the Minister upheld the order passed by regulator.[20]

An important objective of regulation is to protect consumer interest and involve stakeholders in the decision-making process. Consultative process in decision making would not be meaningful if interest groups do not have required capability to take advantage of it. In practice, under representation of consumers remains a concern in developing countries as they lack in capacity and resources to represent their interests.[21]

4. Efficient appointment of resources: An important requirement of good regulation is to have the right people on board. This requires having in place proper mechanisms to ensure appointment of experts as regulators.

In Indonesia, vacancies are announced in media and candidates have to pass a vigorous test process prior to being considered for appointment as regulators. In South Africa, nominations for appointing telecom regulator are invited from the market and public hearings are held in respect of each candidate. In some countries, the Parliament plays a decisive role in ratifying candidates.[22] These practices ensure transparency in selection and keeps discretionary elements at bay.

The Capital Market Authority in Kenya maintains a policy of attracting and retaining a small multidimensional team of professionals and administrative staff. Regulatory bodies in Zambia and Cambodia are also empowered to appoint their own staff and determine their terms and conditions. This allows them to offer the staff a market-based salary, as witnessed in the case of the water regulation in Zambia.[23]

Selections must be broad-based and consider other professions, not just government bureaucracy. Younger regulators and tenure of five years must be aimed as regulators in most cases do not need expertise in sectoral areas such as electricity, telecommunications, oil and gas, etc. They must understand the main drivers and the contours of their sector. Equally important, they must be skilled at understanding interdisciplinary connections — the economy, societal conditions, finance, accounting, the constitutional framework, legal rules for the sector and the regulatory commission, and the behavioural characteristics of the consumers. They must be intellectually honest and strong, possess the courage of conviction and be able to stand firmly against contrary government and public influences.[24]

The government must make the selection process transparent and short of interference. To ensure this, the chairpersons and members of regulatory bodies may be appointed by the President of India on the recommendation of the Prime Minster. The Prime Minster can choose these names from a panel of two or three names empanelled by a committee comprising the Chairperson of the Union Public Service Commission (UPSC), Cabinet Secretary and Chairperson of the respective regulatory body and an independent expert. Similar arrangements are planned at the State level.[25] The draft Regulatory Reform Bill, 2013 has albeit brought out such arrangements but accurate implementation can only bring real changes.[26]

5. Accountability: Independence must go hand in hand with accountability. Along with independence, all regulators need to be accountable. Appropriate mechanisms are required to make independent regulatory agencies accountable. Accountability is of two types: political and legal. Political accountability involves reporting to the line ministry/legislature which may have a special committee to scrutinise and debate its contents. Legal accountability enables those aggrieved by a regulatory decision to file an appeal and complaint.

Parliamentary supervision seems to be the ideal form of political accountability as accountability to the line ministry can often be associated with pressure being exerted on the regulator to favour utilities being operated by the ministry. Similarly, vested interest groups often find it easier to effectively pressurise the regulator through the line ministry rather than through the Parliament. Therefore, replacing the line ministry's control by Parliamentary supervision across the board is necessary.

Another mechanism to make regulators accountable is by having provisions for appeals against decisions of regulator. It is important to ensure that the review provision does not create a second layer of regulation, as is currently experienced in the telecom sector in India. TRAI is not empowered to settle disputes; rather TDSAT has been assigned with the responsibility. This division of labour has adversely affected the telecom regulatory environment, as any issue can be presented as a 'dispute'. Nevertheless, judicial review is important in guarding against decisions of a regulator that fall outside its statutory mandate or that fail to follow established administrative procedures.[27]

Desired accountability amongst these independent institutions could also be attained through activism on part of civil society organisations, as well as pressure from informed public. This would work as an effective deterrent against a possible 'institutional capture', which varies with the degree of institutional independence.

6. Co-ordination between ministries and regulators: The present proliferation of new 'independent' regulatory bodies adds another layer of clutter to our governance structure without improving it. Government departments must, with the creation of regulatory agencies, simultaneously downsize. Safeguards to keep both government and regulatory bodies effective are required. For this, ministries and departments must coordinate decision-making. Combining responsibilities between regulatory bodies to reduce the number of regulators dealing with related subjects must happen. While mandatory consultations between regulatory agencies on specific issues that impinge on common jurisdictions should be in place, more important is commitment on the part of government, and clear and consistent policy objectives. The relationship between Ministry and regulator should be well defined, as it can become a source of tension and uncertainty. As stated above, it will be best to keep the regulators under a different ministry than the line ministry.

The role of the regulator is to achieve predetermined policy objectives and maintain competitive conditions in the market by ensuring that everyone follows the basic rules of the game. On the other hand, the role of policy makers is to provide long term objectives and vision to the development of a country. Policy makers issue policy guidelines which set out national priorities for sustainable development of sectors and measures for servicing disadvantaged areas of the country or sections of consumers.

Given that regulatory bodies are often created to achieve predetermined policy objectives, an absolute divorce between the two is not desirable and proper interaction between them becomes very important. At the same time, it is equally important to ensure that the regulator's domain is not encroached upon by the government in the name of achieving policy objectives. This calls for creating a clear distinction between policy and regulation, which is often missing in India.

Conclusion

Hence, we see that independent regulation is the only way to prevent theft and misuse of government resources. It will become the major factor in economic governance, in spite of administrators having captured regulatory bodies. Visible changes in the socio-economic context will ensure this happening.[28]

Regulatory efficacy demands functional independence which calls for the regulator maintaining an arm's length relationship from interest groups. One aspect of such autonomy is the ability of the regulator to access funds, the magnitude of which does not depend on the whim of the line ministry, i.e. financial independence. However, independence requires satisfaction of other pre-conditions – regulators once appointed should have fixed tenure and immunity from removal except in the case of incompetence and moral turpitude.

Regulatory reforms are important for attracting investment to creation of infrastructure and promoting consumer satisfaction to the extent possible. In India, (so called) independent regulators have been established in certain sectors but the government has continued to encroach on the domains of various regulators in the name of achieving policy objectives. A clear distinction between policy and regulation and its use in practice is required.

Since the plethora of laws that govern many regulatory agencies in India is enormous, a comprehensive overview is an arduous task. Moreover, there is little doubt that in undertaking piecemeal approach to fix problems separately, there will be little harmony that will be achieved. The government has recently approved the draft Regulatory Reform Bill 2013, which aims to make regulators across key infrastructure sectors accountable to the Parliament and also vests in them, the power to issue licenses (which hitherto lay with the ministries, majorly). Even though there are several issues that remain ignored in the draft Bill but being in consultative phase, it is hoped that the inconsistencies will be corrected in time.

To sum up, institutional independence should not be mistaken as an objective in itself. It should rather be seen as an important pre-requisite for achieving desired effectiveness, economy and efficiency in the system.

Endnotes

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CHAPTER 4

Harmonising Regulatory Conflicts*

Introduction

The common goal shared by the competition and sector regulators is to improve economic performance by preventing market failures and associated economic inefficiencies. The mandated competencies of the competition authorities and the sector regulators are different. The former focuses on preventing anticompetitive practices by checking competition abuse, while the latter encompasses technical regulation, such as the assessment of tariffs, entry and exit barriers, third party access, service standards, promotion of competition in the regulated sector etc., thus, indicating a clear difference in the methods and objectives of both. The mooted points have always been the jurisdiction conflicts, overriding powers of the regulator over the competition authority or vice-versa and encroachment issues. As far back as in 1977 David Boies[1] remarked that:

"The interface between antitrust (competition law is referred to as antitrust in the US) and regulation is a veritable no-man's land for students and practitioners alike. Since the theories of antitrust and regulation reflect differing assumptions about government intervention into the market place, it is often difficult to rationalise their impact on particular industry behaviour. The antitrust laws, to borrow a phrase, are brooding omnipresence, with pervasive, almost constitutional meaning in our jurisprudence. Direct economic regulation (which is entrusted to agencies rather than the US Courts) may supplant the anti-trust laws and specific industries for carefully carved-out purposes. But at the edges these purposes thin out and the anti-trust laws inevitable reappear in the background. At this point it is no small matter to blend the policies of the two conflicting regimes into an overall regulatory purpose that preserves the values of both".

Policymakers world over are addressing the interface of regulation and competition, where the traditionally monopolistic sectors can be subjected

* This chapter is based on a study done by CUTS International for the Indian Institute of Corporate Affairs, in November 2012. 'Harmonising Regulatory Conflicts', Indian Institute of Corporate Affairs, New Delhi. Available at: *www.iica.in/images/Harmonising%20Regulatory%20Conflicts.pdf,* last accessed on October 29, 2013

to competition norms rather than being regulated by sector-specific regulation, in order to be more cost effective and save time lapses. However, there is not much analysis on the evolution and jurisprudence of such conflicts, which is why no solution has been reached, and is also the prime focus of the present paper.

Genesis of Jurisdictional Conflicts

A growing number of countries are moving towards liberalisation, privatisation and deregulation of telecommunications, electricity, natural gas, transportation and financial sector, to curb market failures, while others such as the US, have dealt with jurisdictional problems between the two regulatory regimes, for decades.

Jurisprudence of Conflicts

Overlaps and jurisdictional clashes leading to locking of horns between the two regulators is not at all a recent issue. The awakening to issues of conflicts is in consonance with the global trend of utility privatisation and the proliferation of sectorial regulatory agencies and the breeding ground of this problem is most often at the level of domain, rules or institutions. Historically, there have been two conflicting approaches.

First, the American approach, which restricted the reach of competition to sector regulators, at the expense of the consumer and second; and the UK approach, where each sector regulator was given a mandate to deal with competition and regulatory issues. UK embarked upon a completely different approach towards privatisation of publicly owned utilities and transport industries. The latter approach has been the most favoured one, followed by many countries such as Chile, New Zealand and Jamaica.

Thus, the challenge lies in contemplating the extent to which general competition laws should have a pervading effect on sector regulation and the role each of the two types of government interventions should play. For doing this, the strategic objectives which are desired by the regulatory agencies have to be assessed, in relation with the operation and enforcement of competition law in the economy generally.

Rationale for Competition

In India, most prone to conflict issues are the network utilities, which are natural monopolies, where turf disputes and legal complexities, are mostly in areas of licensing, market dominance, pricing, mergers and restrictive business practices. All network utilities have displayed high sunk costs and demanded lofty investments. Therefore, as certain economists argue, in an economy where competition exists, regulation is hardly required as the former will address the inevitable risks of businesses and market externalities, whereas regulation, tampering with the natural state of market forces, may invariably lead to misallocation of resources, wrong investments and reduction in consumer welfare. Market externalities, which can be both positive and negative, are the unaccounted costs which are a result of actions of one party, but the brunt has to be borne by a party totally uninvolved in the transaction.

On one hand, information asymmetry is a negative externality, knowledge spill overs generated from research and development is a positive externality. The other market externalities could be regulatory changes, foreign entrants, environmental pollution etc. In addition, the public good nature of many products/services also entails the externality argument and attracts regulation. The role of the sectoral regulator should thus be more of a facilitator. For the protagonists of competition law, it maximises both, consumer and producer welfare, by lowering down costs and prices and ensures productivity, by determining economy wide rules.

Simmering Issues at Competition and Regulation Interface: Indian Scenario

The competition law boom came to India only after the enactment of the Competition Act, 2002 – which replaced the Monopolies and Restrictive Trade Practices Act (MRTPA), 1969 – which created two institutions, namely, the CCI and Competition Appellate Tribunal (COMPAT). Liberalisation and privatisation brought with it quasi-independent sector regulators, but the setup lacked clarity in distribution of roles between competition authority and sector regulators, resulting in court litigation and clashes.

For instance, Reliance Industries Limited filed a complaint with the CCI alleging cartelisation against its rivals for supply of aviation fuel to Air India. During investigation, CCI's competence was challenged by the three state-owned companies which claimed that the sector regulator: Petroleum and Natural Gas Regulatory Board (PNGRB) had the appropriate jurisdiction. This argument was upheld by the Delhi High Court in an interim order. The final disposal is yet to take place.

The electricity sector also projects certain inconsistencies in jurisdictional roles, which have come to light in few cases. For instance, in the case of Delhi Electricity Regulatory Commission (DERC), it objected to CCI's orders against three power distributors for abuse of dominance, stating that these were exclusively under their domain pursuant to Section 60 of the Electricity Act, 2003.[2] This section empowers electricity regulators to check anticompetitive practices. However, a contrary position was taken by DERC in another similar case.

Competition Agencies and Sectoral Regulatory Authorities Overlap: International Case Studies

The jurisdiction of regulatory and competition authorities has been overlapping across nations. This brings out how conflicts have emerged between the two authorities, problems arising out of failure to clearly demarcate jurisdictions, identifying potential for conflicts and process of resolving them. Countries have adopted several models to deal with conflicts and address them effectively. International experience favours the 'Institutional Approach' for governing regulatory interface, with five institutional models.

Box 4.1: Five Institutional Models

1. Primacy to competition agency for economic regulation of sectors
2. Sector regulators dealing with competition issues in a regulated industry
3. Competition law enforced through competition authority given primacy over sectoral regulatory law
4. Concurrent jurisdiction of sector regulator and competition authority.
5. General mandated division of labour

General approaches taken by countries can be broadly categorised as under:

Concurrent

In this model, application of competition law in a regulated industry by either the sector regulator or the competition authority, takes place. Here, both the regulators, i.e. the competition regulator and the respective regulator, possess equal jurisdiction and act through a consultative approach. This will help avoiding conflicts on overlapping matters and in case of failure to settle the issues amicably, a referral body of judicial persons having expertise in the field, is constituted.

The UK model is also a Concurrent one, where regulators share powers with the Office for Fair Trading (OFT) to make references to the Competition Commission. Furthermore, the COMPAT has jurisdiction over appeals from all the three bodies, thus creating a convergence. However, with the launch of a unified competition body, the Competition and Markets Authority, the Competition Commission and the OFT will be merged into a common body, for the benefit of the consumers.

Box 4.2: Structural Changes Leading to Emergence of Regulatory Agencies
In Brazil, several structural changes have taken place since the 90's leading to the emergence of regulatory agencies. The Brazilian Competition Policy System (SBDC) proposed that the administrative bodies (Secretariat for Strategic Affairs-SAE, Secretariat of Economic Law of the Ministry of Justice-SDE, Secretariat for Economic Monitoring of the Ministry of Finance-SEAE and Administrative Council for Economic Defence-CADE) should apply the anti-trust legislation as well and request one expert opinion for mergers and anticompetitive behaviour. The telecom sector presents a model of complementary jurisdiction. The General Telecom Law (GTL) empowers ANATEL (National Agency for Telecom), to enforce competition in the market. ANATEL is empowered to enforce competition in the market. GTL defines the competencies of ANATEL and CADE; however, there is no formal co-operation. A working group established by both bodies addresses the overlap and conflict problems. ANATEL is authorised to investigate merger cases and CADE is the disposal authority for banks except in mergers. Still, clarity in division of powers is required.

Coordination

This Model adopts a system of cooperation between the competition authorities and the sector regulators. Ireland, for example, has a formal cooperation agreement, envisaged in Section 34 of the Competition Act.

Spain had also introduced requirements for closer cooperation between the two regulators; however, the opinions were non-binding. However, such a framework did not suffice and the government has proposed a new approach.

Box 4.3: Spain Created a 'Super Regulator'
Spain has created a 'Super-regulator' called the National Commission of Markets and Competition (CNMC), combining the regulators for energy, telecom, gaming, postal agencies and airports under the umbrella of the anti-trust agency, to overcome the institutional overlap between the sector regulators having responsibility of the technical nitty-gritties and seeking opinions of the competition authority only on certain matters, while reserving their powers of competition surveillance.

Australia, New Zealand and South Africa also follow the same model. However, the South African Model fits both, the concurrent as well as coordinated approach. South Africa has evolved from being focused on sectoral regulation to appreciate the importance of competition law and has introduced a framework much like the UK model. The Competition Act was enacted in 1998 constituting an independent Competition Commission having investigative and prosecutorial authorities, CAT with adjudicative powers and Competition Appeals Court having a dedicated bench. The Commission has the authority to enforce law and facilitate fair competition in market. Despite the inclusion of the principle of 'concurrency' to address jurisdictional and overlap conflicts, problems could not be resolved. The rising number of telecom and merger cases, explain the state of limbo.

A MoU between the Competition and Telecom regulator, led to further duplication of cases, making the scenario worse. In the case of Telkom, Competition Commission's power and jurisdiction to address the matter was questioned. The Commission's recommendation and referral to Tribunal was challenged in High Court and Supreme Court. Finally, Supreme Court upheld the Commission's power and jurisdictional competence to hear the matter.

In 2006, Electronics Communication Act (ECA) made matters worse. The Act gave Independent Communications Authority of South Africa (ICASA) wider powers than the Commission. Attempts have been made to amend the Competition Act, 1998. In 2009, Competition Act was amended to include concurrent jurisdiction, repealing relevant sections of ECA.

Mandatory Consultations

There are several other countries where the new laws addressing overlap and jurisdiction issues, make it mandatory for a consultation procedure between the competition agency and the sector regulators, by either forming a common consultation committee or electing a representative from the Competition authority, to regularly assist and act as an ex-officio member of each sector regulator. The latter approach is followed in Zambia.

Box 4.4: Ex-Officio Member on Regulatory Boards of Sector Regulators

In Zambia, a member of the Zambian Competition Commission (ZCC) acts as an ex-officio member on regulatory boards of sector regulators, to provide necessary inputs on competition law, while deliberating on sectoral policies. In India, the current framework provides for consultations between the two regulatory authorities but it is not adequate as the opinions of the authorities in these matters are not binding. However, the proposed Competition (Amendment) Bill, 2012 inter alia seeks the inclusion of mandatory consultation.

In South Korea, overlap conflicts exist mostly in the telecom and financial sector with KFTC responsible for enforcement of MRFTA and sector regulator being the Korea Communications Commission (KCC). There have been conflicts between the Ministry of Information and Communication (MIC) – KCC and KFTC; ambiguity in mergers and acquisitions (M&As) with regard to KCC adopting KFTC's opinion. There are other conflicting provisions such as Article 63 of MRFTA (consultation with KFTC for proposing legislation or amendments); Section 54 of the Telecom Business Act (TBA) (precludes the application of MRFTA in case of anticompetitive practices in the telecom sector); Section 28 of TBA (notification to KCC and authorisation of its service rates).

Argentina, France and Turkey, also have legal provisions for consultations between the competition authority and sector regulators. The European Union follows the French model and thus many of their member state laws are required to comply with mandatory consultation.

Collaborative

In this model, the competition agency is entrusted with the responsibility of enforcing competition and determining whether or not effective competition exists or is absent, to justify price regulation. Administration of price regulation is done by the sector regulator. Mexico has adopted this approach.

In Mexico, the Federal Competition Commission (FCC) has the power to determine whether in the absence of effective competition in the market, regulatory intervention is warranted. It also possesses enforcement powers. Thus, the FCC has technical as well as operative autonomy and makes declarations on competition conditions and existence of substantial market power, in consonance with various sectoral legislations.

Use of Common Appellate Authority

Many countries have common appellate tribunals/authority, to adjudicate over disputes arising between the competition authority and sector regulator. For instance, in the UK, there is a COMPAT which has jurisdiction over all appeals from sector regulators and competition authorities. Similar structure exists under the anti-monopoly court in Poland. In India, the COMPAT is empowered to hear and dispose of appeals from decisions/orders/directions issued by the CCI. It also acts as the appellate authority called Airports Economic Regulatory Authority Appellate Tribunal, to adjudicate any dispute between two or more service providers, between a service providers and a group of consumers and to hear and dispose appeal against orders of the Airports Economic Regulatory Authority (AERA).

Use of Competition Authority to Administer Sectoral Regulatory Rules

Here the competition agency is entrusted with the task of administering industry specific rules and related matters. The Australian Competition and Consumer Commission (ACCC) which is responsible for maintaining a level playing field in the market for the benefit of consumers and businesses and also regulates national infrastructure services. In this model, it is important to understand that there needs to be specialised technical knowledge related to sectors to exist within the structure of the competition authority.

Lessons for India and the Way Ahead

Countries world over have adopted approaches to address regulatory overlap conflicts to fit their varied realities. India needs to do the same in terms of tailoring the best approach that suits its needs while taking helpful lessons from global best practices in this area.

Transition from Cooperation to Mandatory Consultation

The current procedure only provides for reference by the statutory authority to the CCI and vice-versa, in sections 21 and 21A of the Competition Act, 2002, respectively. But, this does not pacify the problem because the opinion provided by both agencies to each other, are not binding. There has been only one reported case by the Maharashtra Electricity Regulatory Commission, which sought an opinion from CCI, but whether or not the opinion was adopted, is not known.

The importance of coordination between the competition authorities and sector regulators was also highlighted by a Working Group on Competition Policy, established in 2006, whose recommendations were incorporated in the Policy Document in the 11th Five Year Plan: Inclusive Growth, (under Chapter 11: Consumer Protection and Competition Policy). This was also adopted by the National Development Council in December 2007. (Its Para 11.33[3] recommended mandatory consultation mechanism).

Box 4.5: Interface between the Competition and Sector Regulators
The interface between the Competition Commission vis-à-vis sectoral regulators is critical. The basic premise to be recognised is that sectoral regulators have domain expertise in their relevant sectors. The Competition Commission, established under the Competition Act, 2002 on the other hand, has been constituted with a broad mandate to deal with competition for which certain very specific parameters are laid down under the Act. A formal mechanism for coordination between the Competition Commission and the sector regulators is, therefore, of key importance. Coordination between sector regulators and Competition Commission should be made mandatory through suitable provisions in the Competition Act, 2002 and sectoral laws.

In this regard, the NCP (at Para 8.6[4]) provides that coordination between sector regulators and the CCI should be made mandatory through suitable provisions in the Competition Act, 2002 and relevant sectoral laws. The same has been incorporated in the proposed Competition Amendment Bill, 2012, which is awaiting Parliament's approval.

Recommended Approach

The conclusion drawn after carefully studying various jurisdictions is that the best approach for India is a concurrent framework, envisaging a mechanism for mandatory consultations between sector regulators and competition authorities. Here, demarcation of roles will be a sensitive issue. Thus, the following elements become necessary:

a. Recognition of the roles and competency of the both, the sector regulator and competition authority
b. Designing a framework mandating cooperation between the two
c. Creation of an independent body comprising of chairpersons of the appellate authorities of CCI, Appellate Tribunal for Electricity (APTEL) and Telecom Disputes Settlement and Appellate Tribunal (TDSAT) to resolve the conflicts, when they arise between the two. These could be chaired by former judges (with suitable time lag after retirement, to avoid sinecures).

The regulators need to appreciate the technical and behavioural differences existent between them. The sector regulators should have the lead in the *ex-ante* technical issues and competition authority in the largely behavioural *ex-post* issues and where regulators cannot solve issues amicably, joint expert bodies as stated above should resolve the dispute.

Emerging Competition Framework

Towards meeting the goal of having a robust competition framework in India, the FSLRC and the NCP, break new ground. The main objective of these is to suggest reformatory measures for lessening the impact of overlap issues in jurisdiction and related matters and to address the problem of turf wars between both the regulatory agencies, thereby harmonising regulatory conflicts.

National Competition Policy

The NCP is an overarching policy aimed at infusing competition principles in various statutes, policies and regulations of the government for promoting a competitive market structure of the economy, thereby unleashing a wave of new economic reforms, to make the economy more competitive, boosting productivity and helping in achieving inclusive growth.

It suggests the establishment of the National Competition Policy Council as an oversight mechanism for effective implementation. Some of the key objectives of the policy are for:

- ensuring a level playing field through competitive neutrality
- enforcing and advocating competition policy through international/national/regional cooperation
- rectifying anticompetitive features of new and existing acts/regulations/statutes/policies, thereby promoting competition, through Competition Impact Assessment measures by in-house cells of ministries and departments of the government
- guaranteeing consumer welfare by optimal allocation of resources and ensuring fair pricing and inclusionary behaviour, particularly of public utilities
- striving for a single national market
- separating (institutional) policy making, operations and regulation
- ensuring access (third party) to 'essential facilities', i.e. requiring dominant infrastructure owners to grant to third parties access (e.g., electricity, communications, gas pipe lines, railway tracks, ports etc.) to their infrastructure on agreed terms and conditions and at regulated prices, aligned with competition principles
- working towards promotion of competition in the market place through public policies and programmes
- coordinating with CCI and sectoral regulators to avoid overlap in interpretation of competition-related concerns
- facilitating functioning of autonomous and independent competition authorities

The NCP is believed to be a second wave of legislative reforms, after 1991. Taking the view that sectoral regulation has been in place ever since 1991, it is impossible to venture into dismantling the current frameworks and establishing new ones. The NCP seeks to facilitate a co-existence between the CCI and regulators and persuades different ministries of the Central, State governments and sub-state authorities to initiate the process of harmonisation. Thus, it is an initiative taken in the right direction and provides for an all-encompassing framework as opposed to the current vague set-up caused due to legislative omissions or legislative ambiguities or jurisdictional overlap.

The NCP through its recommendations, makes it imperative for the CCI to understand sector specific technical issues involved in the business line of the sector, such as, industry structure, market design, etc. and for the sector regulators to understand that the CCI has exclusive control on issues central to competition, consequently, paving way for both the agencies to acknowledge and accept the opinions given by each other, resulting in lesser turf disputes.

Also, the NCP does not encourage litigation with respect to the above issues, as it is often a time consuming process and should therefore only be the last alternative. (As rightly pointed out in the Policy Document in Para 10.2.5 and 10.2.6,[5]) the framework for interface between the competition and a sector regulator should deliver the following benefits:

- identify issues of concern;
- ensure appropriate channelisation of various concerns to the appropriate forum and obtaining corrective action at the earliest;
- establish a framework that avoids duplication of effort;
- conserve the Commission's resources and limit its ambit only to matters of competition; and
- promote capacity building and developing expertise both at the level of the competition and the sectoral regulator.

It also emphasises that the CCI and sectoral regulators need to cooperate and establish a forum for regular exchange of ideas.

Financial Sector Legislative Reforms Commission

The key features of the FSLRC are:

- Power of the CCI to issues directions to the sector regulators
- Mandatory reference by the CCI and the regulator
- A MoU between the CCI and the regulator, for promoting cooperation
- CCI's power to issue directions on competition related issues

The FSLRC brings regulators under the scanners, which have for long functioned on the mandates provided by their statutes, by imposing greater accountability standards and setting out fresh ground rules for their due process.

Conclusion

Theoretical frameworks suggest that a formal mechanism between the CCI and the sector regulators *vis-à-vis* institutional support is necessary to resolve existing conflicts. Thus, a Concurrent approach is the best suited approach for India, but has to be carefully and keenly examined and adopted into the system, to avoid ambiguities and ensure efficient implementation.

International experiences evidently explain the need for robust competition policies, coordinated with sector-specific issues. With time, countries have acknowledged the need for strengthening the competition set up to run businesses efficiently and produce effective outcomes for consumers and a conducive climate for lucrative investments. The emphasis all over the globe has been on competitive regulation by introducing policies and laws which acknowledge the market processes and understand the different mandates of the regulators, thereby suggesting mechanisms for restoring harmony and reducing turf wars.

The current framework in India has been criticised for its vagueness and incompleteness in being able to curb anticompetitive business practices, eroding the market structure and in turn defying consumer interests. Towards this end, the NCP is designed to curb market distortions, improve business facilities, deal with the corruption menace, improve consumer welfare and so on, though; its implementation will need strong political will.

The need of the hour is the adoption of robust policies, such as the NCP and more so focus on its effective implementation to achieve the desired results which it categorically spells out, significantly and timely. Like India, all countries mentioned earlier, which have moved towards more competitive frameworks, have done so after the wave of liberalisation and privatisation. Therefore, adopting the NCP can prove to be a game changer for India.

CUTS International has pursued the goal of having a pro-competitive economy and has been a major catalyst in promoting the broader objective of adoption and implementation of the NCP. Through various mediums such as Research Publications, Dossiers, Projects such as ComPEG and CREW, it has taken forward this agenda, by identifying gaps against effective competition and rectifying measures that can be taken. For fostering such a change, it has actively organised National Seminars, where the key issue of overcoming challenges in adopting the NCP has been discussed in the presence of policymakers, industry players, stakeholders including business groups and CSOs.

In this regard, several sector specific studies have also been conducted. Recently, CUTS International has petitioned the Lok Sabha Petitions Committee to ask the government to adopt and implement the draft NCP.

However, there are issues left for deliberation and as a leading advocacy group, CUTS can act as a bridge between the policymakers and stakeholders, so that the benefits of competition policy in India trickle down for the benefit of the common man also and a healthy competition culture exists. A lot more work needs to be done to ensure effective adoption of the NCP and to do the same, involvement of state actors, industry players, media etc., is essential, to facilitate which, role of CUTS and other CSOs could prove crucial.

Endnotes

1 David Boies (1997) "Public Control of Business", Little Brown

2 Electricity Act, 2003, Section 60-Market **domination -** The Appropriate Commission may issue such directions as it considers appropriate to a licensee or a generating company if such licensee or generating company enters into any agreement or abuses its dominant position or enters into a combination which is likely to cause or causes an adverse effect on competition in electricity industry

3 11th Five Year Plan Report on Inclusive Growth, available at *http://planningcommission.nic.in/plans/planrel/fiveyr/11th/11_v1/11th_vol1.pdf*, last accessed on October 28, 2013

4 Available at: *www.mca.gov.in/Ministry/pdf/Revised_Draft_National_Competition_Policy_2011_17nov2011.pdf*, last accessed on October 28, 2013

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CHAPTER 5

Competition and Regulatory Issues in the Railway Sector in India

Introduction

Indian Railways (IR) consisting of 17 zonal railways is a state-owned, monopoly-owned and operated by the Government of India (GoI) through the Ministry of Railways (MoR). The Seventh Schedule of the Constitution of India describes railway as a union subject and all activities of construction, maintenance and operations of Railways in India are governed by The Railways Act, 1989. The railways are an integral part of the nation's transport sector and its growth, efficiency and competitiveness are essential for the rapid growth of the economy.[1]

However, various reports have highlighted a gradual decline in the share of railways in the inter-modal transport mix of the country in the last few decades.[2] In goods transportation, the share of railways was around 35 percent in 2007 (which is a steep decline from 71 percent in 1970), whereas in countries like US and China the share of the railways in the movement of freight is much higher. Even in passenger transport, the share of the railways in India has dropped from 36 percent in 1970 to almost 14 percent in 2007.[3] Apart from leading to economic inefficiencies and loss of comparative advantage in international trade, the increased share of road in both freight and passenger transport imposes a significant burden on the environment.[4]

State of Railways in India

Several internal factors have held back the rapid growth of the railways and it has come to become characterised as a politically sensitive sector facing acute supply-side shortages due to inadequate infrastructure.[5]

Various reports and studies have also identified limitations and concerns about the quality of railway services. According to a nation-wide survey of users of rail freight services conducted in 1997, the results of which were highlighted in the Rakesh Mohan Committee report,[6] IR was rated below roadways on many parameters like reliability, availability, price, time, connectivity, suitability, damages, information sharing, adaptability, cost-friendliness, negotiability, access to officials, ease of payment and claim time. The scenario has not changed much in the last decade, and a similar picture emerged in the CAG's Performance Audit of the Railways Fright Services.[7] The railways have lost its competitive advantage in freight services due to indiscriminate increases in freight rates for cross-subsidising lower passenger fares.

Exhibiting several of the negative traits of a monopoly business where consumers not only pay higher prices for the services due to lack of competition coupled with fewer alternatives to choose from, the IR has also become inefficient in its operations as highlighted by the expert groups in their reports.[8,9] As a result of following issues, such as its monopoly nature, capacity constraints, poor quality of services, inadequate reforms and politically motivated pricing, the railways have lost significant percentage of its shares of national passenger and freight traffic to transportation.[10]

There is, therefore, a need to address these issues and to make the IR an efficient, commercially viable and competitive mode of transport. This would not only help by increasing the intra-modal efficiencies but would in turn help in improving the overall efficiencies of the transport sector by increasing inter-modal competition with the roads, coastal shipping and inland water transport and lead to a reduction in transaction costs for trade and industry.

The Twelfth Five Year Plan emphasises the need for capacity augmentation, extensive modernisation, increase of speed of both freight and passenger trains, improvement in safety and modernisation of rolling stock of the railways to meet the needs of a rapidly growing economy. One of the possible ways that have often been suggested for improving quality of service and efficiency has been the introduction of competition by welcoming private players into the railways business.

Private Participation in the Railways

At present however, the private sector can only participate in railway activities barring haulage, such as in catering, wagon ownership and leasing and in the creation and maintenance of railway infrastructure, etc.[11] This restriction on private participation appears to be based, not on any provision in the Railways Act, 1989 but on the Industrial Policy Resolution, 1991 of the Ministry of Industry[12] which reserves all forms of "Railway transport" to the public sector. This decision to restrict "Railway transport" to the public sector, in addition to atomic energy appears to be a matter of policy and can be changed in the larger interests of introducing competition in the IR if the government so chooses.

In 2006, the container business which was earlier restricted to the Container Corporation of India (CONCOR), a public sector undertaking under administrative control of MoR, was opened for private participation and 15 companies were given licenses for the containerisation of freight on IR. Through these licences the private companies got limited access for operating container services on specific routes and for a certain number of years on the IR network. Although under this new policy the private participants were entitled to own and supply the rolling stock for container operations, given the 'public nature' of "Railway transport", the haulage rights were retained with the IR.[13]

However, the experience of these companies had not been happy as CONCOR continued to dominate the container business due to its relationship with the IR and access to its preferred infrastructure. This kind of a lack of transparency and competitive neutrality in dealing with operators has been one of the reasons why the privatisation of container business has not taken off as envisaged by the IR.

Recently, MoR has also come out with a draft policy for private participation in rail construction and capacity augmentation projects by welcoming concessionaires (Ministry of Railways, 2013). The policy includes different models to attract private capital for accelerated construction of fixed rail infrastructure. However it remains uncertain whether the private sector would be interested in investing in major infrastructure projects of the IR when a small operation like the container business could not take off satisfactorily due to the absence of a conducive environment.

While the Eleventh Five Year Plan had envisaged private investment in the IR of the order of 26 percent of the proposed investment in the IR during the plan period, the actual investment by the private sector was only four percent.[14] One of the primary reasons that have been identified for this limited enthusiasm of the private sector to invest in the IR is the fact that the Indian Railways combines in itself the role of the policy maker, regulator and the operator, making it impossible for the private players to invest in the railways and enjoy a level playing field.

The All-inclusive Policy Maker, Regulator and Operator

Historical Perspective

It would be interesting to see how historically the Ministry of Railways through the Railway Board came to acquire the policy making, regulatory and operational functions that it now carries out. At the turn of the twentieth century, a major part of the railway network in the country was operated and managed by private enterprises (defined in the Railways Act as non-government) across various parts of India. Given this diversity of operators with profit motives, the government constituted a Railway Board [under the Indian Railway Board (IRB) Act, 1905][15] as the apex regulatory authority acting on behalf of the Central Government for monitoring and coordinating inter-railway movement of traffic, fixation of rates, etc. While the Railway Board was vested with certain powers of the Central Government vide Section 2 of the IRB Act, a further Notification, (No.801 dated 24th March, 1905) of the Department of Commerce and Industry, vested all the powers and functions of the Central Government in the Board.

Apart from being the apex regulator, one of the important functions of the Board, now carrying out the functions of the Government was to also regulate tariff and fix bands of maximum and minimum rates for passenger and freight travel for the operators. The railway administrations and companies were allowed to fix rates within this band. The object was to safeguard the interests of rail users given the monopolistic nature of services on rail networks. However, after Indian independence, the complete railway network consisting of national and state railways in was regrouped (1951) and Zonal Railways were formed (1952) under a single umbrella commonly referred to as the IR, under the Ministry of Railways.

At this juncture the Railway Board, which was originally envisaged as the regulator of the different rail operators assumed the role of the policy maker, exercising the functions of the Ministry of Railways, regulating tariff under the Railways Act and operating and managing the IR: In a sense the Railway Board was regulating itself. The Indian Railways has emerged as a monopoly with no law or institution to address consumer concerns and to ensure efficiencies and a level playing field for private investors.

Current Situation

Tariff Fixation

Currently, the powers of the Central Government to fix tariff (Section 30 of the Railway Act, 1989) is vested in the Railway Board by the Ministry of Railways. Tariff setting in the passenger segment is highly influenced by political considerations and the tariff is mostly lower than the costs of service provision. While passenger traffic constitutes around 64 percent of the total traffic on the railways (in terms of train-kms), it contributes less than 30 percent to the total revenue earned.[16]

This loss from the passenger transport segment is cross subsidised by the earnings from the freight segment. Freight tariff is often increased irrationally to counter the loss from the passenger business. This is also one of the reasons why the railways have lost some share in the overall freight movement and even a large part of bulk cargo like steel, fertilisers and cement have increasingly shifted to road transport. It is time now to de-politicise the tariff fixation in the railways both for passenger and freight and rationalise tariffs through a tariff regulator.

Logistics Plan

The Railways Act empowers the Central Government to regulate the railways as it gives preference to certain commodities in movement and also restricts and rationalises certain routes for movement of freight and passenger traffic in public interest. This authority is again exercised by the Railway Board, which is the operator and provider of railway services in the country, and there remains a lingering suspicion that commercial interest sometimes may influence its actions in the public interest.

For instance, in 2010, the Railway Board issued a logistics plan for rationalising routes for the movement of imported coal from ports to thermal power stations. The plan has been criticised by both ports and power utilities as it restricts movement of imported coal to thermal power stations located in central India from the closer Eastern ports due to capacity constraints on routes. Thermal power stations in central India have to incur much higher transport costs in bringing coal from ports located on the Western coasts. As a result, the logistics plan for movement of imported coal not only increases the transport costs of coal for thermal power stations affecting their competitiveness and profitability, but it also affects the volumes of traffic loadings from the Eastern ports.

Safety

At present, safety in railway operations is being regulated by a body outside the railway system. According to the Railways Act, adherence to safety rules in the railways is overseen by the Commission of Railway Safety (CRS), headed by the Chief Commissioner of Railway Safety (CCRS). The main tasks of the CRS are to inspect and open new railway lines for public carriage, conduct statutory enquiries into accidents involving death or grievous injury to passengers including train crew and to advise IR with respect to the safety of train operations. Although under the administrative control of the Ministry of Civil Aviation, the CCRS submits its investigation reports to the Ministry of Railways that by default is the Railway Board, which as the manager of IR should have been accountable.

Considering the lack of effectiveness of such regulatory provisions in ensuring safety, setting up of the Railway Safety Authority as a statutory regulatory body[17] was proposed in the Railway Budget Speech 2012: action on this should be initiated without further delay.

Grievance Redressal

The Railways Rates Tribunal (RRT) and Railway Claims Tribunal (RCT) were established for ensuring the non-discriminatory setting of freight charges and for addressing claims of railway users.

The RRT is an independent body comprising a senior judge and two members with the primary function of ensuring non-discriminatory setting of freight charges and also ensuring that railway administrations do not make or give any undue or unreasonable or advantage to any particular person or description of traffic in the carriage of goods (sections 36 & s 70 of the Railways Act). These functions of the RRT are outlined in Section 39 of the Railways Act. Consumers of freight services can approach RRT in case of any discrimination in charging of freight rates for a commodity or a distance.

However, certain matters like classification or re-classification of any commodity, fixation of wharfage and demurrage charges, fixation of fares levied for the carriage of passengers and freight levied for the carriage of luggage, parcels, railway material and military traffic and fixation of lump sum rates are not within the jurisdiction of the RRT. Consequently, the RRT has remained virtually ineffective.

With respect to RRT, it may be however noted that Section 71 of the Railways Act gives Central Government the power to restrict or give preference to any goods, charge any rates on any route if it is of the opinion that it is necessary in the public interest to do so. This has to be done by general or special order. However, since the MoR, through the Railway Board, is the principle operator of the railways, the vesting of tariff setting powers in the Central Government does raise issues of transparency and neutrality.

The other independent agency, the RCT, was established through the Railway Claims Tribunal Act, 1987 with the objective of adjudicating and providing relief to rail users by payment of compensation against loss, destruction, damage, deterioration or non-delivery of goods entrusted to IR for carriage and for death, injury or loss to a passenger in a railway accident or untoward incident. However, the efficient operation of such institution remains a suspicion.

Need for Separation

Given this background it has now become imperative to separate the roles of the policymaker, regulator and the operator in the IR as has been done in the electricity and telecom sectors in order to introduce competition and to make regulation effective.

Domestic Experience

In the telecom sectors the Department of Telecommunications (DoT), like the Railway Board was the policymaker, regulator and monopoly service provider of telephony in the country. In 1986, two new public sector corporations – the Mahanagar Telephone Nigam Limited (MTNL) and the Videsh Sanchar Nigam Limited (VSNL) were set up under the DoT. Private participation in the value added services was introduced in 1992 with the new economic policy of the Government of India. The participation of private players was extended to basic services by the National Telecom Policy, 1994. Further, with the Telecom Regulatory Authority of India (TRAI) Act, 1997 the regulatory powers of the DoT were separated and vested in the TRAI[18] which was empowered to regulate the service providers including the public sector who were licensed to provide both basic and value added services.[19]

Similarly, in the electricity sector the state electricity boards (SEBs) were restructured to leave policy making with the State Governments, service provision with public and private sector companies and regulation with the SERCs.

This has led to an increase in investments and competition in the telecom and electricity sectors, leading to an overall improvement in efficiencies; in the telecom sector in particular this has resulted in a marked increase in penetration of telecom services and reduction in tariff. Action on similar lines is imperative in the case of the IR if it is to be made more efficient and competitive and if private investment is to be attracted to complement the limited public funds available for investment in the railways.

A similar environment exists in the civil aviation sector in India where the Ministry of Civil Aviation, the principle policy making authority, is separated from the state owned operator (Indian) and the tariff regulator (AERA).

It is interesting that even the CCI has observed (CCI case number: 64/ 2010,02/2011 & 12/2011) that "*there is a conflict of interest in as much as Railway Board / IR exercise multiple roles as a licensor and operator, apart from owning the railway network. In view of this, it is desirable that these functions be delegated to independent entities.*"

International Experience

Even in the international context, it is relevant to note that the Ministry of Railways in China which owned, regulated and operated the Chinese Railways, has recently been abolished and its policy making, regulations and operation functions have been separated. While the Ministry of Railway's planning and policy making functions have been entrusted to the Ministry of Communications (MoC) under the State Council, a State Railway Administration (SRA) has been established under the Ministry of Transportation (MoT) for performing its administrative functions. In addition, the ownership and powers to operate the railways on commercial lines have been transferred to an independent China Railway Corporation (CRC).[20, 21]

In similar initiatives, introduction of Amtrak in the US, VIA in Canada and JR Freight in Japan as early as 1970s saw increased transparency in tariff setting and improved market participation. In the early 1990's, the European Commission's and UK's efforts to separate their infrastructure from rolling stock operations also led to increased competition by the introduction of private participation. It should be possible for the IR to learn from these experiences for attracting private investments and for introducing competition.

Table 5.1: Separation on Functions

S. No	Sector	Policymaking	Regulation	Operations
Domestic				
1	Telecom	DoT	TRAI	MTNL, VSNL
2	Electricity	State governments	SERCs	Public sector utilities
3	Civil aviation	Ministry of Civil Aviation	AERA	Indian
China				
4	Railways	Ministry of Communication	State Railway Administration	China Railway Corporation

Case for an Independent Regulator

As stated earlier, tariffs are set by the Ministry of Railways and not by an independent regulator. There is also no agency to address consumer concerns, formulate service level benchmarks and ensure transparency. The need for an independent railway tariff regulator has been repeatedly emphasised in the various Five-Year Plan documents. A Railway Tariff Authority (RTA) was also proposed in the Railway Budget, 2013.[22] Some reports suggest that the Railway Ministry appears to be exploring the option to establish this RTA through an executive order, rather than an enabling legislation. Regulatory experience has shown that regulatory independence cannot be achieved unless the regulator is setup through an enabling legislation which cannot be altered or amended by executive whims. There is thus a need for an independent regulator set up through an enabling legislation to regulate not only tariff, but also to address broader concerns such as:

- Protection of consumer interests
- Quality of service standards
- Ensuring transparency
- Rationalisation of tariff and subsidies
- Prevention of anticompetitive practices

As far ensuring fair competition is concerned, it is important that the Railway Regulator, when established, is vested with powers to promote and maintain competition as the regulator would have more intimate knowledge of the rail business as compared to the competition authority. This would similar to the provisions of Section 60 of the Electricity Act 2003 which empowers the CERC to maintain competition in the electricity sector.[23] It is true that vesting the powers of the CCI under the Competition Act 2002 to a sectoral regulator, as has been done in the electricity sector, would result in an overlap with both the sectoral regulator and CCI having jurisdiction over the sector. It could be argued that this could lead to conflicts and the emergence of two different jurisprudences.

In most jurisdictions this issue of overlap has arisen and been satisfactorily dealt with even without statutory provisions to address the interface between the sector regulator and the Competition Authority. Different models have been adopted by different countries. In UK, for example, there is a working group comprising of representative of the Competition Authority and sector regulators which meets to decide as to which of them is best equipped to deal with the competition issue. There is also a common appellate authority to ensure convergence in application of competition and regulatory laws whenever there is an overlap.[24]

In many other countries such as South Africa, the Competition Commission and the sector regulators enter into a Memorandum of Understanding (MoU) specifying procedures aimed at promoting co-operation and exchange of information.[25] In India, on the other hand, there are statutory provisions namely, Sections 21 and 21A of the Competition Act which address the issue of interface between the regulators and the competition authority.

Section 21 of the amended Competition Act enables a sectoral regulator to refer competition matters either *suo moto* or at the instance of any of the parties to the CCI. Section 21A in turn enables the competition authority to refer any matter which falls within ambit of the sectoral law to the sector regulator. Although in either case, the reference is voluntary – the sector regulator or the CCI, as the case may be are required to state the reasons for their decisions on the advice. It would be desirable to make provisions both competition law and sectoral laws to make references to the CCI or the sectoral regulators, as the case may be obligatory.

An enabling and conducive regulatory framework will encourage private investment in the railways and facilitate intra-modal competition in different railway businesses.

Recommendations

Based on the discussions above, a set of measures that need to be undertaken to increase the competitiveness and improve the regulatory practices of the IR have been identified. However, given that some of these recommendations would require significant structural changes within the railways, they would have to be undertaken cautiously over a five to ten year period so as to not to disrupt the day to day railway operations. Keeping this in mind, the recommendations are identified as long and short term actionable items.

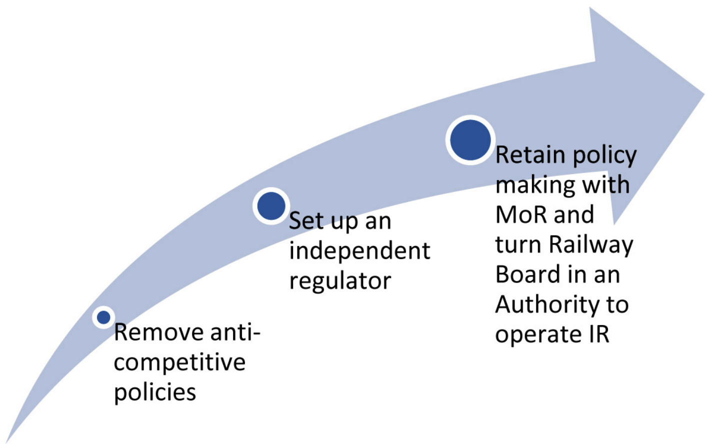
Long term recommendation: Separation of policy making and operation functions of the Railways

1. Policy making, regulations and operations which are today combined in the Railway Board, should be separated. While it is felt that policy making should rest in the Ministry of Railways, the Railway Board should be constituted as an Authority like the National Highways Authority of India (NHAI) or Airports Authority of India (AAI), through an enabling legislation to operate and manage the IR. The setting up of an Authority, rather than vesting operations in a corporate entity would enable the railway business to be conducted with larger social interests in mind and not be dictated by profit considerations alone.

Short term recommendations: Setting up of an independent regulator and removal of regulations that hinder competition in Railways

1. The regulatory powers of the Ministry of Railways should be vested in an independent regulator established through an enabling Act. That regulator should set and rationalise tariff, protect consumer interests, set quality of service standards and ensure transparency. This regulator should also be vested with powers to maintain competition.

2. The Industrial Policy Resolution, 1991 which requires 'railway transport' or haulage to be in the public sector should be amended to allow private participation in railway transport as well.



Conclusion

Separation of the policy making function and management of railways coupled with setting up of an independent regulator, as outlined in this chapter, will go a long way in promoting accountability, transparency and both intra and inter modal competition in the railways. The first step towards introduction of competition within the railways should start by removal of regulations and acts that prohibit the introduction of private players into the railway business. This could have an immediate effect on increasing industry confidence and enhanced private investments in the Railway sector to meet the objectives as has been envisaged in the 12th Five Year Plan of the Government of India.

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CHAPTER 6

Competition and Regulatory Issues in the Coal Sector in India

Introduction

India, as a growing economy, faces growing challenges in the form of energy security. Coal has always been the primary and crucial resource to assimilate the need of the growing economy, however, inconsistent supply, inferior quality and lately sectoral reforms are paving way for new and greener sources of energy. Still, for Indian Industry, coal is indispensable.[1]

Coal supplied about 53 percent of the primary commercial energy in India in 2011[2] and is projected to supply about 47 percent of primary commercial energy in 2031-32 even in the least coal usage scenario of the Integrated Energy Policy.[3] The coal production all over India has been 384.19 million tonnes (MT) in 2012,[4] a growth of 5.5 percent from the production in 2011 with Geographical Survey of India (GSI) estimating its reserves up to the depth of 1200 meters at 293.497 billion tonnes as on April 01, 2012.[5] India has the fifth largest coal reserves in the world. Of the total reserves, nearly 88 percent are non-coking coal reserves. While tertiary coal reserves account for a meagre 0.5 percent and the balance is coking coal.[6]

Table 6.1: Coal Reserves in India

(In million tonnes)

Company	2012-2013 Target	Actual Up to Dec 2012	Achievements (%)	2011-2012 Actual up to Dec 2011	Growth (%)
CIL	464.10	308.89	66.60	291.24	6.06
SCCL	54.00	37.18	68.90	35.26	5.45
Others	57.20	38.12	66.60	37.62	1.33
Total	575.30	384.19	66.80	364.12	5.51

**Excluding Meghalaya*
Source: MoC. 2013. Annual Report 2012-2013. Ministry of Coal. Government of India. 2013.

In particular, currently and still for many years to come, the sector will play important role for the power sector, given that about 76 percent of coal consumed in the country is used by the power sector and that 67 percent of the electricity generated comes from coal.[7]

With limited domestic production capacity for oil, falling production of natural gas with no new major discoveries being reported, demand for coal has spurred. This is reinforced by the increasing resistance to large hydro-electric and nuclear projects, and falling domestic production of natural gas. It is obvious that effective management and efficient utilisation of the country's coal resources are clearly important for the progressive growth of our country. Harnessing and use of the coal reserves, efficiently in the country is also critical if India has to meet its development objectives while minimising local and global environmental impacts. Based on the reserves and current production levels, the Reserves/Production (R/P) ratio of coal is more than 100 years compared to around 18-20 years for oil and 25-27 years for natural gas.[8]

Table 6.2: Geological Resources of Coal in India

States	Geological Resource of Coal (In Mt)			
	Proved	Indicated	Inferred	Total
Andhra Pradesh	9566.61	9553.91	3034.34	22154.86
Arunachal Pradesh	31.23	40.11	18.89	90.23
Assam	464.78	45.51	3.02	513.31
Bihar	0.00	0.00	160.00	160.00
Chhattisgarh	13987.85	33448.25	3410.05	50846.15
Jharkhand	40163.22	33609.29	6583.69	80356.20
Madhya Pradesh	9308.70	12290.65	2776.91	24376.26
Maharashtra	5667.48	3104.40	2110.21	10882.09
Meghalaya	89.04	16.51	470.93	576.48
Nagaland	8.76	0.00	306.65	315.41
Orissa	25547.66	36465.97	9433.78	71447.41
Sikkim	0.00	58.25	42.98	101.23
Uttar Pradesh	884.04	177.76	0.00	1061.80
West Bengal	12425.44	13358.24	4832.04	30615.72
Total	**118144.82**	**142168.85**	**33183.48**	**293497.15**

Source: MoC. 2013. Annual Report 2012-2013. Ministry of Coal. Government of India. 2013.

Production of coal has been a natural government monopoly with over 90 percent of the production coming through Coal India Limited (CIL) along with its subsidiaries. Captive mining as a policy instrument was introduced in the year 1993. This policy was instrumental in encouraging private players in the sector. However, private players have not yet provided for any promising progress in this regard. Out of the 200 allocated blocks (22 have been de-allocated); only 30 mines have commenced production and the rest are stalled. These mines had a combine production of 36.30 MT (FY 2010-11) as against the desired target of 104 MT, 1/4th of the desired performance. The reasons for having dismal production have been issues like unavailability of data, cumbersome Land Acquisition, Rehabilitation and Settlement (LARR) provisions, and multiple clearances under various legislations, among others.[9]

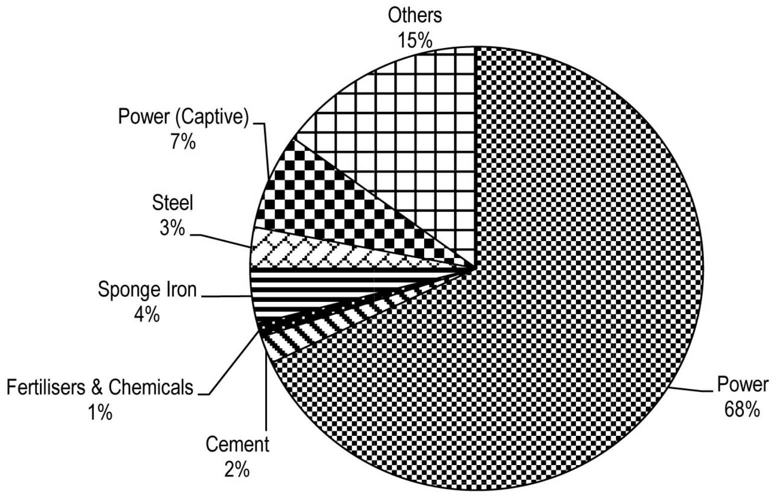
By introducing an independent regulator, through Coal Regulatory Authority Bill 2013, the government postulates a transparent and efficient process for auctions. Further articulations are under process for selling certain stakes in CIL, a government owned entity, to bring in private equity.

Although India has the fifth largest reserves of coal in the world, and being the third largest producer of coal after China and US (5.6 percent of the global coal production), it is not able to meet its domestic demand. It has been projected that the likely overall demand for coal for the 12th Five Year Plan ending 2016-2017 is going to be 980.5 MT, of which the demand from power utilities would be 75 percent (inclusive of captive generation) with steel forming 7 percent of the total demand and cement and sponge iron forming 4.7 percent and 5.1 percent respectively.[10]

The gap between the projected demand of 980.50 MT with the estimated domestic availability of 715.0 MT works out to 265.5 MT for the Five Year plan period ending 2016-17. This comprises of 35.5 MT of coking and 230 MT of thermal coal. The projected gap between demand and supply is likely to escalate to 423 MT in the 13th Plan period (2017-22).[11] The reason for consistent widening of the gap has been augmented to include procedural delays in project clearances, delays in adopting new excavation technologies and inadequate facilities for evacuation of coal etc.

This gap is considerably bridged every year through coal imports by various industries and sometimes by the state governments too. Since 2004-2005, India's coal import has grown at a compound annual growth rate (CAGR) of 15 percent (till 2010-11). It is during the same period the import of thermal coal grew at a CAGR of 25 percent. According to projections, India's coal import requirement will be more than 200 MT by the end of the 12th Five Year Plan.[12] The overall long-term demand of coal is closely linked to the consumptions options of the end users such as electricity, iron and steel industries. Other industries using coal have only a marginal impact on the long-term demand for coal. Figure 6.2 show the projected sector-wise coal consumption in India by the end of the 12th and 15th Plan.

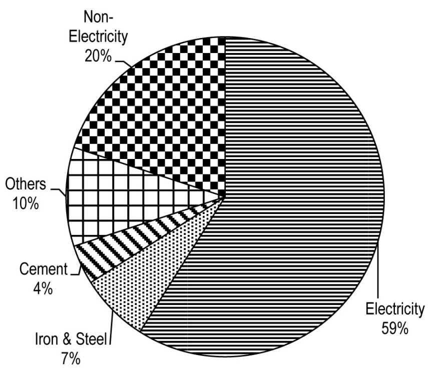
Figure 6.1: Sectoral Usage of Coal in India (2011-2012)



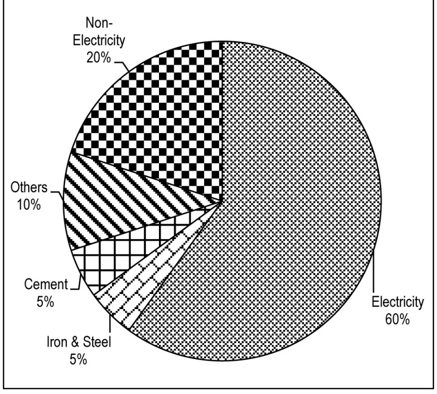
Source: CCO. 2012. Provisional Coal Statistics 2011-12., Ministry of Coal, Government of India. 2012.

Figure 6.2: Estimated Sector-Wise Coal Consumption in India

Estimated Sector-wise Coal Consumption in India (2016-2017)



Estimated Sector-wise Consumption in India (2031-2032)



Source: WEC. 2012. Indian Energy Book 2012. World Energy Council, Indian Member Committee. 2012.

The current shortage of coal stands at 84 MT and the same is expected to upto rise 300 MT per annum in medium-term if all the letters of assurance issued by the state-owned coal companies materialise. It is projected that this shortfall will be met by surplus supplies of captive plants or through imports. Furthermore, it has been observed that quality, timely availability and cost are the factors that determine demand of domestic or imported coal. Meanwhile shortage in domestic coal supply has also led to increased usage of imported coal in power generation, which, in turn, has led to debates about whether the increased costs of such power generation should be passed on to consumers.

State of Competition and Regulation in the Sector

The economic growth target of India as 8.2 percent as set out in the 12th Five Year Plan cannot be achieved unless there is massive increase in infrastructure services in various sectors, including energy. It is pertinent to note that most of the core sector utilities are state-owned companies. The coal sector of India has been no different, CIL accounts for approximately 80-82 percent of the production while Singareni Collieries Company Limited, a joint venture between the Central Government (49 percent) and State of Andhra Pradesh (51 percent), which accounted for approximately 9.5-11.5 percent of India's coal production in the 2013 fiscal year.

It was in 1774 that the Indian history of coal mining started. The then initiatives were taken up by the East India Company. However, with the passage of time and after independence, the mining became part of a public domain. Prior to 1970, several private players were engaged in the mining and production of coal in India. Unplanned growth, inability of the sector to cater to the needs of the economy (acute shortage) along with unscientific exploitation of coal reserves, despicable conditions at work, etc. lead to a series of enactments nationalising coal mining in the early 1970s.[13]

The government first took over the management of the coking coal and coal mines[14] and thereafter nationalised the mines.[15] All existing mines at that time were brought under the umbrella of one behemoth, namely, CIL. Since nationalisation, public sector companies are statutorily conferred with the exclusive right to carry out reconnaissance, prospecting, mining and production of coal (to the exclusion of captive mining). And since then there has been change in the autonomous monopolistic nature of CIL, however, various legislative initiatives and regulatory orders have been set up to tame this monopolistic nature.

Recently, the Competition Commission of India (CCI) has recommended that the government must initiate a process through which more players can be introduced in the mining sector. In a case against CIL for abusing its dominant position in the market, CCI has observed that, *"the effects of various anticompetitive factors identified in the coal sector on the rest of the economy are widespread and create systemic risk. Inefficiencies in any one segment are felt in the entire value chain with a cascading impact on the end-consumers of electricity… there is an imperative need to…restructure the sector by introducing more players to reduce the dominance of any one player and facilitate competition."*[16]

Further, CCI has also observed that due to CIL's monopoly consumers have been paying higher electricity rates. The Order also stated that with over 250 billion tonnes of coal reserves, and despite the domestic demand for coal growing by 8 percent annually, CIL's production has stagnated around 350 million tonnes over the last three years. Therefore, CCI ruled that CIL through its subsidiaries operated independently of market forces and enjoyed undisputed dominance and has imposed unfair/discriminatory conditions in the matter of supply of non-coking coal to power producers and in lieu of its observations imposed a penalty of ₹1773 crores, a first of its kind over a public sector enterprise. CIL is not only the nation's largest coal producer, but is also the single largest producer of coal in the world.[17]

Subsequently, CIL approached Competition Appellate Tribunal (COMPAT) challenging the order passed by the CCI. Though the appeal has not been heard on merits yet; meanwhile a stay on penalty has been given where CIL has been asked to deposit ₹50 crores as security.

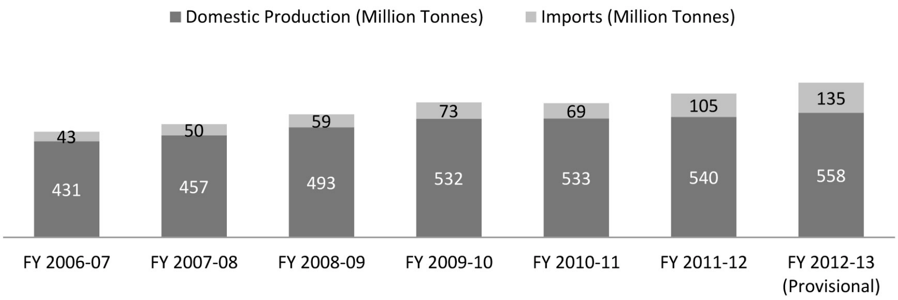
CIL saw a decline in both its production and sector wise dispatches in 2011 led by issues and problems pertaining to procedural delays, land acquisition, forest clearance, adverse geo-mining conditions, tender finalisation for equipment, and delays in getting railway siding leading to a loss of 115.95 million tonnes of production.[18]

It was in this background the Planning Commission, CAG and further pursuant to order recommendations by the CCI, voices emerged for restructuring of CIL.

Four decades ago, the Government of India, in order to protect the interest of the workers and provide them with conducive working conditions, took over the control of mines and minerals development in India. Coal mines were nationalised, excluding some and legislations were passed to this effect. A utility was established in the name of Coal India Limited, entrusted with coal production and distribution. It is the nature of this entrust that CIL became a monopoly. Instead of producing at optimum level, productions became low; CIL has been producing at the growth rate of five percent per annum, wherein coal demand is rising by 10-12 percent per annum.[19]

Since 2007, CIL has failed constantly to achieve production targets.[20] All this has resulted in expensive coal imports and stressed operation of industries dependant on coal and coal by products. Coal mines and mining in India are no longer an issue of national importance to be protected by public sector undertaking (PSU) ring fencing. In fact they are an inefficient and poor utiliser of these assets.

Figure 6.3: India's Rising Coal Imports



Source: CCO. 2012. Provisional Coal Statistics 2011-12., Ministry of Coal, Government of India. 2012.

Thus, restructuring of CIL from a monopoly to smaller entities competing with each other is essential to bring in competition into the sector. This competition will also effectively address the issue of execution, transparency, accountability, monitoring, control and most importantly law and order issues. If implemented well, the restructuring will usher in efficiency into the sector and enable the CIL to become a world class company. Having diminished control of Ministry of Coal and monopoly of CIL less scams and price distortions are expected. Interestingly, with 2014 elections near, the Ministry of Coal has shelved the idea for having restructured CIL as planned according to earlier issued policy document, a step that only re-emphasises how in India, economic policy decisions are also clubbed with election manifestos.

The following section identifies the policy, legislative and procedural barriers plaguing the sector and affecting competitiveness and suggests remedies to overcome the same.

Regulatory/Legislative Framework

Sitting at top of all legislations in India is public interest and at the bottom is the constitutional validity. Under the Constitutional scheme, the Centre is empowered by virtue of Article 246(1) of the Constitution and Entries 54 and 55 of List I (Union List) of the Seventh Schedule to legislate on

‘Regulation of Mines and Mineral Development’ and ‘Regulation of Labour and Safety in Mines and Oilfields’. However, the State is also empowered by virtue of Article 246(3) and Entries 23 and 50 of List II (State List) of the Seventh Schedule to legislate on ‘Regulation of Mines and Minerals Development’ subject to the provisions of List I with respect to regulation and development under the control of the Union and ‘taxes on mineral rights’ subject to any limitations imposed by Parliament by law relating to ‘mineral development’. Thereby making the authority of the States different from Union and also giving due deference to Union’s overriding authority.

Substantive Issues of Interest: There are around 12 legislations governing the coal sector, however not all call for referendum for change. The analyses of the legislative and regulatory rules and policies which affect competitiveness in the sector have been covered as follows:

Mines and Minerals (Development and Regulation) Act, 1957[21]
(MMDRA)
The MMDRA is considered as the parasol for legislations pertaining to mining major minerals[22] in India. The concerned section of this Act is pertaining to competitive bidding of coal blocks. Though the government has introduced allocation of coal blocks through competitive bidding however, the participation has been restricted only to steel industries, power industries and washeries, provided that it is for their captive consumption. Thereby it excludes all other industries from commercial exploitation of coal. CIL is having a natural monopoly over the production and exploitation of coal.

Furthermore, the provision of reserving coal blocks by the State/Union government, a practice that has been criticised by many, end up securing prime blocks for the State Utilities (PSUs), while the private companies participate through competitive bidding. It should also be noted that PSUs are not restricted to participate through competitive bidding and thereby have a generous advantage. The idea of pre-allocating (reserving) blocks for PSUs vitiates the idea of level playing field as propagated by the Ministry of Coal in its invitation brochure and thereby affecting competitiveness negatively.

Coal Mines (Nationalisation) Amendment Bill 2000
The amendment bill was introduced in the year 2000; however, no consolidated decision has been reached so far. In light of the recent events of irregular coal supply, shortage in market and increase in coal imports, there is imminent need to introduce private players in coal mining initiatives ranging beyond captive consumption. With the Coal Mines (Nationalisation) Amendment Bill 2000 domestic private companies were to be allowed to mine and produce coal “either for own consumption, sale of for any other purpose in accordance with the prospecting licence or mining lease or sub-lease”.

This can successfully supplement capabilities of CIL; besides the coal imports estimated at 30 MT for current fiscal can also be offset by private sector access to domestic coal resources. With increase in efficiency through regulated private participation, competitiveness will thrive. However, a concerned view still surrounds the preamble of the principle Act, i.e. Coal Mines (Nationalisation) Act, 1973, as the word *Nationalisation* as represented in the title of the Act would be contrary to the insertion of the amended provisions pertaining to inclusion of private players and thereby re-nationalising the coal mining sector. Therefore, keeping in mind the harmonious construction rule of interpretation of law, there is a need to amend the title and scope of the Act of 1973.

PPP in State Joint Ventures

While the above amendment bill has been pending, various state governments undertook steps to involve private sector in commercial mining. The Central Government having power in allocating coal blocks would allocate to state governments, which, in turn, would hand these allocated blocks to the state utilities, who then partner with private companies for commercial mining. This practice mechanism has not only helped in securing more production of coal, but has also increased the efficiency within the sector and thereby fostering positive competitiveness.

Allocation of Blocks and Policy Ambiguity

A comparative study of the laws in the sector highlights the inadequacy of laws creating level playing field and promoting competition. All the more, it has been noted that the current practices are arbitrary while being prejudicial to private participation and at the most being tailor made for the suitability of CIL. For instance, there exists a natural monopoly in the sector as the extant laws render unbridled preference over CIL. The provisions for acquisition of a coal bearing land, under the Coal Bearing Areas (Acquisition and Development) Act 1957, for example, allows possession of a virgin coal bearing land by the Central Government for a centrally controlled public sector company only. This implies that the PSEs do not have to obtain coal-mining leases for land acquired under the Act. As there is no scope for private players to acquire land under this Act, thus there is a clear lack of level playing field. Further, there is a contradiction with reference to acquisition of land under the Land Acquisition Act, 1894 (*replaced by the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act 2013 w.e.f. 01.01.2014).*[23]

A land to be acquired should be for ‘public purpose’, though the definition has been made clear over time by various judgements of Supreme Court and other High Courts, still the procedural formalities for a PSE and a private player are different. Currently, a number of projects are facing delays due to opposition from local population. In most cases, this opposition stems from inadequate compensation to the project affected people also due to issues related to illegal squatting. Most of the coal mining in India is done by the open-cast method, producing around 90 percent of the coal, which requires acquisition of surface rights and causes displacement of local people. However, compensations are often inadequate and mostly delayed. Such weakness has not been cured through the new LARR Act, providing breeding ground for social distress, alienation of local population and eventual resistance.

Another interesting contradiction has been with reference to the ineffective separation of potentially competitive segments from monopoly structure creates another source of inequality to the potential private players. For instance, there are certain segments in the mining industry like provisions of health, education and housing for mine workers that can be outsourced. But the Contract Labour (Regulation and Abolition) Act, 1970 does not allow outsourcing of perennial jobs and since all jobs in the mining sector are perennial in nature, no outsourcing is legally allowed in this sector.[24]

There are 179 forestry proposals awaiting clearances and if all approvals are secured on time, it can more than double its output to 1,132 MT, given that mines start production from 2016-17.[25] Such approvals have been lying out to dry for too long now and if closely studied the delays have been caused due to policy ambiguity between the Centre and the State with an added advertence of Rehabilitation and Resettlement (R&R) provisions.

Furthermore, it has been observed that a lot of mining leases have been provided to individuals, however the areas are small. Also as the mine owners are not able to use scientific methods for mining, the process has become more cumbersome and inefficient. With added burden of environmental clearances, such small miners are seeking a getaway through joint ventures. However, as no provisions at both Central and State level exists to bail out such miners, the mines are dormant and the national asset is getting wasted.

Issue of Coal Pricing and Imports

The Indian Coal Sector is plagued with structural and administrative irregularities too. According to the MMDR Act and other ancillary provisions, the Central Government possess the right to determine the price for coal in accordance with its grade and quality. However, such power to notify prices has been entirely dependent upon the price notified by CIL. And thereby the issue of price distortion arises. Though it has been observed that price of coal should be determined in a competitive market (price de-regularisation),[26] however still, due to the nature of dependency on coal by major industries along with obscurity of policies in force, pricing distortions are evident. Thus, there is a call for an independent sector regulator, which will not only diminish the monopolistic power of CIL but also foster holistic level playing field for private participation.

Coal imports for the period April-December 2012 had crossed 100 MT, it is anticipated that the imports would rise to 185 MT by 2016-17. In the 2012-13 fiscal, steam coal was exempt from customs duty but attracted a concessional Countervailing Duty (CVD) of one percent, whereas bituminous coal attracted a duty of five percent and CVD of six percent. In course of the Budget Speech for the year 2013-14 the Finance Minister was of the opinion that since both kinds of coal are used in thermal power generation the same amounted to a miscalculation.

Given the same the duties on both kinds of coal were equalised and two percent customs duty and two percent CVD were imposed uniformly. Thermal generators who import low grade coal would feel the pinch of this duty equalisation. This becomes important in the context of the fact that around 60-70 percent of coal imported by power plants is low grade and was exempt from customs duty in the previous fiscal of 2012-13. This move to equalise the duties is again beneficial to coastal power plants which import high calorific value coal but may increase the average cost of power generation.

Further distortions in the price of coal to the power sector (domestic and imported) are leading to differential cost of power generation. Since the power sector is the primary consumer of coal and heavily regulated, the government objective has been to keep power prices as low as possible, to keep the factor cost to the economy low. Thus, any increase in the power prices due to coal prices increase is difficult, and thus, the coal prices for CIL have remained below the international parity price. Recently, when coal was imported by Adani Group as a fuel to be fended in their power plants, as expected the imported coal was priced higher than the domestic. CIL had to compensate the difference of prices, even though when it was clearly evident that domestic coal was, and still is under-priced.

Sustainable Production of Coal

Greenpeace, an environment non-governmental organisation (NGO) has recently released a study,[27] suggesting that the 'extractable' coal reserves would not last more than 17 years at the projected increase in domestic demand for coal. Erratic production/supply for coal will affect competitiveness in the sector. *Firstly*, the sustainability of any business venture (mining in this case) emancipates private investment. Therefore, if the concerned sector is likely to worn out in 17 years, the projected private investment will fall manifold. *Secondly,* if the resource is scarce, the government in that case will not adopt competitive price discovery mechanism rather will monopolise its production even more. *Lastly,* as CIL be given preference, abuse of dominance as already observed by CIL will become rampant.

Surplus production to be transferred

Writing law is easy, governing is not. As already discussed there are 12 principle legislations governing the coal sector, while many contains cumbersome procedures, few are redundant as well. The law provides that a private company can indulge in mining activity for captive consumption. Although the guidelines and procedures are clearly laid down for captive mining, however, in case of surplus production, the companies transfer the surplus outside the end-use sector. Recently after an inter-ministerial deliberation, the Planning Commission has suggested that such transfer should be restricted and that any transfer of surplus production should be done at the notified price to the nearest CIL subsidiary or other firms in the same sector facing shortage in linkage coal from CIL.

Though many appreciated the suggestion of Planning Commission, it bears uncanny resemblance to similar relief being sought by CIL. It seems like another attempt of the Ministry of Coal and the Central Government to protect CIL from its inefficient and ineffective method of mining and piling cases of breach of fuel supply agreements. The private sector works for profit. If these participants are not given right over their production, the interest in the sector is likely to decline and so would the investment.

Does there is any Need for Establishing an Independent Regulator in the Coal Sector?

The T.L. Shankar Committee,[28] the Integrated Energy Policy Report of Experts,[29] The Approach Paper to the 12th Five year Plan and the CAG Report[30] route for the establishment of an Independent Regulator for the Coal Sector. The Shankar Committee opined that there was a need for a new and comprehensive governance structure for the Coal Sector including a regulatory mechanism *"to attend to all issues relevant for development of coal resources, regulation of coal price, whenever necessary, and nurturing level playing field between the influential large public sector coal companies and the emerging small coal companies in the State public sector and the captive mining sector."*

Similarly, the Integrated Energy Policy Report whilst recommending the establishment of a regulator in the Coal Sector suggests the probable functions of such regulatory body:[31]

- Approve coal price revisions as an interim measure;
- Ensure supply of coal to power sector under commercially driven long-term FSA;
- Facilitate the development of formulae/indices for resetting coal prices under long term FSAs;

- Monitor the functioning of e-auctions and ensure that the price discovery through e-auctions is free of distortions;
- Regulate trading margins;
- Develop a mechanism for adequate quantities of coal imports under long term contracts to bridge the gap between supply and demand;
- Create an environment for competitive coal market to operate; and
- Regulator to ensure that mines are planned, designed and developed in a scientific manner, giving due importance to conservation of coal.

At present there is a significant need for reforming India's coal sector in line with other parts of the energy sectors.[32] Currently, Ministry of Coal is not involved in the price setting of coal. However, prices are being fixed by CIL. Evidently enough coal consumers do not directly participate in price negotiations. Nonetheless, there are no comprehensive frameworks that govern the licensing and operational setups of coal mining/trading companies. It is, therefore, voices emerge for setting up of a regulator in this sector, but the question is, whether setting up of regulator is the necessary solution?

With this background, the Cabinet for the Government of India initiated the Coal Regulatory Authority Bill, which was tabled in the lower house earlier in 2013. The proposed bill procrastinated sessions over session in the Parliament. Now given that the Cabinet has already started the process for establishing an independent coal regulator for the sector by passing an executive order, the proposed regulator, is weak and in all possibilities an extraneous position created with the ideology of accountability and transparency but disguised by retiring plans of the incumbent bureaucrats. It should be noted that the creation for the regulator is through an executive order and not through parliament process. An urged decision taken up to bandage the wound inflicted by inefficient decisions on coal pricing and block allocations made earlier. As the legislative mandate is missing, so would be the powers of the regulators.

The Regulator as conceived by the Cabinet has only advisory/recommendatory powers to frame principles and methodology. If there is any violation of the same, powers to impose penalty or take up any other corrective measures to remedy such violations. The regulator will have no decisive role in the cancellation or suspension of mining licences. It is also unclear how a non-statutory body can effectively adjudicate disputes between PSUs and buyers. The conceptualisation of regulator has happened due to various recommendations as mentioned above and in particular the CAG Report which emphasised how coal block auctions did not followed a competitive bidding process. Many thrashed the wise suggestion of CAG as overstepping its mandate in projecting 'notional losses' from coal allocation; however the observations so made cannot be rendered to nullity.

It is true that with *ad hoc* screening committees, inter-ministerial groups and empowered groups of ministers, looking into allocation, there has been little transparency, let alone oversight, in the allocation and de-allocation of blocks. The scant regards given to the best practices model in government procurement by the Union Government certainly raises doubts about the efficacy of interventions from a mere advisory body such as the conceived regulator. If the government has serious thoughts about the coal regulator then it must first break the monopoly nature of CIL by bringing in private players and accentuating the level playing field. Unless a legislative mandate is there the regulator being merely a non-statutory body would only raise red flags without any tangible effect on arbitrary or corrupt practices.

Conclusions & Recommendations

Recently, the government has taken initiatives to bring reforms in the legal system governing the mineral sector. The latest MMDR Bill, 2011 (as introduced in the Parliament) has attempted to address the key industry concerns of transparent concession systems, scientific mining, sustainable development and curbing illegal mining by repealing MMDRA.[33] The Draft Act in line with National Mineral Policy 2008 aims to achieve speedy application processing by delegating power to the state government for award of mineral concessions with prior consent of Central Government required only in case of coal and atomic minerals.

In the case of the coal industry in India, the legislation restricts entry and confers exclusive rights, by statutorily limiting the production of coal to government companies. In terms of the effects on competition in the coal sector, the Coal Mines Nationalisation Act creates and maintains a monopoly in favour of the government companies. Although the Nationalisation Act does not confer a monopoly on a particular company, in reality there is no competition between public sector/government companies. Unlike the petroleum sector in which some level of competition appears to exist between public sector companies.[34]

Moreover, the Ministry of Coal governs the overall policy decisions of CIL & Singareni Collieries Company Limited (SCCL). Similarly the law discriminates against the private companies to the extent that they are required to participate in the auction as opposed to the allotment option given to the government companies. Central Mine Planning & Design Institute Limited (CMPDIL) which is a subsidiary of CIL is the repository of all geological data as far as exploitable coal reserves are concerned, thus leading to an information asymmetry.

The Coal Mines Nationalisation Amendment Bill 2000 was aimed at opening up the sector for private participation. However, it could not be passed given the opposition from the unions and political compulsions. Pending the passing of the Coal Mines (Nationalisation) Amendment Bill, 2000, other avenues permitted under existing legislation need to be resorted to so as to increase the number of players in the sector. The same includes:

a) Encourage mining by State Government public sector companies;
b) Captive users must be allowed to sell incidental coal surpluses, during the development and operation of a block to CIL or other third parties;
c) Group captive mines must be allowed for small end users; and
d) Those allotted captive blocks must work the block within a stipulated period of time failing which the allotment either stands cancelled or a penalty is imposed.

The government could consider promoting state level public sector companies on the lines of SCCL and give them greater managerial freedom so that these companies become true competitors to CIL. One another idea to increase CIL's production capacity has been to introduce contract mining, whereby the private player would be paid at a per tonne basis by CIL which would be eventually selling the mined coal on per tonne basis.[35]

Likewise the achievement of production targets depends on early and timely clearance of project proposals by the environment and forest agencies and mine approval agencies. Streamlining of procedures for giving a decision on the application of mining of coal in a block within a specified time by the Central and State Ministries of Environment & Forests at Central and State level is a must. Similarly, there is a need for inter-ministerial coordination for development of infrastructure facilities in the nature of roads, railway lines and ports for speedy evacuation, distribution and import of coal.

The bottlenecks and the legislative hurdles in ushering greater sectoral productivity have been a source of debate and many a committees and expert groups have identified and suggested plausible solutions to overcome the same. However, a majority of the recommendations (including those discussed above) have not been implemented. There is a lack of political will, given the legislative measures that may have to be taken given the dynamics of coalition politics. This again is without prejudice to the fact that legislative and policy reform is imperative so as to increase domestic coal production. Having said that, piecemeal legislative interventions, in the absence of a sectoral regulator to coordinate the activities of the statutory players across the various activities involved in coal mining, import and distribution; it may not yield the desired results.

It is clear that the effects of various anticompetitive factors identified in the coal sector on the rest of the economy are widespread. Some initiatives have already been taken to reform the sector and there is a need to further carry forward the same. It is required to clearly define the reform objectives in coal sector and make sure that all policy changes are coherent in nature and can simultaneously help in achieving the stated objectives:

a) Restructure the sector by introducing more number of players so that it can reduce the dominance of any one player and can facilitate competition.
b) Keep a close track on the licences issued for captive mining periodically.
c) Bring the coal sector under the independent regulatory oversight. It is also required to streamline process, procedure and remove various discriminatory provisions in the existing legal framework against the private players in order to incentives and expedite coal production.
d) Address sustainability issues and securing private investment through coal block banking mechanism.

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CHAPTER 7

Regulation Competition and Consumer Protection in Indian Financial Sector

Introduction

W.E. Gladstone rightly pointed out in 1858, "*Finance is, as it were, the stomach of the country, from which all other organs take their tone.*" A healthy stomach contributes to efficient functioning of other organs of the body. The same applies in the field of finance, as the recent financial crisis showed. Taking Gladstone's theory further, Schumpeter[1] argued that financial markets play an important role in the growth process by channelling funds to the most efficient investors and by fostering entrepreneurial innovation. It is now widely recognised that the financial system contributes to economic growth by acting as an efficient conduit for allocating resources among competing uses. An efficient financial system has, thus, come to be regarded as a necessary pre-condition for higher growth.[2]

But what constitutes an efficient financial system? Does India have an efficient financial system, as it remained largely unscathed from the recent financial crisis? This chapter analyses these questions with a focus on banking, non-banking financial companies, and insurance sectors. The concerns discussed are limited to the areas of regulation, competition and consumer protection.

This chapter briefly discuss the state of the financial sector and explain the regulatory architecture and market participants. It highlights specific issues regarding regulation, competition, and consumer protection in the financial sector, and concludes with recommendations.

Regulatory Architecture

The institutional framework governing the financial sector in India has been built up over a century. Regulators supervising different sectors of the financial sector have been constituted from time to time. While the RBI, constituted in 1934, regulates banking, non-banking and payments sectors, the Securities and Exchange Board of India (SEBI), established in 1988,[3] is the securities market regulator. The insurance sector is regulated by the

Insurance Regulatory and Development Authority (IRDA), established in 1999, and the Pension Fund Regulatory and Development Authority (PFRDA), established in 2003, regulates the pensions sector.[4]

In addition to these special laws, the structure of market participants can entail application of other laws[5] such as the Companies Act, 1956 (partially repealed by the Companies Act, 2013), the Indian Partnership Act, 1932, and the Indian Trusts Act, 1882. Various institutions operating in states, such as the Registrar of Companies and the Registrar of Co-operative Societies (RoCS), also partly regulate certain financial sector entities. In sum, there are over 60 acts and multiple rules and regulations that govern the financial sector.

Regulatory Reforms

Since the 1990s, major regulatory reforms in the financial sector, starting with adoption of certain recommendations of Narsimham Committees (1992 and 1998),[6] aimed to alter the organisational structure, ownership pattern and domain of operations, and infuse competition in the financial sector. In addition, market reforms such as the use of sophisticated technology, has enabled markets to graduate from outdated systems to modern business processes, bringing about a significant increase in the speed of execution of trades and reduction in transaction costs.[7]

However, it has been felt that majority of these reforms have focused on products rather than functions, adopted a quick-fix approach by amending legislation in a piecemeal fashion and at times, remained more or less static with serious fractures visibly harming the system. This has led to unintended consequences, such as regulatory gaps, overlaps, inconsistencies and regulatory arbitrage. The fragmented regulatory architecture has led to a loss of scale and scope that could be available from a seamless financial market with all its attendant benefits of minimising the intermediation cost.[8] The short term mindset has resulted in lack of predictability and clarity for market participants and the consumers alike.

From time to time, various expert committees have recommended substantial overhaul of regulatory architecture for the financial sector to achieve its potential.[9] Most recently, the FSLRC, released draft Indian Financial Code[10] aimed at harmonisation of consumer protection and micro-prudential obligations[11] across sectors, in order to prevent regulatory arbitrage. The FSLRC recommended creation of a unified financial agency to implement the consumer protection and micro-prudential laws for all financial firms other than banking and payments, for which the RBI would implement such laws, due to their distinct characteristics.

Market Participants

Banking

The banking sector comprises commercial banks and co-operative credit institutions. Commercial banks comprise of public and private sector banks,[12] and local area banks. The public sector banks include the State Bank of India[13] and its associates,[14] nationalised banks[15] and regional rural banks.[16] The principal legislations governing private sector banks are Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934.

The co-operative credit institutions comprise urban co-operative banks and rural co-operative credit institutions.[17] Such institutions may carry out operations in one or more states and are currently subject to a system of dual regulation, namely, registration with the RoCS and limited supervision by RBI.

Non-Banking Financial Companies (NBFCs)

NBFCs are entities other than banks which are engaged in lending and investment.[18] NBFCs are classified as deposit and non-deposit taking. Non-deposit taking NBFCs are further classified into systemically important and other NBFCs.[19] Principal legislation governing NBFCs is the RBI Act. However, certain categories of NBFCs are under supervision of other regulators, such as SEBI (stock brokers), National Housing Bank (housing finance companies), IRDA (insurance companies), and state governments (chit funds).

Insurance

The insurance sector comprises life insurance and non-life insurance businesses.[20] The life insurance sector is dominated by the Life Insurance Corporation of India (LIC).[21] Private players are present in both life insurance and general insurance business. The primary legislation governing insurance sector is the Insurance Act, 1938.

Regulation in the Financial Sector

Until recently, financial regulation has been deployed globally to improve risk management practices of financial sector entities and as a reaction to some prior crisis. Inability of such detailed and micro-level regulatory interventions in preventing the recent financial crisis forced a rethink of the purpose of financial regulation. This led to a realisation that risk management concerns of individual banks are quite different from those of regulators. It should not be for the government/regulators, to try to determine how much risk market participants take on board, nor to set out the

Box 7.1: Access to Financial Services in India

Bank account penetration in India is reported to be 35 percent, as compared to 63.8 percent in China, and staggering 93 percent in South Korea.[22] It is estimated that about 40 percent of Indians (about 5,00,000 villages) lack access even to the simplest kind[23] of formal financial services.[24] Similarly, insurance penetration[25] is around 4.10 percent[26] and the insurance density[27] is approximately US$459,[28] much lower than world standards. Simplest financial services such as banking and insurance (specifically health insurance) fall within the scope of 'public good' and should be available to the entire population without discrimination. Basic insurance facilities are imperative for risk management. Without inclusive financial systems, the poor must rely on their own limited savings or informal sources of finance which contributes to persistent income inequality and slower economic growth.[29] Unavailability of formal financial services also leads to mushrooming of unregulated schemes that lure poor to invest their hard earned money based on misleading promise of high return. Absence of clear and efficient regulatory mechanism motivates unscrupulous entities to launch such schemes time and again.[30]

*For various studies on the state of financial inclusion in India, see **Annexure I**.*

particular way that they assess such risks.[31] The regulators must focus on maintaining competition, managing information asymmetry, and systemic concerns.[32]

Countries that were greater integrated with the international financial system felt larger impact of the financial crisis, and consequently have been benefitted post-crisis by an opportunity to overhaul their financial regulation. However, other economies which were largely neglected by the financial crisis might have missed the opportunity to overhaul their financial regulation.

Indian economy remained largely unscathed from the global financial crisis. The financial sector regulation in India carries on the legacy of pre-crisis approach and considers bankers inefficient requiring policing (as opposed to bankers having inappropriate objectives that require fixing).

This section raises certain critical regulation issues with respect to licencing policy, regulatory arbitrage, and regulatory co-ordination, plaguing the Indian financial sector.

Licences are required for almost every aspect in Indian financial sector, and regulators impose considerable risk management guidelines. Multiple regulators with often muddled jurisdiction and lack of formal co-ordination mechanism are inviting systemic crisis.

Licensing Policy

RBI grants licences to banks and NBFCs and IRDA grants licences to insurance companies. The applicants have to comply with a plethora of requirements and the regulators have been granted ample discretion to prescribe additional conditions or reject applications on 'such basis as they may think fit.' In fact, it seems that RBI has informally decided not to issue further registrations to NBFCs.[33] No judicial or quasi-judicial appellate body has been created to review decisions of the RBI.[34] The only recourse is the writ courts, which would not get into merits and would only review if due process of law and equity was followed.

The legislations further prescribe minimum capital requirements, reserve requirements, eligibility conditions of directors, and provide significant powers to the regulators to interfere in the business of regulated entities. Approvals are also required for branch expansion. Excess regulation, and unfettered regulatory discretion act as deterrent in growth of the financial sector and thwarts achievement of market efficiency. For instance, the last batch of bank licences was granted by RBI in 2002-2003, and after a long wait,[35] in February 2013, RBI issued guidelines for providing bank licences.

The guidelines prescribe detailed conditions such as eligible promoters, 'fit and proper' criteria, corporate structure and voting rights, prudential and exposure norms, amongst other things. The guidelines provide that it may not be possible for RBI to issue licences to all applicants meeting the eligibility criteria, which means that discretionary discrimination is indeed to be expected, without an appellate remedy.[36] RBI recently granted licences to two applicants, after a gap of more than a decade.

Licences create important economic opportunities but lack of transparency and wide discretionary powers to the regulators act as entry barriers for market participants.[37]

Regulatory Arbitrage

Sectoral approach amongst financial regulators has left the scope of market participants benefitting from regulatory arbitrage and introducing products that percolate through cracks. This hampers interests of the most vulnerable in the financial markets, the consumers.

Presently, NBFCs, as compared to banks, are subjected to more relaxed prudential norms and need fewer approvals for doing business[38] due to the difference in the liability side between the two.[39] However, on the assets side both banks and NBFCs undertake substantially similar loaning and investment activities. Experts have recommended that bank-like financial institutions which provide similar products/services should be regulated similarly.[40]

Reduced regulatory burden on NBFCs has led to apprehensions that banks are routing funds through NBFCs to sectors in which bank investment is tightly regulated.[41] Recent experiences show that such shadow banking entities can pose potential threats to long-term financial stability if their transactions connect to banks, the banking system, or asset markets.[42]

Recently, a working group on issues and concerns on the NBFC sector was constituted by the RBI. Based on its recommendations, the RBI has issued draft guidelines[43] that provide for increasing the NBFC capital requirements and risk weights,[44] and making asset classification and provisioning norms similar to banks, in a phased manner. The guidelines also require NBFCs to obtain prior approval from RBI in cases of changes in control or transfer of substantial shareholding. It remains to be seen if such recommendations are implemented.

In addition, in spite of carrying on substantially similar activities, NBFCs have not been extended certain benefits conferred to banks, such as rights/ benefits under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.[45] NBFCs are also not eligible to avail certain tax benefits available to banks.[46] Further, certain benefits under the foreign direct investment policy[47] have not been extended to NBFCs.[48] While the government[49] has proposed to extend some tax-benefits available to banks to NBFCs, these are yet to be adopted.

Further, SEBI regulates securities market-related NBFCs that are not required to comply with prudential requirements prescribed by RBI. However, such SEBI-regulated NBFCs[50] have access to funds from the financial sector.[51] This creates uneven playing field between NBFCs[52] regulated by RBI and SEBI, as the former are subject to stricter regulations. Likewise, even if securities' firms do not access public monies and are entirely funded by their shareholders' equity, the RBI has been seeking to inspect them, creating lack of clarity on what precisely constitutes compliance. Experts have recommended that the issue of SEBI regulated entities undertaking fund based business without capital adequacy type of stipulations may be reviewed by the sub-committee of the Financial Stability and Development Council (FSDC), the macro-prudential supervisory body for the economy.[53]

Box 7.2: Regulatory Arbitrage: Specific Instances
Regulation of co-operatives: RBI regulates only such co-operatives operating within a particular state, where it is empowered by the state government (by way of a MoU) or where the state government has accepted the authority of Parliament to legislate on co-operative matters.[54] Protection under the Deposit Insurance and Credit Guarantee Corporation Act, 1961, is extended to only those co-operatives which are regulated by the RBI.[55] In states not having legislated for RBI supervision, or not having entered into MoUs with RBI, depositors do not get benefit of deposit insurance and are consequently at a disadvantage. Such legislative lacunas and inequality of regulatory outreach leads to differential standards for similarly placed entities.   *Differential treatment of foreign banks:* Currently, foreign banks operate in India through branches as opposed to being incorporated as subsidiaries.[56] The regulatory oversight over branches is less stringent than for locally incorporated banks.[57] Further, foreign banks are allowed to open up to 20 branches per year as opposed to unlimited number of branches that can be opened by domestic banks in a year. Such differential treatment of foreign banks impedes competition and market efficiency.[58] RBI has recently released framework for setting up wholly-owned subsidiaries by foreign banks in India. The policy is guided by principles of reciprocity and single mode of presence. The branch expansion policy (including the requirement to open branches in unbanked rural centres), and the priority sector lending requirements, would be applicable to foreign bank subsidiaries also.[59] The effectiveness of such policy is yet to be seen, as concerns have been raised about such stringent norms.[60]

Regulatory Co-ordination

Co-ordination amongst financial regulators

Entities operating in the financial sector often offer products and services that fall under regulatory purview of more than one regulator. Lack of co-ordination in regulating such products may lead to restrictive and unintended consequences. For instance, IRDA issued guidelines prohibiting a bank to tie up with more than one insurer for offering insurance products. This has invited criticism as being anticompetitive and limiting choice available to consumers. IRDA then issued draft of the revised guidelines[61] that rectifies this situation.[62]

Similarly, the guidelines for licencing of new banks in the private sector issued by the RBI[63] that provide for setting up of a bank only through a wholly-owned non-operative financial holding company require certain specialised activities, such as insurance, to be conducted through a separate subsidiary/joint venture/associate structure, limits structural innovation in the interest of functional and regulatory clarity.

Regulations governing investment advice, notified by SEBI opens the scope for SEBI to regulate advisors who provide advice even on financial services that do not constitute securities. Likewise, in an amendment to the SEBI Act by way of a Presidential Ordinance promulgated in March 2014, any pooling of funds of ₹100 crores or more would automatically be deemed to be a "collective investment scheme" necessitating registration with SEBI.[64]

Box 7.3: The Linked Insurance Products' Issue
In recent past, jurisdiction over unit linked insurance products (ULIPs) and index linked insurance products (ILIPs) have been a contentious issue between SEBI and IRDA. The Finance Ministry had to step in and clarify that IRDA has the jurisdiction to regulate ULIPs. Confusion also arose on the jurisdiction of IRDA and PFRDA over pension linked insurance products (PLIPs). Such instances highlight lack of co-ordination amongst regulators, absence of clarity regarding regulatory scope and entice unscrupulous market players to offer unregulated products and services in the market.

Co-ordination with competition regulator

The financial sector regulators also need to co-ordinate with the competition regulator in certain conditions. For instance, mergers and takeover of two listed financial sector companies would require interaction between financial sector regulators (RBI/IRDA), capital markets regulator (SEBI) and the CCI.

Box 7.4: Regulating Bank Mergers
The recent amendments to the Banking Regulation Act require prior approval from RBI to acquire five percent or more of the share capital of a bank.[65] The amendments also exempt regulation of combination of banks from the purview of CCI and provide RBI the power to regulate such transactions. Notably, such special treatment has not been provided to any other regulators at present. The Competition Act also provides an option to statutory authorities and CCI to refer matters to each other to manage overlap of jurisdiction between CCI and such statutory authorities.[66] In light of CCI being a specialised body to check adverse impact on competition, experts decry the amendment to banking laws and have recommended reversing or reviewing its impact within a specific time period, at a minimum.[67]

Co-ordination for systemic regulation

As an outcome of the financial crisis in India, FSDC[68] was constituted to conduct macro prudential supervision of the economy, supervise functioning of large financial conglomerates and address inter-regulatory coordination issues. FSDC has representatives of the financial sector regulators and is headed by the Finance Minister. Its sub-committee is headed by the RBI. In addition, the financial sector regulators have also signed a memorandum of understanding to monitor financial conglomerates.[69] However, effectiveness of such measures is still a subject of debate. Concerns have also arisen about FSDC graduating into a super-regulator for the financial sector in future.

Box 7.5: RBI's Conflicting Roles

RBI officers are nominated as directors on the boards of public sector banks while at the same time RBI serves as the prudential supervisor of these banks. Experts suggest that it would be preferable for the government to focus on policies that ensure the appointment of well qualified, independent Board members that are not from the RBI. And while there may be some synergies, RBI's role as monetary authority, bank regulator, and government debt manager may have led it to require banks to hold larger holdings of government debt than might be needed on prudential grounds. Finally, using the banking system rather than government programmes in meeting the needs of priority sectors (agriculture, small and micro credit, education, health) and underserved areas may conflict with RBI's supervisory role.[70]

Competition in the Financial Sector

Owing to considerable information asymmetries and high switching costs for consumers, competition in financial sector is inherently imperfect. Existence of such imperfections provides significant opportunities for generating and sustaining rents, in the absence of effective regulation.[71]

As in most sectors, competition can have enhanced benefits in financial sector. However, promotion of excessive competition has often been blamed for the financial crisis. Consequently, regulatory misconception of existence of adequate level of competition in economies that avoided crisis seems to have developed. Unfortunately, India seems to be part of the club of such countries, suffering from policies of state-preference and discrimination amongst financial market participants. Improper focus of financial regulation on preventing competition rather than promoting financial sector resilience could be hazardous to the health of financial sector.

In India, public sector entities operating in the banking, NBFCs and insurance sectors have historically been preferentially treated, as against their private sector counterparts. In the banking sector, laws governing public sector banks contain provisions that vary or exclude the applicability of general corporate and financial laws to the institutions created under them (such as exclusion of laws governing winding up of companies).[72] In addition, majority of government funds are mandatorily deposited with public sector banks.[73]

Similar and additional privileges (government guarantee for sums assured)[74] have been granted to the LIC.[75] Certain government-owned NBFCs have also been exempted from prudential norms (including capital adequacy and credit exposure requirements) applicable to other NBFCs.[76] Such benefits are not available to private players.

The public sector entities operating in financial sector have significantly larger balance sheets and interconnectedness with broader financial system. Further, these entities are recipients of large funds from budgets and are accountable to public.[77] Thus, favourable treatment to government-owned entities impinges competitive neutrality and prevents economic efficiency. Privileges such as deposit of government funds come with responsibilities such as pension disbursement to government retirees and requirement to extend unviable loans, which may increase the burden and reduce efficiency of public sector banks.

Box 7.6: Implicit Government Guarantee to Public Sector Banks

Public sector banks enjoy a perception of implicit deposit guarantee from the government. Between June and December 2008 (financial crisis), deposits in ICICI Bank dropped by a tenth and public sector banks posted significantly faster deposit growth.[78] Experts argue that the principal reason for this was implicit guarantee by the government.[79] Such deposit flee is likely to destabilise private sector banks. They will have to hold more capital and maintain more liquidity to reassure depositors, which will work to their competitive disadvantage. In addition, the perception that public sector banks enjoy an implicit guarantee is a moral hazard that limits the incentive to enhance efficiency and may encourage complacency or excessive risk taking by public sector banks.[80]

Further, the public sector banks enjoy an unlimited access to taxpayer funds. The government has repeatedly stated its intention to recapitalise public sector banks from time to time.[81] This luxury is not available to the private sector banks. Experts argue that while private banks grow their balance sheets by making profits, retaining them and keeping a check on the non-performing assets (NPAs), public sector banks keep turning back to the taxpayer to pay for their inability to make adequate profits and reining in the NPA levels.[82] When public sector banks get recourse to taxpayers' money, instead of being nudged to become more efficient and profitable, they are given a further unfair advantage.[83] This makes the playing field for non-public sector banks even more unequal.[84]

Box 7.7: Specific Competition Concerns in Insurance Sector

1. *Relaxation in investment norms:* The government has given its implicit assent to LIC to invest in a company up to 30 percent of paid up capital of such company, as against the investment limit of 15 percent prescribed by the IRDA. This not only creates an uneven playing field amongst entities in insurance sector, but also allows usage of public funds by the government in achieving its disinvestment target.[85] Such relaxation hinders efficient risk management by private sector entities and may encourage LIC to excessive risk taking.

2. *Inefficiency in re-insurance sector:* The sole reinsurer in the country is General Insurance Corporation (GIC), a public sector entity. Experts have suggested creating an enabling framework for the entry of global reinsurance firms, including Lloyds, in the Indian reinsurance sector.[86] Further, general insurance companies are required to mandatorily reinsure portion of their business with GIC.[87] Recommendations for doing away with such mandatory reinsurance requirement to promote efficiency in the insurance sector have been consistently made,[88] however, without achieving much success.

Consumer Protection in the Financial Sector

Complexity of financial markets has led to an increase in information asymmetries, market externalities and differences in bargaining power of consumers and service providers. This has not only increased the hurdles faced by consumers while dealing with financial sector, but has also brought to the fore various difficulties traditionally faced by financial sector consumers.

One of the outcomes of financial crisis in severely affected economies was realisation of loss of trust born of profound lapses in banking standards. It was acknowledged that retail and business customers alike are often denied sufficient choice or access to enough information to exercise effective judgment. Greater market discipline can help address the resulting consumer detriment and lapses in standards, and buttress regulation.[89]

Unknowingly or otherwise, relatively unaffected economies (including India) have failed to learn from experiences of west that has burnt its hands in the financial crisis.

Product Bundling

Product proliferation and an emphasis on incremental growth in fee-based income have prompted many financial service providers to develop and market a bundle of products as one package, not necessarily in a homogenous way. The pricing of products and services in a bundled approach may not necessarily serve the best interest of the customers who need only basic financial services. As a result, consumers often end up either paying for products they do not require or not getting access to products they need, but at a high price due to the product bundle.[90]

Box 7.8: Product Bundling in Insurance Sector
In insurance sector, the problem of product bundling has an additional dimension, wherein insurance policies are bundled with goods and services of other sectors (such as automobile). This has lead to concerns regarding conflicts of interests, non-availability of choice, and often misselling when consumers are not told about the cost of insurance. Further, concerns about mis-selling of insurance products, wealth-management and other related activities by banks have been rising.[91]

Non-availability of Comparison

As financial product offerings are based on cost of funds, asset-liability management, and risks incurred, the offerings need to be objective and transparent. However, financial sector is marred with similar products which the consumers are required to choose from. For instance, in the banking sector, multiple maturity schemes offered by different banks make it difficult for customers to understand and compare products. Experts suggest that all deposit rates should indicate the annualised rate of the offering, and also indicate penalty for premature withdrawal, so that the customers understand the product and can easily compare the same with similar such offerings by other banks.[92]

The RBI, in certain cases, has issued guidelines in line of expert recommendations. However, in absence of periodic review, practical adherence with such guidelines remains an issue.

Lack of transparency in product offerings also leads to inability to compare different products. In order to bring transparency in providing correct and complete details of suitable products and thus assisting product comparison, IRDA has set minimum standards of performance for agents.[93] However, compliance by insurance agents with such standards remains an issue.

Multiple Know Your Customer (KYC) Requirements

KYC serves recording of customer identification and location. Such requirements ought to be constant across service providers. Further, need for a revised KYC in subsequent transactions should not arise unless customer location is changed. However, the procedure followed by banks and the formats for opening of accounts differ from bank to bank. Absence of a common format causes avoidable inconvenience to the customer.[94]

To top it up, strict KYC requirements for opening of basic no-frill bank account leads to denial of financial services and aids in lack of financial service penetration. Concerns about necessity of certain conditions in KYC norms have also been raised.[95]

IRDA has initiated efforts towards issuing a standard proposal form for basic life insurance products. It has also been reported that the government proposes common KYC for all financial products.[96]

However, if and when such a proposal will see light of the day remains to be seen.[97] While KYC is an important measure from the standpoint of pre-empting money laundering, because of the cumbersome nature of multiple KYC requirements, it has become an entry barrier and a means of exclusion of segments of the economy to the financial sector, thereby impacting the penetration of the financial sector in the economy. While at one end, low and middle-income consumers face complex KYC requirements, reports suggest that such norms are brushed aside in large-scale transactions.[98]

Unreasonable Charges

Concerns have arisen about charges levied by financial service providers as not being uniform and unjustifiable, such as foreclosure charges levied by banks on prepayment of loans, high credit card interest rate, charges levied by value added services provided, and levy of charges even when consumers do not conduct any transaction, etc. While RBI has directed banks to disclose the list of basic banking service charges on their websites, reports suggest that majority of banks are yet to comply with such directions.[99]

Ineffective Redressal Mechanism

The redressal mechanism in the financial sector consists of two-tiers, first being the redressal department of the service provider, and second being the relevant Ombudsman. The complaints filed with the Ombudsman are relatively small as compared to the vast sector. There seems to be little awareness of the Ombudsman scheme and how to access an Ombudsman office. The urban-centric nature of offices and the level of literacy required to file grievances also impede easy access.[100]

Redress to financial sector consumers is also available under the Consumer Protection Act, 1986. However, concerns about its insufficiency to deal with growing complexities in the financial sector have arisen. The FSLRC suggested creation of an independent financial redress agency to redress complaints of retail consumers against all financial service providers.[101]

Box 7.9: Sector Specific Concerns on Financial Consumer Protection

Banking: Issues such as transferring accounts to the inoperative category by banks unilaterally and without prior intimation to the account holder, deducting penal charges without intimation to the customer, non-issuance of cheque books in the 'no frills' accounts, are of considerable concern. It has been suggested that every bank should offer a basic account which permits a minimum number of transactions without penalty for non-maintenance of a minimum balance.[102] RBI has issued guidelines in this regard but non-compliance with such guidelines remains a concern. The RBI has recently advised banks not to levy penalty on non-maintenance of minimum amount in bank accounts.

NBFCs: Concerns about various NBFCs and multi-level marketing firms making false promises of high returns and vanishing subsequent to collection of advances, have arisen time and again. This is a consequence of inadequate supervision of NBFCs and lack of coordination between regulators. Similarly, charging of high rates of interests and adoption of coercive practices for repayment of loans by micro-finance entities has led to harassment of customers.

Insurance: Concerns about impersonation as insurance agents and as agents of IRDA have tainted the credibility of various insurance companies besides duping the consumers. Not intimating maturity of policies and policy lapses due to non-payment of premium to the holders despite guidelines to the contrary are common concerns. No compensation scheme is available at present which protects inability of an insurer to meet its financial obligations in the event of its failure.[103]

Conclusion and Recommendations

A correlation (and much less a causal link) is difficult to establish between the level of financial regulation, competition and consumer protection in India and Indian financial sector remaining largely unharmed from the financial crisis. Much reforms need to be undertaken in these areas and to make Indian financial system efficient. Some of the preliminary steps are:

Withdrawal of Benefits to Public Sector Enterprises

A running theme in this chapter has been regulatory preference of public sector entities over private sector entities in the areas of banking, NBFCs and insurance. While such approach may be suited to requirements of a socialist country wherein 'public goods' such as banking and insurance must be controlled by the government, it does not fulfill the requirements of present day India. This is particularly true in a scenario where in spite of government incentives, public sector enterprises have continuously managed to remain inefficient, unproductive, and poorly run.

It is time that privileges accorded to public sector firms are withdrawn and such firms are made subject to competitive market forces. This would usher competitive neutrality, prevent misuse of resources, and increase efficiency in financial sector.

Banking: Benefits extended to SBI and its associates under their respective legislations must be withdrawn. Further, the government must clarify that deposits maintained with public sector banks are not guaranteed and push public sector banks towards better risk management practices and higher efficiency. In addition, public sector banks must not enjoy unlimited access to taxpayers' funds. There are better avenues for utilisation of exchequer. Public sector banks must be forced to adopt better cost management practices and must be able to manage capital adequacy and provisioning requirements from other sources.

NBFCs: Requirements for public sector NBFCs must also be made equal to private sector NBFCs and they must be encouraged to follow capital adequacy, credit exposure and other requirements applicable to other NBFCs. Further, the RBI should have a transparent system for registration of NBFCs.

Insurance: Entry barriers in re-insurance business must be removed and private and foreign players must be allowed in the re-insurance sector. Benefits accorded to LIC under the LIC Act must be withdrawn and LIC Act must be amended to bring LIC at par with other life insurers. The investment norms for LIC must be made equal to other insurers in the country and government must not force LIC to bail out its disinvestment proposals. LIC must be allowed to use its funds for financial inclusion and better risk management practices.

Similar recommendations have been made by various expert bodies earlier. While the RBI expert committee on NBFCs recommended government owned NBFCs to comply with regulatory framework applicable to other NBFCs, the FSLRC recommended large scale amendment of all special legislations that: (a) establish statutory financial institutions; or (b) lay down specific provisions to govern any aspect of the operation or functioning of public sector financial institutions. It went on to state that the undertakings of all statutory institutions should be transferred to ordinary companies incorporated under the Companies Act and their regulatory treatment should be identical as that applicable to all other financial companies.

Avoiding Regulatory Arbitrage

Avoiding regulatory arbitrage opportunities by clarity in roles and responsibilities of financial sector regulators is of foremost importance. Regulatory uncertainty and conflicts in regulatory objectives often result in unintended consequences of over or under regulation. Various tools have been adopted around the world to avoid regulatory arbitrage.

One such tool is the 'twin peak' model adopted in the UK wherein consumer protection across financial sector is administered by Financial Conduct Authority and prudential regulation is administered by Prudential Regulation Authority. The US, however, has retained the complex multiple-regulator model. The FSLRC recently recommended merging of SEBI, IRDA, PFRDA, and Forward Markets Commission into a unified regulator, to supervise financial sector entities, other than those engaged in banking and payments.

While there is no foolproof regulatory model, it is imperative for regulators to work in tandem and co-ordinate actions to prevent supervision leakage. While FSDC might be the apt platform for inter-regulatory interaction and coordination, wherein the representative from Ministry of Finance acts as a dispassionate observer and interjects only when required, it must be ensured that FSDC does not turn into a super-regulator in future. Also, as the sectoral regulators, adopting a silo-approach and expected to be neck-deep into the sectoral issues, the FSDC must adopt a macro-economic view and manage any systemic concerns that may be developing in the financial sector.

In addition to inter-regulatory interaction, development of a formal mechanism for constant interaction between financial sector regulators and Central and state governments is imperative. Such mechanism would ensure concurrence in regulatory and governmental objectives, act as feedback and experience-sharing tool, and cross-learning between agencies and ensure that financial sector entities are efficiently regulated and the vulnerable are adequately protected.

Ensuring Competitive Neutrality

Competitive neutrality requires that governments should not use their legislative or fiscal powers to advantage their own businesses over the private sector. If governments do advantage their businesses in this way, it will distort the competitive process and reduce efficiency, more so if the government businesses are technically less efficient than their private sector competitors.[104]

In the modern intricately inter-related financial world, banks and NBFCs act closely, often residing under one large conglomerate. With the issuance of RBI bank licencing norms, this is more possible now than ever before. Thus, it is important that NBFCs carrying on bank-like activities implement risk management policies similar to that of banks and follow capital adequacy and provisioning norms. Additionally, tax benefits accorded to banks should be extended to NBFCs so that they are able to adopt better fund management practices. Similar endorsements were made by the Ministry of Finance constituted key advisory group on NBFCs.

Fair Treatment to Consumers

Regulatory restrictions on the number of market players force consumers to receive services from a limited set of service providers.[105] This, coupled with rampant financial illiteracy in an overwhelmingly complicated marketplace, little awareness of benefits of effective personal finance management, and mistrust on the regulators, make consumers vulnerable in the financial sector.[106]

In order to counter information asymmetry in the financial sector, financial regulators internationally, have adopted a 'treating customers fairly' policy which requires the financial service providers to ensure that customers are treated fairly at each phase of the product life cycle.[107]

In addition, the Sergeant review of simple financial products in the UK revealed that simple processes and products must be available to the consumers that allow them to make straight forward purchasing decisions.[108] It identified following attributes for financial products to be simple:

- The product should help consumers benchmark and compare with other products in the market.
- The product must be understandable and accessible to the mass market.

- The product must not be tailored to meet individual needs, but provide consumers with confidence that the product will meet their basic needs and offer them a fair deal.
- The product should be a viable commercial proposition for the provider.

Simple financial products are needed in the Indian financial sector also. Use of benchmark products fulfilling basic consumer needs would address concerns such as tying, bundling, over pricing and misselling. Regulators must endeavour to issue product profiles of simple financial products and ensure that market players comply with such profile. Availability of simple and understandable financial products and services would provide confidence to consumers in using financial system considering it as a viable investment option. Use of technology in providing simple financial products could also provide greater access and acceptance to financial markets.

Box 7.10: Specific Recommendations on Financial Consumer Protection

Need for uniform KYC requirements: Uniform KYC requirements and avoidance of multiple KYCs would promote accessibility of financial markets. Storage of KYC data within an inter-regulatory body providing access to such data to regulators on need-to-know basis, subject to confidentiality requirements, would greatly reduce burden on regulators as well as market players.

Fraud: Jurisdiction of regulators must be extended to act against unregulated entities and those impersonating as market intermediaries/ purporting to be registered with the regulators. This will assist in reigning in instances of fraud and misrepresentation in the financial sector.

Strong supervision: Regulators have regulations in place to deal with common consumer grievances such as penal charges, basic bank accounts, and vanishing entities but effective implementation of such policies has been an area of concern. The regulators must ensure that the regulations issued for consumer protection are strictly followed by the market players. Awareness about the grievance redressal mechanism needs to be increased and its effectiveness must be periodically reviewed. Continuous updation of redressal mechanism to meet expectations of consumers is necessary for development of financial system.

Role of Civil Society Organisations

Civil society organisations (CSOs) act as a catalyst between civil society/ regulated entities, and the regulators/government. A regulator would not formulate and an effective solution without adequate demand from the society, and a solution prescribed by the regulators cannot be successful unless implemented in letter and spirit by the regulated entities.

The findings of this chapter suggest that India lacks on both these grounds. Absence of adequate demand from civil society has led to lack of large scale financial sector reforms, and minor reforms that have been introduced by the regulators have still not been adequately internalised by the regulated entities.

CSOs have a crucial role to play at this juncture. They need to engage with consumers to inform them the adverse consequences of inefficient financial regulation, and low levels of competition and consumer protection standards prevailing in financial sector, with the objective of generating demand for big bang financial reforms in the country. At the same time, CSOs need to engage with the regulated entities to understand the problems in effectively implementing the minor reforms introduced, and help such regulated entities in implementing such reforms, which are for the benefit of consumers and the financial system as a whole.

Regulatory Activism

It is felt that in order to advocate pro-competition and consumer oriented practices, a culture of regulatory activism rather than regulatory competition needs to be instituted. With the rapidly changing and ever evolving financial world, the regulators should periodically review their policies to ensure that they do not become out dated, remain pro-competitive, advocate consumer interests and suit the test of times.[109] The regulatory review must also pre-empt the future needs of the fiercely competitive world and ensure that absence of policies is not disincentivising market players or hampering competition. This is important as the financial crisis indicated that pre-crisis regulation and supervision was inadequate, and underdeveloped for tackling the developments that had taken place in the financial sector.[110]

However, the regulatory policies must not act as burden on market players and must have proper incentive alignment to guide market players towards a competition neutral world that enhances consumers' interest and creates an efficient financial system.[110]

Annexure I

A. IMF Financial Access Survey 2012

Access to & use of Financial Services			
Commercial bank branches per 1,000 km^2	33.17	Commercial bank branches per 100,000 adults	11.38
ATMs per 1,000 km^2	32.67	ATMs per 100,000 adults	11.21
Outstanding deposits with commercial banks (% of GDP)	68.64	Outstanding loans from commercial banks (% of GDP)	54.24
Deposit accounts with commercial banks per 1,000 adults	1042.48	Loan accounts with commercial banks per 1,000 adults	151.06
Household deposit accounts with commercial banks per 1,000 adults	892.49	Household loan accounts with commercial banks per 1,000 adults	23.54

B. World Bank Global Financial Inclusion Index 2011

Indicator	Figures in %, age 15+
Account at a formal financial institution	35
Account at a formal financial institution, female	26
Account at a formal financial institution, income, bottom 40%	27
Saved at a financial institution in the past year	12
Loan from a financial institution in the past year	8
Loan from family or friends in the past year	20

C. Mastercard Index of Financial Literacy 2013

Country (Ranking out of 16)	Overall financial literacy index	Basic money management	Investment
India (**15**)	59	50	57

D. CRISIL Inclusix Index (2009-2011)

- The number of savings bank accounts, at 624 million, is close to four times the number of loan accounts at 160 million.

- The bottom 50 scoring districts have just two percent of the country's bank branches.

- The bottom 50 scoring districts in India have only 2,861 loan accounts per lakh of population, which is nearly one-third of the all India average of 8,012.

- India's six largest cities have 11 percent of the country's bank branches. At the other end of the scale, there are four districts in the North-Eastern region with only one bank branch each.

Endnotes

1 Joseph A. Schumpeter, *A Theory of Economic Development*, Cambridge, MA: Harvard University Press, 1911

2 S. Sahoo, *Financial Structures and Economic Development in India: An empirical evaluation,* RBI Working Paper Series, DEPR, 2/2013

3 Without statutory powers, and with powers conferred in 1991

4 Statutory powers were conferred on the PFRDA pursuant to the PFRDA Act, 2013

5 Having their own prudential requirements

6 The Committee on Financial System, 1992 and the Committee on Banking Sector Reforms, 1998

7 Supra Note 2

8 Government of India, *Report of the Financial Sector Legislative Reforms Commission*, March 2013, *http://finmin.nic.in/fslrc/fslrc_report_vol1.pdf, http://finmin.nic.in/fslrc/fslrc_report_vol2.pdf*

9 For instance, Tarapore Committees, Percy Mistry Committee, Raghuram Rajan Committee

10 Supra Note 8

11 On the basis of risk taken by the financial firm measured in terms of intensity of promise

12 Including foreign banks

13 Constituted under the State Bank of India Act, 1955

14 The subsidiaries of State Bank of India were constituted under the State Bank of India (Subsidiary Banks) Act, 1959

15 The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking companies (Acquisition and Transfer of Undertakings) Act, 1980, nationalised majority of private sector commercial banks operating in India and brought them under government control

16 Constituted under the Regional Rural Banks Act, 1976

17 The rural co-operative credit institutions include state co-operative banks, district central co-operative banks, primary agricultural credit societies, state co-operative agriculture and rural development banks and primary co-operative and agricultural and rural development banks. Reserve Bank of India, *Manual of Financial and Banking Statistics*, March 2007

18 Such entities cannot accept demand deposits, cannot issue cheques drawn on themselves, and deposit insurance is not available to its depositors. (*Frequently asked questions on NBFCs*, available at: *www.rbi.org.in/scripts/FAQView.aspx?Id=71*)

19 Within this broad classification, different types of NBFCs are asset finance companies, investment companies, loan companies, infrastructure finance companies, systemically important core investment companies, infrastructure debt

funds, NBFC-micro finance institutions and NBFC factors *(www.rbi.org.in/scripts/FAQView.aspx?Id=71).*

20 In addition, General Insurance Corporation is the sole national reinsurer. Export Credit Guarantee Corporation of India Limited is a specialised insurer underwriting business in export credit insurance. Agriculture Insurance Company of India Limited specialises in underwriting business in agricultural insurance. Insurance Regulatory and Development Authority, *Annual Report*, 2011-12.

21 A fully-owned government insurance company which was constituted under the Life Insurance Corporation Act, 1956. LIC had a market share of around 70 percent in financial year 2011-12

22. K.C. Chakrabarty, *Financial Inclusion, Issues in measurement and analysis*, November 2012

23 Deposit and access to formal credit

24 K.C. Chakrabarty, *Financial Inclusion, A road India needs to travel,* RBI Monthly Bulletin, November 2011

25 The ratio of premium collected in a given year to the GDP

26 Insurance penetration in life insurance business in FY 2011-12 slipped to 3.40 percent, from 4.40 percent a year before (The ratio had risen from 2.15 percent in 2001-02 to 4.60 percent in 2009-10, before reducing to 4.40 percent in 2010-11.) Countries such as Taiwan, South Africa and Japan recorded a life insurance penetration of more than 10 percent in 2011-12. The penetration of non-life insurance sector was 0.70 percent in 2011-12 as compared to 0.71 percent in 2010-11. Countries such as South Korea, Switzerland and Japan recorded a non-life insurance penetration of around 5 percent in 2011-12.

27 The ratio of premium collected in the given year to the total population (measured in US$)

28 The insurance density of life insurance fell to US$49.0 in 2011-12 from US$55.7 a year before. The world life insurance density is around US$400 and countries, such as Switzerland and Japan recorded a life insurance density of more than US$4,000 in 2011-12. The insurance density of non-life sector was US$10.0 in 2011-12. The average world non-life insurance density was around US$300 with countries, such as Switzerland, Australia and US had non-life insurance density of more than US$2,000 in 2011-12. Insurance Regulatory and Development Authority, *Annual Report*, 2011-12.

29 Supra Note 22

30 Such as the recent Saradha ponzi scheme, that was introduced in West Bengal and flourished primarily as a result of regulatory cracks in financial sector

31 Charles Goodhart, *How should we regulate the financial sector*, The future of finance and the theory that underpins it, The London School of Economics and Policy Science, 2010

32 *The Fundamental Principles of Financial Regulation*, Geneva Reports on the World Economy, 2009, the financial regulation must focus on, *"(i) constraining the use of monopoly power and the prevention of serious distortions to competition and the maintenance of market integrity; (ii) protecting the essential needs of ordinary people in cases where information is hard or costly to obtain, and mistakes could devastate welfare; and (iii) [managing situations] where there are sufficient externalities that the*

social, and overall, costs of market failure exceed both the private costs of failure and the extra costs of regulation."

33 Leading to an abnormal premium for purchase of existing NBFCs. Moreover, the policy on determining whether a company is an NBFC (if 50 percent of income and assets are financial in nature) has resulted in many companies having to get registered as NBFCs but with the RBI refusing to give them any registration

34 Appeal from decisions lie with the Central Government, however, no recourse is provided from the Central Government's decision (Section 45-IA(7) of the RBI Act)

35 The guidelines were issued after the Banking Laws (Amendment) Bill, 2011 was passed by the Parliament. Among other things, the bill gave RBI the power to supercede Board of Directors of a bank, inspect associates of a bank, and regulate mergers and acquisitions in the banking sector. Reports suggest that RBI had put on hold issuance of bank licencing guidelines until given such powers. (The Economic Times, *Finally, RBI gets power to issue new bank licences*, December 2012.) Situations like these create conflicts amongst regulators and unnecessary delay in adoption of measures that further interests of consumers and competition

36 The guidelines note that 'Banking being a highly leveraged business, licences shall be issued on a very selective basis to those who conform to the above requirements, who have an impeccable track record and who are likely to conform to the best international and domestic standards of customer service and efficiency.'

37 It must be mentioned here that the RBI has recognised that, "*there is a case for reviewing the current 'stop and go' licensing policy and consider adopting a 'continuous authorisation' policy, as continuous authorisation keeps the competitive pressure on the existing banks and also does not strain the banking system as the 'block' licensing may do. However, it is important that the entry norms should be stringent so as to encourage entry by only well-qualified entities in order to improve the quality of the banking system and promote competition.*" RBI Discussion Paper on Banking Structure in India – The Way Forward, August 2013

38 Banks need to comply with cash reserve and high statutory liquidity ratio requirements, require RBI approval for branch expansion, have mandated priority sector lending requirements and are subject to stringent foreign ownership requirements. Such requirements are either absent or applicable to a limited extent in case of NBFCs. Lighter prudential requirements in relation to exposure norms, capital adequacy, risk weights, asset classification and provisioning requirements, are applicable for NBFCs

39 NBFCs are not allowed to take demand deposits and consequently have to comply with lenient requirements

40 RBI, *India's Financial Sector – An assessment*, March 2009. Also, Lev Ratnovksi, *Competition Policy for Modern Banks*, IMF Working Paper, May 2013

41 As on March 23, 2012, gross outstanding bank credit towards NBFC sector was ₹2,569.5bn. It must be noted that the RBI now aggregates exposures of banks and NBFCs affiliated to them for purposes of various prudential requirements

42 Liikanen et al, *Final report of the High Level Expert Group on reforming the structure of the EU banking sector*, October 2012

43 www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2620

44 For capital market exposures and commercial real estate

45 Despite being secured lenders (Under Section 2(m)(iv) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002)

46 These include exemption from tax deduction at source on receipt of interest, deduction on provisions relating to bad and doubtful assets, and certain indirect tax benefits

47 Issued by the Department of Industrial Policy and Promotion, April 2013

48 "*The foreign direct investment policy provides that downstream investments by foreign owned/controlled banks will not be treated as indirect FDI under corporate debt restructuring, or under any other loan restructuring mechanism, or in trading books, or for acquisition of shares due to defaults in loans. Such exemption is not provided to NBFCs, in spite them often being involved in such debt restructurings or end up acquiring shares due to defaults,*" Nishith Desai Associates, *Corpsec Hotline,* April 2013

49 Ministry of Finance, *Report of Key Advisory Group on NBFCs*, January 2012

50 Like stock brokers and merchant banks

51 In the form of bank borrowing, commercial papers, non-convertible debentures from the market including from mutual funds. (RBI, *Working Group on Issues and concerns in the NBFC sector, Report and Recommendations*, August 2011)

52 Having access to public funds

53 RBI, *Working Group on Issues and Concerns in the NBFC Sector, Report and Recommendations*, August 2011

54 At present, RBI enters into MoUs with relevant state governments for regulation of co-operative banks. A state government can accept authority of the Parliament to legislate on co-operative matters under Article 252 of the Constitution of India

55 This is also provided under MoUs with the relevant state governments. See definition of eligible co-operative banks under the DICGC Act

56 The legal distinction is that branches are not separate legal entities (as they are only agents of the parent), whereas subsidiaries are locally incorporated as a separate legal entity with their own board

57 The detailed corporate compliance requirements on matters such as board and management do not apply when entities operate through the branch route as they are not incorporated in India. Further, since capital is fungible the assets of foreign branches in India can be repatriated back to the home country with relative ease which raises concerns of governance and resolution. However, liberalised norms to open branches in smaller cities applicable to domestic banks are not applicable to foreign banks. (Financial Sector Legislative Reforms Commission, *Report of the Working Group on Banking*, March 2013)

58 RBI discussion paper, *Banking Structure in India – The Way Forward*, August 2013, recognises, "*The significance and need for foreign banks' participation in India arises primarily to increase competition, promote efficiency of the local banking system and also to bring in sophisticated financial services and risk management methodologies which can be adopted by the domestic banks. Post crisis, domestic incorporation of foreign banks through the subsidiarisation route has acquired importance.*"

59 RBI scheme for setting up of Wholly Owned Subsidiaries by foreign banks in India, November 2013

60 Madan Sabnavis, *Banking on India*, The Financial Express, November 09, 2013

61 Exposure Draft of IRDA (Licencing of Bancassurance Entities) Regulations, 2012

62 Tie up with more than one insurer is proposed to be allowed for a minimum of 10 states and a maximum of 20 states

63 RBI, *Guidelines for licensing of new banks in the private sector,* February 22, 2013

64 The Securities Laws (Amendment) Second Ordinance, 2013, September 2013

65 The Banking Laws (Amendment) Act, 2012. The RBI has the power to impose conditions while granting approval for acquisition of the share capital

66 Sections 21 and 21A of the Competition Act, 2002. The Competition (Amendment) Bill, 2012, proposes to make this reference mandatory in case of possibility of violation of Competition Act or any other relevant Act, as the case may be

67 The Draft National Competition Policy, 2011, while recognising the need for interaction between the competition regulator and sector regulator, provides, "*the CCI, which is expected to have developed the core competence, expertise and capacity in competition related issues, will be able to apply uniform competition principles across all sectors of economy*."

68 Press Information Bureau, Press release dated October 12, 2010

69 RBI Press Release dated March 08, 2013

70 IMF, *India: Financial System Stability Assessment Update*, January 2013

71 OECD Competition Committee, *Competition Issues in Financial Sector,* 2011

72 The State Bank of India Act exempts SBI from the applicability of laws governing winding-up of companies and provides for its liquidation only by an order of the government (s. 45 of the SBI Act). Consequently, such entities cannot be wound up even if they go bankrupt, contrary to what private sector entities would face in similar circumstances

73 In January 2008, the government decided that funds under the control of the government departments/ministries or funds amenable to their control (including funds distributed by government departments/ministries to agencies/entities) shall, at least to the extent of 60 percent, be placed with public sector banks. (*Ministry of Finance, Department of Expenditure, Office Memorandum dated January 15, 2008*). These instructions applied equally to subordinate offices, attached offices and autonomous organisations which are mainly funded by the government

74 Applicability of laws governing winding-up of companies and liquidation only by an order of the government (s. 38), explicit government guarantee for all sums assured under LIC policies (s. 37), power to government to modify applicability of certain provisions of the Insurance Act for their applicability to LIC (s. 43), any interest or dividend payable to LIC in respect of any securities/ shares owned by it or in which it has full beneficial interest is not subject to deduction of income tax (s. 43A)

75 The IMF in its Financial System Stability Assessment Update dated January 2013 recommended providing the government with administrative scope to phase out LIC's government guarantee (or requiring LIC to price the guarantee into its products). In its Financial Sector Assessment Programme dated August 2013, the IMF further noted, *"Given LIC's explicit government guarantee, GoI is effectively providing the return guarantee on new [pension] linked insurance products. As already implied, GoI could legitimately charge LIC a fee for this service, particularly if the PSU does not set aside adequate additional capital as the exposure grows. Other life insurers had developed a product guaranteeing minimum unit values based on stock index values, but this was under supervisory review due to its potential to destabilise stock markets."*

76 Supra Note 53

77 *Ibid*

78 In financial year 2008-2009, SBI and associates registered a deposit growth of staggering 30.13 percent as compared to 9.09 percent deposit growth in private banks

79 Barry Eichengreen and Poonam Gupta, *The global financial crisis and Indian banks: survival of the fittest?*, MPRA Paper No. 43365, December 2012. The authors note, *'It seems that depositors were confident for other reasons that their deposits were safer with the SBI due to the government's implicit guarantee of its liabilities, and that this dominated other considerations.'*

80 *Ibid*

81 In January 2013, the government decided to provide capital funds to public sector banks during 2012-13 to the tune of ₹12,517 cr. The principal reason for recapitalisation was to enable PSBs to maintain Tier-I CRAR at a comfortable level (Press Information Bureau, Government of India, *Recapitalization of public sector banks,* January 2013). This was repeated in the budget speech of the Finance Minister of India wherein he further proposed to provide an amount of ₹14,000 cr in 2013-14 for capital infusion in public sector banks *(http://indiabudget.nic.in/ub2013-14/bs/bs.pdf*). Interestingly, the government has noted that the funds required are commensurate to the increase in risk weighted assets of the public sector banks and that the infusion will help public sector banks to withstand impact of stress in the economy and expand credit growth. In October 2013, the government confirmed capital infusion of ₹12,517 cr. in financial year 2012- 13, and approved infusion of ₹14,000 crores during financial year 2013-14 (*http://pib.nic.in/newsite/PrintRelease.aspx?relid=100196).*

82 The Finance Minister also sported concern on NPA levels of PSBs, which eat away large proportion of profits in form of provisioning, leaving less scope for meeting capital requirements. (See, *Chidambaram tells banks to contain NPAs*, Business Standard, June 2013, *www.business-standard.com/article/finance/rise-in-banks-bad-loans-unacceptable-says-fm-113102200488_1.html.* The gross NPAs (as a percentage of gross advances) increased from 3.17 percent to 3.84 percent for public sector banks during 2012-13, while decreased from 2.18 percent to 1.91 percent for new private sector banks. Net NPAs to net advances ratio of state-run lenders slipped to 2.02 percent at end-March 2013 from 1.47 percent a year earlier (See, RBI, *Annual Report*, 2012-13, Parnika Sokhi, *Fix asset quality first, RBI tells banks,* DNA Money, November 2013).

83 It is interesting to note that return on assets (ROA) of PSBs reduced from 0.88 percent in 2011-12 to 0.78 percent in 2012-13 while ROA of private sector banks

increased from 1.53 percent to 1.63 percent during this period. During the same period, PSBs posted a decrease in return on equity (ROE) from 15.33 percent to 13.24 percent while ROE for private sector banks increased from 15.25 percent to 16.46 percent. (See, RBI Report on Trends and Banking in India, 2012-13, November 2013)

84 The Indian Express, *An Unfair Advantage*, January 2013

85 Samie Modak, *LIC invests 3,800 crore in government's FY13 disinvestment*, Business Standard, March 2013.

86 Supra Note 8

87 GIC recorded a net loss (after tax) of Rs. 2,469 crore in FY 2011-12, in spite of mandatory reinsurance requirement

88 Supra Note 8

89 Report of the Parliamentary Commission on Banking Standards, *Changing banking for good,* House of Commons and House of Lords, London, June 2013

90 RBI, *Report on Committee on Customer Service in Banks*, 2011

91 RBI, *Financial Stability Report*, June 2013

92 Supra Note 90

93 IRDA, *Guidelines for Individual Agents for Persistency of Life Insurance Policies*

94 Supra Note 90

95 K.E. Adajania et al, *Clunky KYC norms putt off investors*, Hindustan Times, February 2013 and R. Jagganathan, *Does KYC Stand for Kick You Customer*, First Post, July 2011

96 Sidhartha, *Common KYC for all Financial Products*, The Times of India, November 2011 and M. Venkatesh, *Single point know-your-customer to ease form filing headaches,* Hindustan Times, March 2012

97 While Aadhar has been quoted by UIDAI as adequate for KYC to open bank accounts; its legal sanctity remains doubtful.

98 Josy Joseph, *Banks supressing alerts on suspect dealings: RBI probe,* The Times of India, May 2013

99 K. Memon, *All banks defy RBI circular on disclosing all service charges on their websites,* Moneylife, July 2013

100 P. Malyadri et al, *Success of Banking Ombudsmen Scheme: Myth or Reality*, International Journal of Research Studies in Management, 2012

101 Supra Note 8

102 Supra Note 90

103 The DICGC guarantees deposits (up to a specific amount) with banks

104 Government of Australia, *Commonwealth Competitive Neutrality Policy Statement*, June 1996

105 K.C. Chakrabarty, *Financial Consumer Protection*, March 2013

106 Sergeant Review of Simple Financial Products, *Final Report*, March 2013

107 RBI Report on Trend and Progress of Banking in India 2012-13, further provides, *"The intent and basic structure for TCF is in place in India for banking products of scheduled banks. However, it is now being considered to extend the TCF structure to third party products, viz., mutual funds, capital market and insurance products sold by banks and also extending the BOS Scheme to non-scheduled banks."*

108 The review further stated, '*Achieving this will have wide ranging benefits. Simplicity helps to build consumer trust and engagement, and encourages them to compare products and shop around.*'

109 The FSLRC has suggested mandatory review by regulator of its policies

110 Supra Note 42

111 This is specifically needed in the area of access to financial services, where due to incentive misalignment; compulsory regulatory policies (such as priority sector lending and branches in unbanked areas) might actually be creating additional burden on the market players and thus not achieving desired results

CHAPTER 8

Regulation and Competion in Private Healthcare in India

Introduction

Private healthcare[1] in India has grown in an exponential phase. From providing eight percent of the healthcare in 1949, private sector now accounts for 93 percent of hospitals and 85 percent of doctors in India.[2] In spite of the presence of both public and private sector in healthcare, regulatory standards are not adequately defined and in any case are ineffectively enforced, leading to prevalence of anticompetitive practices, such as prescribing costlier medicines and diagnostic tests, costly referral and tied selling practices.[3]

If in force, regulatory standards in health, "reduce exposure to diseases through enforcement of sanitary codes, ensure the timely follow up of health hazards, and monitor the quality of medical services, and products including drugs."[4] In this chapter, the focus is on select issues concerning competition and regulation: (a) private medical education; (b) retail pharmacy; (c) medical devices; (d) drug manufacturing units; and (e) implication of the Clinical Establishment Act (CEA) 2010, and restricted to allopathy sector alone. The chapter discusses the state of the private healthcare sector.

State of the Private Healthcare Sector

Reasons for the Growth of the Private Healthcare

Some of the reasons for growth in the private healthcare in India are: (1) rising incidence of morbidity (57 percent) due to non-communicable diseases which warrants life-long care; (2) increasing health awareness among consumers; (3) inadequate human resources reflecting in wide variation in availability of healthcare providers across the country, forcing the consumers to seek alternatives; and (4) lack of essential medicines in the public healthcare.

Size of the Private Healthcare

While the number of human resources could be arrived at from different councils for the health professionals, there is no precise estimate of the healthcare institutions. Private sector accounts for 60.5 percent of the total hospital beds (13,77,000) in the country, out of which 70 percent are functional. Of the US$54.5bn hospital sector in 2012, US$45bn is estimated to have accrued to the private sector, which has grown at the compound annual growth rate of 26.9 percent between 2009 and 2012.[5]

Medical devices industry in India is entirely run by the private enterprises. The Indian pharmaceutical industry consists majority of private sector (also has five public sector units). There were 6,964 original licencees, 3414 loan licencees and 722 Certificate of Pharmaceutical Product holders[6] with a domestic market size at ₹62,055 crores in 2010 which is expected to reach a value of ₹233,000 in 2019-20.[7] The retail pharmaceutical market is majority held by private pharmacy shops (estimated to be more than 6 lakhs), besides a few trust and NGO-owned retail pharmacy shops that operate in few states. There are about 160 Central Government-sponsored *Jan Aushadhi* stores that sell generic medicines.

Investment in the Private Healthcare Sector

Investment in the private sector is largely by private corporate sector and individuals,[8] besides the foreign direct investment (Table 8.1) which is permitted up to 100 percent under the automatic approval route in hospitals and greenfield investments. The role of government policies, such as provision of land at discounted rates or concessions in taxes and duties for importing drugs, medical equipment and medical research cannot be undermined in the growth of private players.[9]

Table 8.1: FDI Equity Inflows in Healthcare Sector (April 2000-July 2013)

Sector	Amount (Rs in crores)	% with total FDI
Hospital and diagnostic centres	9,731.83	1
Medical and surgical appliances	3,477.04	0.35
Drugs and pharmaceuticals	54,332.65	5.65

Source: http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_July2013.pdf

State of Competition and Regulation in the Sector

Medical Education

Human resources in healthcare sector, such as doctors, nurses, dentists and pharmacists are governed by the Medical Council of India (MCI), Nursing Council of India (NCI), Dental Council of India (DCI) and Pharmacy Council of India (PCI) respectively.

MCI is a statutory body that looks after medical education, recognition of medical qualifications and registers doctors to practice in India. Competition in the arena of medical education is between the government and private sector. Of the 362 colleges in the country, 184 or 51 percent are government colleges.

70 percent of the medical colleges are concentrated in Southern and Western states of India which has distorted the distribution of healthcare professionals in the country and indicates violation of the MCI rules. As per the MCI rules, to start a new medical college, a no-objection certificate needs to be obtained from the state authorities justifying the need and the clinical load in that area to sustain a medical college.

Ananthakrishnan and Shanthi (2012)[10] point out that in the city of Pondicherry with 10 lakhs population, there are 8 medical colleges and a thriving cottage industry which rents the expensive medical equipments to colleges for the purpose of inspection. As inspection schedules by MCI are known earlier, prior 'arrangements' are made, and faculty shortages is overcome by showing the same teacher to be affiliated with more than one college, due to which a number of teachers are under investigation by the MCI.

Also certain courses offered by private medical colleges (PMCs) are not recognised by the MCI. The icing on the cake is the recent Supreme Court (SC) judgement which enables PMCs to conduct their own entrance exam bypassing the one conducted by MCI. The implication of this decision of SC for students is that they will have to write more entrance tests that will involve huge costs including payment of capitation fees to get admission.

Culmination of various malpractices resulted in dissolving the MCI. Since then the Union Ministry of Health & Family Welfare (MoHFW) has set up an *ad hoc* body of governors to run the MCI, whose term will end by November 10, 2013. Meanwhile, MoHFW proposed to strengthen the system of regulating medical education and health professionals in the country through the National Commission for Human Resources for Health (NCHRH) Bill. The NCHRH would be an overarching regulatory body and subsume all other councils, such as MCI, DCI, NCI and PCI.

The bill proposes to establish the NCHRH with three constituent bodies, viz the National Board of Health Education, the National Evaluation and Assessment Committee, and the National Councils. They will be responsible for medical education, evaluation and regulation of educational standards as well as the standards.

Indian Medical Association (IMA) fears that NCHRH will lead to red tapism and harassment of doctors.[11] 18 state governments have made their written submission to the Committee emphasising the adequate representation of state governments in the decision making process and revamping present councils rather than creating new ones.[12]

While the CCI could check the exorbitant fees charged by the PMC, overall standards could be improved by appropriate enforcement of the MCI regulations on the PMC.

Though India produces about 30,000 doctors per year, the average per college is only 100 which is less than the average of many other countries.[13] As per the MCI guidelines, only government or trust hospitals can set up medical education facilities and corporate hospitals are not allowed to do so. Amendment of this regulation perhaps would increase the number of health professionals in the long run.

Regulation of Retail Pharmacy

99 percent of the retail sales of medicines are in the private sector, which frequently violates regulations laid by the Pharmacy Act 1948 and indulges in collusive practices utilising its position as a member of the larger All India Organisation of Chemists and Druggists (AIOCD). AIOCD has more than 750,000 chemists as members and comprises of the district (DLA) and state level (SLA) chemists and druggists association.

Recently, the following practices of AIOCD have been brought under the scanner of CCI:[14]

i. Any drug manufacturer can appoint a stockist/distributor only after taking a letter of consent from AIOCD which is always issued to a member of DLA or SLA, who becomes the stockist. Deviation from this, results in the threat of boycott by AIOCD of the manufacturer.
ii. It is an unwritten law of the AIODC, that a medicine which is not described in a Product Information Services (PIS) bulletin of SLAs, will not be sold in the market.
iii. For those drugs outside the orbit of Drug Price Control Order (DPCO), the margins are fixed at 10 and 20 percent for the whole-sellers and retailers respectively.

iv. AIOCD has also directed the drug manufacturers to call back the goods with non-members of AIOCD or those who have indulged in anti-associational activities.

As all these practices are in gross violation of Section 3 (3) of the Competition Commission Act,[15] the CCI ordered AIOCD to:

i. Cease and desist from anticompetitive practices
ii. Discontinue practices, such as grant of NoC for appointment of stockist, fixation of trade margins, collection of PIS charges and boycott of products of pharmaceutical companies within 60 days from the date of receipt of CCIs order and also issue a letter to all the drug manufacturers' associations to this effect
iii. Issue a circular to all chemists and druggist associations that they are free to give discounts to customers
iv. Pay a penalty of INR 4,740,613. AIOCD, promptly communicated these to all its members.[16]

In another instance, resisting the Maharashtra Food and Drug Administration's drive against chemist shops operating without a registered pharmacist at the counter, around 6000 chemists shops in Mumbai, operated only between 10 am and 6pm.[17] Under Section 42 of the Pharmacy Act, a qualified pharmacist is required to dispense the medicine, a rule, which is grossly violated throughout the country. Such cartel behaviours by associations come under the scanner of CCI under Section 3(3).

Regulations Governing Medical Devices

Medical devices (MD) industry in India was estimated at US$2.7bn in 2008, grew to US$3bn in 2011 and estimated to grow at 16 percent in that year.[18] 75 percent of the MD are imported into India due to the tax structure. MoHFW has nominal jurisdiction over MD. Though, an amendment to the existing Drug and Cosmetics Act (DCA) to bring the MD under a Medical Devices Authority that will function under Central Drug Standards Control Organisation (CDSCO) was prepared, but was not discussed in the monsoon session of the Parliament 2013.

Presently, only around 10 MD, such as heart valves, cardiac stents, orthopaedic implants are under CDSCO, and require pre-market approval. Imported devices that have marketing approval in the US and UK are allowed for sale in India without any other procedure. But even US, recalled medical devices with potential health risks, concerning 800 companies between 2005-2010[19]. Hence, it defies all logic to allow devices to be marketed without any procedure.

A few of the manufacturers in India adopt ISO and Good Manufacturing Practices (GMP) on their own. But, with the Clinical Establishment Act covering the diagnostic centres also, there will be some reforms in this sector.

Though CCI is looking at the possible anticompetitive practices like hospitals referring the patients to a particular service entity only, health services are not in its purview of activities. According to CCI Chief, "...otherwise whether the charges are high or low, it is not really for us to see. We don't interfere in fixing of prices and the actual movements in the market place. That is not our job."[20]

Clinical Establishments Act

There have been several attempts to regulate the clinical establishments (CE) under the CEA by the Central Government since the early 1990s, which was finally notified in March 2012. Though, with major hospital mishaps, a discussion on CEA would erupt, yet any effort to bring in CEA have been met with stiff resistance by IMA.[21]

A few state governments, however, had their own acts much before the discussion on CEA. But those were obsolete/irrelevant for monitoring the healthcare infrastructure that exists today, lacked uniformity and hardly implemented. The acts have no provisions for maintaining minimum standards, cost and quality of healthcare and medical treatments.[22]

CEA applies to both public and private healthcare sectors in any stream of medicine, and excludes only establishments under the armed forces.

Under the Act, all CE would get provisional registration within two years of notification. Minimum standards[23] for different categories of CE in terms of equipment, infrastructure and human resources will have to be adhered to and is subject to inspection and cancellation for violation of standards. All the institutions will have to maintain computerised records, conduct audits and display the rates for various services (fixed by government) in the local dialect and English.

For implementation, a separate body, i.e. National Council for Clinical Establishments will be established and chaired by the Director General of Health Services. At the state level, district registering authorities will be set up.

However, states will have to adapt this Act through their legislative assemblies. The GoI (2013a) states that in view of lack of registration of CEs in many states, and the ones existing in a few states have major gaps, all states will be persuaded to adopt the CEA under Clause (1) of Article

252 of the Constitution. The CEA's website also provides standard treatment guidelines (STG) for a few health conditions. STGs, in certain diseases, would be ideal as the prevalence of antibiotic resistance is particularly high in infectious diseases and use of STGs could also check over prescription.

If implemented across all states, the CEA will bring uniformity in the healthcare delivery process and the country would get an estimate of functional CEs, type of services offered and the associated number and type of human resources.

But, there are practical hitches in implementing the CEA at the state level since CEA places enormous responsibilities with the district-level authorities which often function without adequate staff.

IMA fears that implementation of CEA would promote *inspector raj* once again; lead to closure of small establishments; and frequent inspections would result in patients losing faith in institutions and instead would like voluntary accreditation of the CEs.[24]

Voluntary standards would help hospitals establish their brand image and provide competitive edge over those who do not have. But, if CEA is implemented, there would be minimum uniform standards in all types of CEs. As of June 2013, 19 and 166 Indian hospitals were accredited by Joint Commission International and National Accreditation Board for Hospitals.

Producers of Health Products: Drug Manufacturing

In total contrast to the CEs, drug manufacturing is subject to scores of regulatory standards that govern the pre-production, production, post production and marketing of drugs in short comprising of 'cradle to grave' approach. Strict enforcement of GMPs in 2005, ensured that only those who have standard manufacturing procedures are allowed to produce drugs.[25]

Besides, the DCA, 1940, the Drugs and Magic Remedies (Objectionable Advertisements) Act, 1954, Narcotic Drugs and Psychotropic Substances Act 1985, Medicinal and Toilet Preparations (Excise Duty) Act, 1955, and DPCO are some of the Acts that have direct bearing on the pharmaceutical industry. Also, rules and regulations that generally govern the industries in India are applicable to pharmaceutical industry. In spite of this, regulatory lapses are frequently exposed, which are primarily due to "inadequate or weak drug control infrastructure at the state and central level, inadequate testing facilities, shortage of drug inspector, non-uniformity of enforcement, lack of specially trained cadres for specific regulatory areas, non-existence of data bank and non-availability of accurate information."[26]

For instance, fixed dose combinations (FDCs) are treated as new drugs and require the approval of Drug Control General of India (DCGI) for production and marketing. Since, routinely drug manufacturers migrate to production of drugs not under DPCO, the CDSCO, from time to time comes out with list of FDCs to be banned. An effort to weed out a list of FDCs in 2007, was promptly challenged by the Association of Pharmaceutical Manufacturers in the Madras High Court, and is yet to be resolved.

The DCGI prepared yet another list of FDCs and asked for the safety and efficacy data from the manufacturers. This list consists of FDCs that have been approved by different state drug controllers before October 1, 2012, but without the approval of DCGI. While no response came from the manufacturers even by the revised deadline of August 30, 2013, yet the Haryana Pharmaceutical Manufacturers Association has moved the Punjab and Haryana High Court, challenging the DCGIs order. Further, nothing is known about the action taken on the state drug authorities for providing license to produce FDCs without the DCGI's nod.

For uniform enforcement of the DCA, a bill concerning the setting up of a Central Drug Authority was introduced in Rajya Sabha in 2007[27] and later referred to the Standing Committee. However, not all the state governments are in support of this, as it would reduce their powers in issuing drug licences and related activities. Hence, even in the last concluded Parliament session also, this bill was not passed.

Gross regulatory lapses in drug approvals by CDSCO, has been strongly debated in a recent report.[28] 42 drugs were randomly selected by this committee, out of 2,167 newly approved drugs (from 2001-2010) by CDSCO. Of this, the CDSCO could not trace files of three drugs (which are controversial because one of them was not approved for sale in many countries). Of the remaining 39 drugs, for 11, phase 3 trials were not done. 31 new drugs were approved between 2008 and 2010, without any trial on Indian population.

In 4 out of 11 drugs, not only the phase 3 trials were not conducted but expert opinions were also not sought. 13 drugs did not have any permission for sale in any of the developed countries. In 14 out of 39 drugs, the number of experts contacted was less than the prescribed minimum and in most of the cases, experts have written identical letters of recommendation. The DCGI, however, has not withdrawn the untested drugs from the market, since another committee was reviewing the approvals. Such drugs should be withdrawn from the market at once in view of the public safety, which is grossly put to risk by such lapses.

One of the reasons for this lapse is the inadequate number of drug testing laboratories (142 totally) that have the capacity to analyse only 36,000 samples annually, compared to more than 60,000 formulations that are produced in the country. With the result, less than one percent of the drugs manufactured come under the scrutiny.[29] Further, the number of drug inspectors is also low[30] to carry out inspection of the units, pharmacy shops, implementation of price control etc.

Regulating Competition in Generic Drugs through Price Control

Because majority of producers in India are engaged in identical generic drug production, companies spend heavily on marketing these drugs to their clientele which pushes the cost of the drugs upwards. Hence, since the 60s, GoI has brought drugs under DPCO, much to the displeasure of the pharmaceutical industry.

The latest DPCO, 2013 has brought 348 drugs listed in the National List of Essential Medicines (NLEM, 2011 – single ingredient) under DPCO. As compared to 70 percent of drugs under 1979 DPCO, DPCO 2013 covers only 24 percent of drugs. NLEM 2011 does not cover important drugs for multi drug resistant tuberculosis, anti-diabetics, HIV/AIDS, cancers, mental health, asthma, rheumatoid arthritis etc. and hence these plus other useful FDCs are out of DPCO.[31]

Further, DPCO 2013 is based on the market based pricing mechanism (MBP). As per this, the ceiling price of a medicine in NLEM 2011 would be the simple average price of all its brands that have more than one percent market share. As getting the prices of all the brands itself is a big task in the absence of any systematic data base, the government would rely on the IMS health data which is criticised by Srinivasan and Phadke (2013)[32] as they are not robust and limited in its coverage. Prohibitively expensive, these data are not accessible in the public domain.

Though prices of drugs outside the DPCO are monitored by the National Pharmaceutical Pricing Authority (NPPA), any attempt by NPPA to recover the excess price charged by pharma companies result in court cases which take years to get resolved.

One way to resolve the stiff competition in the generic drugs is to bring in a legislation that generic drugs should not be sold in brand names and all physicians should prescribe only the generic drugs as mentioned in the code of medical ethics of the MCI. Especially, when MCIs code of conduct forbidding doctors accepting gifts from drug manufacturers is violated grossly, prescription of branded drug alone will be followed. One way to instil confidence among the users of generic drugs is to adopt a logo for all the generic drugs that have passed the quality testing standards of the government.[33]

Regulation of Patented Drugs

The patent amendment clauses like Section 3(d), pre-grant opposition and flexibilities like the compulsory licencing (CL) check the anticompetitive behaviour and induce generic competition in India. Section 3 (d) which prevents 'ever greening' or frivolous innovations getting patent, actually prevented patent status for important drugs for cancer and HIV.

India has recently adopted CL strategy in the case of Nexavor (Sorefenib Tosylate), a kidney cancer drug and couple of more drugs are in the pipeline to be considered for CL. But utilising the CL would be a viable option, only if the domestic industry has the required technology as in the case of Natco, which has the technology to produce Nexavor and also involves withstanding pressures of multinationals as in the case of South Africa, Brazil, Thailand and Malaysia.[34, 35, 36]

Bayer's challenge resisting the CL to Natco was nullified by IPAB on the grounds that Bayer did not take any effort to reduce the price of the drug and improve its availability till the CL.

India also does not allow linking the patent status with the marketing approval of a generic product which is called patent linkage and delays the entry of generics till the patent status of the drug holds good. This Section 107A of delinking patent status and marketing approval had provided relief to Cipla against Bayer's Sorefenib Tosylate, on which Bayer has a valid patent until 2020. Now MSD India, claims that since it has a valid patent on Sitagliptin, marketing approval given to Glenmark's Januvia by the DCGI, infringes its patent.

In March 2013, the CCI dismissed the CSOs plea that Gileads' licencing arrangements on Tenofovir would restrict the supply of HIV drugs in India and make the drugs expensive. The rejection by CCI was on the ground that Gileads HIV drugs constituted a very small segment in the whole of HIV drug segment in India that is constituted by more than 150 brands produced by 21 odd companies.[37]

The recommendations of the recent committee on prices of the patented drugs[38] to negotiate with patent holders, will dilute the role of CL in the case of drugs without and with limited therapeutic equivalence. Also under the CL option for the use of public health, government can fix a lower price, while the negotiated price of the innovator may not match the government price. In the case of drugs with therapeutic equivalence, the recommendation of applicability of the existing price could lead to a higher price, if the drug is already priced high.

Foreign Direct Investment and Competition

Table 8.1 presented the Foreign Direct Investment (FDI) in pharmaceuticals, which consists of both green and brownfield investments. As noted by the GoI committee on FDI,[39] as multinational corporations (MNCs) have paid exorbitant amounts for acquisition of Indian companies, the same would perhaps be recovered by selling costly branded products. In the absence of any policy directive enabling the chemists (as a prior condition, the government will have to enforce that only qualified pharmacist is dispensing the medicine) to substitute the costly drug by cheaper alternatives, the cheaper generics will vanish from the market.

Also brownfield investments and sales alliances by MNCs with leading manufacturers would restrict the voice of the generic manufacturers to file CL applications. Under the existing law, only mergers and acquisitions that involve target companies with a turnover of above ₹750 crores and assets worth more than ₹250 crores need to be vetted by the CCI.

Anticompetitive nature of such brownfield investments like collusion between players in the Indian pharmaceutical industry has not yet been found.[40] Similarly, innovator companies paying the generics to delay their entry (pay- for- delay deals) have not surfaced in India yet. Such cases would come under the CCIs arena as such deals restrict competition. A few Indian companies have however been fined elsewhere.[41]

Conclusion

Private healthcare is here to stay and will continue to grow. While the CCI, has more role to play in the manufacturing sector and in retail pharmacy, in the health delivery systems, enforcement of the existing regulations, continuous monitoring and appropriate action on defaulters is required. Hence, in order to make the private healthcare consumer friendly, the following recommendations need to be considered.

Recommendations

1. The sphere of the CCI may be widened to check the prevailing anticompetitive practices in the health delivery sector.
2. All the activities of the associations in the private healthcare should be monitored routinely by a suitable authority and subject to third party audits to expose anticompetitive behaviours.
3. In order to effectively strengthen the enforcement capacity of the regulatory authorities at the state level, the existing manpower should

be urgently increased. Where there are no sanctioned posts, new posts should be created. As a prior requirement, funding should increase.

4. Consumer rights' advocacy need to be strengthened and whistle blowers should be protected.
5. Number of drug testing laboratories should be increased on a priority basis.
6. MCIs code of conduct of prescribing the generic medicines should be effectively enforced in the private sector as well through the IMA.
7. Transparency in inspection and accreditation reports of educational institutions.
8. Proposed formation of several centralised authorities should not lead to undue bureaucratic burden and red tapism.
9. Government should create separate accreditation standards for different healthcare institutions to effectively implement CEA. Consumer awareness regarding the standards should also be increased to generate demand for standards in CE.
10. All generic drugs that have passed the quality standard tests should bear a logo to instil confidence in the minds of users.
11. IMA should be active in shaping medical policy in India and pro-active in issues concerning public health like its counterparts in US, UK and Canada.
12. Special fast track courts should be set up to deal with cases of public health safety to avoid delays.
13. Various medical colleges should be given the responsibility of doing prescription audits to check the costs and also in view of the increasing antibiotic resistance would ensure health safety.
14. In order to check the prohibitive prices of patented drugs, NPPA and CCI should take co-ordinated action.

Hence, in the best interest of public health, the government should speed up enforcement of regulations on private healthcare.

Endnotes

1 Includes healthcare providers, healthcare institutions and health product producers

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11 Ekbal B (2012) IMA Strike Need for Public Debate, Indian Journal of Medical Ethics, Vol.9, No.4, 226-228

12 Government of India (2012).Fifty Ninth Report on the Functioning of the Central Drugs Standard Control Organisation, Rajya Sabha Secretariat, Parliament of India, New Delhi

13 Supra Note 2

14 Information drawn from *www.mondaq.com/india/x/242336/food+drugs+law/Pharma+Manufacturers+Breathe+Easy+Competition+Regulator+Treats+Old+Ailment+Affecting+The+Industr*y, accessed on October 10, 2013

15 Under Section 3(3) of the Act, actions by those engaged in identical or similar trade of goods and provisions of services, such as entering into an agreement, or carry on a practice, or take a decision, for the purpose of directly or indirectly fixing prices, limiting output or sales, or sharing markets or customers, are termed anticompetitive

16 *www.pharmabiz.com/PrintArticle.aspx?aid=75384&sid=1,* accessed on October 10, 2013

17 *http://pharmabiz.com/ArticleDetails.aspx?aid=73968&sid=3,* accessed October 18, 2013

18 NIPER (Ahmedabad) 2009, Medical Devices in India, Recommendations for NIPERS and *http://casi.sas.upenn.edu/iit/kamal*, accessed on July 22, 2013

19 *http://pharmabiz.com/ArticleDetails.aspx?aid=68654&sid=3*, accessed on October 18, 2013

20 *www.livemint.com/Companies/dNE4adkLnIrVppmLcUcCUI/Unfair-practices-in-pharma-sector-under-CCI-scanner.html* accessed on October 15, 2013

21 Nagral S (2012), Doctors in Entrepreneurial Gowns, Economic and Political Weekly, Vol.XLVII, No.36, 10-12 and Supra Note 11

22 Srinivasan, S. (2013): Regulation and the Medical Profession: Clinical Establishments Act, 2010. Economic and Political Weekly, XLVIII(3), 14-16.

23 Currently debated

24 Supra Note 22

25 Lalitha N (2006): Access to Medicines in the Government HealthCare, Report submitted to the Indian Council of Social Science Research, New Delhi.

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27 The idea to have a central drug authority in place been suggested by various committees beginning with Hathi Committee.

28 Supra Note 12

29 Supra Note 26

30 The CDSCO was planning to increase the number of drug inspectors to 3100 from 864 (in 2010)http://www.business-standard.com/article/economy-policy/dcgi-plans-to-raise-drug-inspectors-tally-in-india-110121300070_1.html

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34 Musungu, S. and Oh, C. (2005): The Use of Flexibilities in TRIPs by Developing Countries: Can They Promote Access to Medicines. Commission on Intellectual Property Rights, Innovation and Public Health. World Health Organisation, Geneva.

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36 Ling CY(2006):Malaysia's Experience in Increasing Access to Antiretroviral Drugs: Exercising the Government Use Option, Third World Network, Malaysia.

37 *http://spicyip.com/2013/03/public-health-activists-lose-challenge.html*, accessed on October 15, 2013

38 Government of India (2013b). Report of the Committee on Price Negotiation for Patented Drugs, Department of Pharmaceuticals, Ministry of Chemicals and Fertilisers, New Delhi.

39 Government of India (2013c), 110th Report on FDI in Pharmaceutical Sector, Rajya Sabha, New Delhi.

40 *http://cci.gov.in/images/media/ResearchReports/BhusanInterns010611.pdf*

41 *http://spicyip.com/2013/06/guest-post-legality-of-reverse-payments.html,* accessed on October 21, 2013

CHAPTER 9

Epilogue: Time to Revisit Regulatory Design

Pradeep S Mehta

Different regulatory designs could be adopted on the basis of different sectoral requirements. Key economic sectors in India are differentially regulated at present. The regulatory framework in the infrastructure sectors has developed autonomously within each infrastructure sector, with very little co-ordination or cross fertilisation of ideas across sectors.

A survey of the provisions of the existing statutory and institutional framework suggests the absence of a common regulatory philosophy guiding the evolution of regulatory institutions in infrastructure sectors. Political constraints and ministerial preferences over time seem to have dominated the reform agenda in different infrastructure sectors.[1]

Variations exist from absence of regulators, to having regulators housed in government departments, to independent regulators. While complete government control exists in hitherto natural monopolies such as railway transport, multiple independent regulators function in sectors such as finance. Increasingly, various sectors are witnessing instances of under-regulation, regulatory overreach, regulatory conflicts, and demands for real regulatory independence and restructuring.

Review of regulatory designs is increasingly being carried out internationally. It is being realised that mere formal regulatory independence might not be sufficient and the level of regulatory discretion should be guided by the local conditions. As the regulatory models and governance systems are located within the political, constitutional, and legal arrangements of the country, they should also fit the country's regulatory commitment, institutional development, and human resource capacity.[2]

Consequently, it is necessary that similar reviews of regulatory designs in key economic sectors are carried out in India.

Planning Commission's Review

The Planning Commission, Government of India in its consultation paper 'Approach to Regulation: Issues and Options'[3] stated that *"For achieving the desired objectives, it is necessary to ensure that the regulatory institutions remain independent and autonomous. The selection, appointment and removal of chairperson and members should be insulated against any perceived interference or manipulation that may influence the outcome."*

As quality of regulation is directly linked to the quality of personnel, the government had resolved to have professionally-run institutions, as stated in the National Common Minimum Programme (NCMP) of May, 2004, which was reinforced in the President's Parliamentary Address of June, 2005. Unfortunately, due to lack of political will, this did not meet its logical conclusion. The next government must pay adequate attention to the regulatory quality.

Selection and appointment of regulators is one of the most crucial aspects that need to be addressed upfront. There has been a tendency in recent years to appoint retired bureaucrats and judges as heads of regulatory bodies without ascertaining their suitability. Moreover, compensation offered to such posts is not competitive enough to attract younger talent. A common (rhetorical) refrain that is often heard is how one can get Members/Chairmen at a peon's salary. Thus, only retired civil servants or judges are available at such low salaries. The salaries have since been revised to far better scales but even these are not attractive for non-government people to apply for such jobs.

The Plan body mentions in its consultation paper, *"The terms of service should be sufficiently remunerative to attract qualified and experienced persons. Further, at least one of the members could be drawn from other than public sector background (such as academics, lawyers, chartered accountants, managers etc.). This would enrich the functioning of the respective regulatory bodies."*

Appointment of Retired Civil Servants and Judges Should be Stopped

A study undertaken by CUTS for Planning Commission, titled, 'Comparative study of regulatory framework in infrastructure sector: lessons for India' mentions that appointing retired bureaucrats/judges to regulatory bodies has become the order of the day, which is not a healthy sign, as the very purpose of setting up independent institutions gets defeated. They lack the vigour and rigour required to do such jobs. The job also requires substantial knowledge of law and economics and its intersection. Attracting young blood and talent is the key to making these institutions work in a desirable manner.

Our own experience with retired civil servants as regulators shows that they are generally ill equipped to handle the tasks, as their approach is based on a generalists' experience. There are many examples of how regulatory failures have taken place due to their incapacity. Albeit, there are some exceptions, but exceptions are not the rule.

At a Finance Ministry/World Bank seminar on Public Private Partnerships (PPPs) in New Delhi, on February 05-06, 2007, a senior executive of Mahindra and Mahindra, Arun Nanda, publicly stated that he is available to work in a regulatory authority at the prevalent scales, provided he is properly empowered. He defended his position stating that there are many like him who would be willing to do so at an advanced stage of their private sector careers, as they are financially well off.

This view is borne out by the fact that many High Court and Supreme Court judges are successful former lawyers who are attracted to the job because of the independence that they enjoy in discharging their adjudicatory functions, and the prestige of the job, in spite of suffering from a huge drop in their earnings. 60 percent of the judges are from the lawyer's community and the rest from the state judicial services. In practice, the percentage of lawyers joining the bench is more than 60 percent because not enough judicial service officers reach that level at a reasonable age to become judges.

In the case of appointing executives from the private sector, one common view is that their functioning may be compromised by their past associations. This may not necessarily be true. Judges who may have a relation with a lawyer or a client are required to recuse themselves from a case where there is the slightest doubt of conflict of interest. Similarly a regulator, too, can exercise discretion or caution in dealing with matters where any nexus is suspected to exist *vis-a-vis* their past association. Distortions can happen in any system, but they will be more in the nature of exceptions rather than the norm. In any event, we have not been successful to ensure a corruption free system, so does it matter whether there was any past association at all.

Currently, members of regulatory commissions and appellate tribunals have *tenure,* which vary between three to five years. Such wide range of tenure, may be unfavourable in attracting qualified professionals and experts. Thus, it is desirable to provide a fixed tenure of five years.

Furthermore, providing protection against possible discretionary dismissal, unlike supersession, would go a long way to ensure functional autonomy to regulators. Such provisions would help regulators to work towards attaining the stated objectives without undue interference and prove an effective deterrent against possible capture by the line-ministry.

Seeking Regulatory Coherence

Our regulatory architecture is a piece of incoherence in so far as the legislative design is. One reason is that line ministries design the law governing the regulatory agency with their own wisdom while the law ministry, which needs to ensure coherence and similarity, does not do so. The incoherence is about the qualifications, terms and period of the commission members varying with legislation, amongst other issues. Finally, an effort to prepare an enabling legislation for a uniform architecture has been made by the Planning Commission.[4] Alas, it is just not moving due to turf issues as myopic ministries would not want to give up their own powers to design the institution in the manner which they think is best.

The problem is really bad. Even the Prime Minister has stated that we need to have an even approach to how regulatory institutions should be framed in his address to the nation from the ramparts of the Red Fort in August, 2010, but to no avail. In a recent case: *Rajiv Garg vs Union of India* before the Supreme Court, it was observed that the tenure and conditions of tribunal members need to be uniform as it varies from one to the other.

The Planning Commission had drafted the Regulatory Reform Bill in 2011 to bring ensure sameness for all regulatory appointments in the infrastructure sector under an omnibus legislation. Subsequently, the Bill was approved by the Government after much toing and froing among our ministries and it has now been put up in the public domain as the Regulatory Reform Bill, 2013.

The Bill introduces some prolific reforms in the infrastructure regulatory arena. It seeks to bring the 13 regulators in India (except for those in the financial sector) under its umbrella to ensure uniformity in "powers, functioning and accountability of the regulatory commissions", while providing independence in "determination of tariff, enforcement of performance standards, promoting investment". The Bill provides that the regulators shall have the power of licensing and shall be accountable to the Parliament. Further, protection of consumer interest and promotion of competition has been established as the pillars of the Bill. It is not going to be a regulator of regulators, as is being misinterpreted by some.

Although, the Bill has been judiciously drafted, it fails to adequately provide for some of the goals it sets to achieve. For instance, independence and accountability has been clearly enlisted as important factors for the regulators, however, the mechanism to achieve these is vague.

Overlap of Functions

The draft legislation provides that the government may constitute regulatory commissions and appellate tribunals. Furthermore it adds another clause that the government may also establish tariff regulatory commissions for the purpose of tariff determination. Determination of terms and conditions to stipulate tariffs have also been mentioned as one of the functions of the regulatory commission.[5] Thus, there seems to be duplicity of functions. The provision for establishing two separate commissions for carrying out the same function baffles the reader. The purpose of the Bill is to sharpen the regulatory framework in the infrastructure sector. Creation of two commissions hereby for tariff determination would only create an unnecessary overlap.

Need to Ensure Accountability

According to the Bill, the Central Government, shall for the purpose of "search and selection" of chairperson and members of the commission and tribunals, establish a selection committee. The selection committee is to provide recommendations to the Central Government, which may appoint such members it deems fit. The mechanism for establishment of regulatory commission and tribunal members seem rather arbitrary and opaque and continues with the practice of wide discretion to the Central Government.

The intention of the enactment is to ensure accountability of regulators to the Parliament. It is hence important that the suggested powers of the regulators flow from the Parliament itself. Thus, while the line ministry establish the selection committee, its recommendations should be submitted to the Parliamentary Standing Committee to narrow the nominations after conducting a public hearing as is the practice in the US and UK. After such procedure, the Parliamentary Standing Committee may accordingly forward the list to the Government for final selection. Such a mechanism will ensure transparency as well as accountability to the parliament.

More importantly, the selection committee should be comprised as having more than half the members from outside the bureaucracy (serving or retired), so that objectivity is not lost. What we have seen so far is that the selection committees are packed with serving or retired bureaucrats and they end up selecting retired bureaucrats as chairs or members of the regulatory commission. Even when they have a non-bureaucrat as chair of the selection committee, the poor guy is filibustered into accepting the majority opinion. In most cases, retired bureaucrats are good administrators, but not at all adept at understanding the interstices of law and economics. Not only that they are past their prime and such jobs need both vigour and rigour.

Overriding Effect of this Law

The Regulatory Reform Bill will have an overriding effect in case of conflict with any other laws, except in the case of the Consumer Protection Act, 1986, the Atomic Energy Act, 1962 and the Competition Act, 2002. Although, the jurisdiction of the Bill is clearly defined, there is yet scope for confusion and overlap.

For dealing with such issues of jurisdictional conflict, a panel comprising of three appellate tribunal chairs as they have the judicial and subject background to deal with them should be established. In the British system, there is a concurrence working party of the competition authorities and sector regulators to decide on which issue which agency will take the lead. Furthermore, there is a common appellate body: Competition Appellate Tribunal for the competition agency and all sector regulators thus bringing in healthy convergence.

The Regulatory Reform Bill, 2013, seems to bring an important transformation to the infrastructure regulation, the implementation of which may reap immense benefits. However, for optimising the purpose of the Bill, it should be ensured there is no disconnect with its preamble. It should also be renamed as Infrastructure Regulatory Reform Bill because there are other areas of regulatory reforms which are crying for change, such as pharmaceuticals, business operations, construction, agriculture markets etc.

In Lieu of Conclusion

In concluding we have the following suggestions:

1. *A standing committee of eminent people should be constituted to select regulators for various regulatory agencies at the central level and a similar model should be followed in the states;*
2. *Proper manpower planning should be carried out to ensure that a regulator is selected in advance of a position falling vacant;*
3. *Applications should be invited against pre-determined selection criteria;*
4. *Members or Regulators should be given a fixed tenure of five years with a maximum age limit of 60 years for appointment, with the reasons for any exceptions recorded in writing;*
5. *Those provisions in regulatory laws that deter people from business/non-government sector to move to regulatory bodies should be removed;*
6. *The prevailing practice of sinecure needs to be discouraged. The bottom line must be to encourage experts and young professionals to join such positions, and offer attractive compensation to draw young professionals to join regulatory bodies;*

7. *Regulators and their staff should be provided with short-term training prior to induction;*
8. *An Indian Regulatory Service should be created to hire professional personnel to be engaged with regulators with a career path of becoming members and chairmen of a regulatory commission;*
9. *Protection of regulators against arbitrary removal by the Government is necessary. A member of a regulatory agency should be removed only in case of proven guilt or inability established by due process;*
10. *Powers of appointment and removal of regulators should vest with the Parliament so as to curb arbitrariness and ensure proper independence and freedom from line ministries;*
11. *The government's Department of Personnel should be designated as the administrative ministry for regulatory bodies, responsible for release of appointment letter and other administrative matters. This will ensure that there is an arms' length relationship between the line ministry and the regulatory agency, which is otherwise under their control;*
12. *To deal with overlap conflicts there should be a resolution body comprising of the chairmen of the appellate tribunals on competition, electricity and telecom;*
13. *Creation of cognate regulators should be explored vigorously, such as one for energy (including coal) or transport or finance. This will reduce the government expenditure and also bring in convergence, coherence and synergy in a particular domain.*

Endnotes

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2 Anton Eberhard, *Matching regulatory design to country circumstances*, Gridlines, Public-Private Infrastructure Advisory Facility, 2007

3 *Ibid*

4 In form of the draft Regulatory Reform Bill, 2013, available at http://planningcommission.nic.in/reports/genrep/reg_bill2711.pdf

5 Section 39(1)

…Competition and Regulation in India, 2013, lives up to the benchmark created by previous three reports in providing a thorough, comprehensive and frank analysis of the reality of economic regulation in the country...As this report reflects, compliance with principles of separation of powers in regulation, and adoption of consumer empowerment and competitive neutrality, more specifically the NCP, as focal points of regulation are need of the hour.

Vijay Kelkar
Chairman, India Development Foundation

India's regulatory system has grown in a haphazard unplanned manner without a clear roadmap as brought out in this excellent publication by CUTS…examples of over regulation resulting in a kind of re-licence raj, under regulation and regulatory capture in different sectors and need a revamp of the entire regulatory system and need for parliamentary oversight of staffing and structure.

Ajay Chhibber
Director General, Independent Evaluation Office, Government of India

The reports issued annually by CUTS and CIRC have tried to create awareness and advocacy for true competition principles. They highlight that competition requires effective economic regulation...reports serve an important purpose in advocating competition and as a watchdog on economic and competition regulation.

S L Rao
Member, Board of Governors, Institute for Social and Economic Change

CUTS fourth Biennial Report on Competition & Regulation is a must read for those wishing to understand more about the factors underlying the recent dismal performance of the Indian economy…Report is timely by clearly identifying the competition and regulatory issues where urgent action is needed but importantly by putting forward concrete steps that can be taken. The Government decision-makers should pay heed.

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This fourth Report of CUTS and CIRC on the status of competition and regulation in India is an invaluable contribution both to knowledge and possibility…The Report's diagnosis of shortfalls and its concluding proposals to enhance competition and efficiency for the benefit of the people of India deserve close attention. They should be implemented.

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